



Xiao Yaqing
Chairman and CEO



Xiong Weiping
Executive Director and
President



Luo Jianchuan
Executive Director and
Senior Vice President

The following discussion and analysis should be read in conjunction with our financial statements together with the accompanying notes, included elsewhere in this annual report. The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong ("HK GAAP"), which differ in certain material respects from the generally accepted accounting principles in the United States ("U.S. GAAP"). A discussion of the material differences is contained under the heading "Supplementary Information".

Overview

The Group is engaged principally in alumina refining and primary aluminum smelting operations. We organise and manage our operations according to the following business segments:

- Alumina segment, which consists of mining and purchasing bauxite and other raw materials, refining bauxite into alumina, and selling alumina both internally to the Group's primary aluminum smelters and externally to customers outside the Group. This segment also includes the production and sales of alumina hydrate, alumina chemicals and gallium.
- Primary aluminum segment, which consists of procuring alumina and other raw materials, supplemental materials and electricity, smelting alumina to produce primary aluminum and other aluminum, and selling substantially all primary aluminum products to external customers. In addition, this segment includes production and sales of carbon products.
- Corporate and other services segment, which includes the headquarters' operations, research conducted by the Group's research institutes and provision of the Group's research and development services to third parties.

Results of Operations

The Group's profit amounted to RMB6,223.9 million for the year ended December 31, 2004, representing an increase of RMB2,671.9 million, up 75.2%, from the previous year's RMB3,552.0million. The increase was mainly attributable to a significant increase in prices of the Group's principal products such as alumina and primary aluminum and the increased external sales volume of alumina.



Chen Jihua
Executive Director,
Vice President and CFO



Zhang Chengzhong
Vice President



Liu Xiangmin
Vice President



Sun Zhaoxue
Vice President

Revenues

The Group's total revenues amounted to RMB33,021.2 million for the year ended December 31, 2004, representing an increase of RMB9,195.2 million, up 38.6%, from the previous year's RMB23,826.0 million. Total revenues include sales of goods and other revenues. Sales of goods accounted for 97.6% and 97.9% of the Group's total revenues for the years ended December 31, 2003 and 2004, respectively. The Group's sales of goods increased by 39.0% from RMB23,245.9 million for the year ended December 31, 2003 to RMB32,313.1 million for the year ended December 31, 2004, representing an increase of RMB9,067.2 million. The increase was primarily due to the increase in selling prices of the Group's principal products such as alumina and primary aluminum, and a growth in external sales volume of alumina was also a major contributor to the increased revenue of the Group. For 2004, the Group's average external selling price for alumina reached RMB3,229.7 per tonne (tax excluded, similarly hereinafter), representing an increase of RMB822.0 per tonne or 34.1% from RMB2,407.7 per tonne for the previous year. The Group's average external selling price for primary aluminum reached RMB13,756.3 per tonne, representing an increase of RMB1,295.8 per tonne or 10.4% from RMB 12,460.5 per tonne of the previous year. The Group's external sales volume of alumina increased from 4,219,600 tonnes of 2003 to 4,870,200 tonnes of 2004,

representing an increase of 650,600 tonnes or 15.4% from the previous year. The Group's external sales volume of primary aluminum increased by 13,700 tonnes or 1.8% from 746,900 tonnes for the year ended December 31, 2003 to 760,600 tonnes for the year ended December 31, 2004.

Cost of Sales

The Group's total cost of sales increased by RMB5,024.7 million or 30.6% from RMB16,439.5 million in 2003 to RMB 21,464.2 million in 2004. The increase was mainly attributable to a growth in external sales volume of alumina, and the increased unit production costs of primary aluminum and alumina caused by the increase in raw material prices.

Selling and Distribution Expenses

The Group's selling and distribution expenses increased by RMB98.1 million from RMB549.4 million in 2003 to RMB647.5 million in 2004, up 17.9%, which was primarily attributable to the increase in transportation and loading fee and packaging fee by RMB79.1 million. The increase was mainly attributable to the fact that transportation fee increased approximately by RMB56.2 million due to an increase of 15.4% in sales volume of alumina. The rise in transportation fee constituted the increase in the expenses for transportation by RMB16.2 million.

General and Administrative Expenses

General and administrative expenses increased by RMB173.4 million from RMB 1,047.5 million in 2003 to RMB1,220.9 million in 2004, up 16.6%. The increase was mainly due to the increase of RMB94.8 million in relevant taxes other than income tax causing by the expanded business, the increase of RMB30.9 million in remuneration and welfare expense for management members under the Group's incentive plan as a result of desirable fulfilment of operating objectives for 2004, as well as the increase of RMB13.4 million in insurance premiums as the Company spent more in the property insurance to strengthen its capability against force majeure risks.

Research and Development Expenses

The Group's research and development expenses decreased by RMB40.8 million or 23.5% from RMB 173.4 million in 2003 to RMB132.6 million in 2004. The decrease was primarily due to the fact that the Company put the previous years' research results into practice and conducted meticulous verification for some of the research topics, resulting in a slow down of some of the research projects. The Group will continue to properly invest in the research and development.

Other Income / Expenses

The Group's expenses (net of other income) changed from a net expense of RMB 25.54 million in 2003 to a net expense of RMB3.38 million in 2004. This was attributable to the fact that the Company entered into an agreement with a financial institution in 2004, pursuant to which, the Company paid off the loans of prior years at one go and thus interests of RMB9.78 million were reduced and exempted. Also, the income from foreign exchange increased by RMB10.85 million derived from the increased deposit denominated in foreign currency as a result of exercising placing right in January 2004.

Operating Profit

The Group's operating profit increased by RMB3,881.5 million from RMB5,078.5 million in 2003 to RMB8,960.0 million in 2004, up 76.4%. The Group's operating profit as a percentage of sales of goods increased from 21.8% in 2003 to 27.7% in 2004, mainly attributable to the increase in selling price of alumina, however, the surging in the price of raw materials and energy partially offset the increase.

Finance Costs

The Group's finance costs decreased by RMB42.4 million, or 9.4%, from RMB 451.4 million in 2003 to RMB409 million in 2004. The decrease was mainly attributable to the repayment of part of short-term loans and the adjustment of loan structure for operating capital which lowered the average interest rate.

Income Taxes

The Group's income tax expense increased from RMB 918.9 million in 2003 to RMB2,079.5 million in 2004, which was mainly attributable to the increased profit of the Group. The Group's effective income tax rate was 24.3% in 2004, which was lower than the statutory tax rate of 33.0%. This was mainly because three branches of the Company situated in Guizhou Province, Pingguo County and Qinghai Province in the western region of the PRC were entitled to a preferential income tax rate of 15.0% in connection with the national policy to develop the western region. Certain of the Group's plants are also entitled to preferential income tax treatment for the purchase of domestically-produced equipment in investment projects, resulting in the expenses in income tax decreased by RMB208.9 million.

The effective income tax rate of the Company in 2004 increased by 4.4% as compared to 2003, mainly attributable to a subsidiary of the Company in Shandong Province which ceased to be entitled to an income tax rate of 15.0% as enjoyed in prior years and its rate of income tax in 2004 resumed to 33.0% under the notice from the tax authorities by the end of 2004. Thus, the expenses of income tax increased by RMB202.5 million in 2004. Meanwhile, the Company had been granted approval from the State Tax Bureau of the PRC for consenting the Company to use the tax losses from prior years in 2003, which led to the decrease of income tax by RMB142.3 million in 2003. The two factors mentioned above are the main reasons accounting for the effective income tax rate in 2004 being higher than that in 2003.

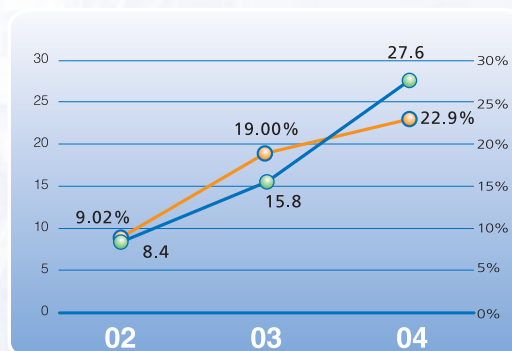
Minority Interests

Minority interests increased from RMB 157.37 million in 2003 to RMB243.54 million in 2004 primarily due to the increase in the profit in Shandong Aluminum Company Limited, a subsidiary of the Company in which the Company has minority interests.

Net Profit for the Year

As a result of the foregoing, the Group's net profit for the year increased by 75.2% from RMB 3,552.0 million in 2003 to RMB6,223.9 million in 2004.

- Return on net assets
- EBITDA interest coverage ratio



Discussion of Segment Operations

Revenue by Segment

Alumina Segment

Sales of Goods

The Group's total sales of goods of alumina segment increased by RMB7,990.8 million, up 51.7% from RMB15,459.2 million in 2003 to RMB23,450.0 million in 2004.

The Group sold alumina products to its smelters and to other domestic smelters. Revenues from the external sales of alumina in 2004 rose by RMB6,896.4 million, up 55.9% as compared with 2003, mainly due to an increase in selling price and external sales volume of alumina. Selling price of alumina in 2004 increased by 34.1% to RMB3,229.7 per tonne from RMB 2,407.7 per tonne in 2003, mainly due to the increase in price of alumina driven by the strong demand of alumina in the PRC. The external sales volume of alumina increased by 15.4% to 4,870,200 tonnes in 2004 from 4,219,600 tonnes in 2003, mainly attributable to the fact that the Company's production capacity of alumina increased to 6.47 million tonnes in 2004 from 5.95 million tonnes in 2003 and that the productivity of existing production line was improved. Revenues from the sales of alumina to the Group's smelters in 2004 rose by RMB1,094.5 million, up 34.9% from 2003, primarily due to the increase in the Group's selling price. The Group's internal sales volume was approximately 1,485,400 tonnes, basically equivalent to the previous year. The proportion of the Group's internal sales volume of alumina to the total sales volume of alumina dropped from 25.2% in 2003 to 23.4% in 2004.

Cost of Goods Sold

The total cost of goods sold in the alumina segment of the Group in 2004 increased by RMB3,493.8 million, up 36.4% as compared with that of 2003. The increase was mainly attributable to the growth in sales volume of alumina products. In addition, due to the increase in price of raw materials, the unit production cost of alumina products increased. Particularly for the second half of 2004, there were significant increases in prices of materials such as bauxite, coal, electricity and energy sources, resulting in the significant increase in alumina production cost. As the rationalization mode of management was adopted by various factories of the Company in their productions, the Group's operations achieved further improvement in technical and economic index than that of 2003. Consumption rate decreased continuously, offsetting the influences imposed by the rising prices of certain raw materials. Also, the Company procured large volume of raw materials under a concentrated and unified mechanism, the influence exerted by the inflated raw material prices has been partially offset. In order to address the increasing price of bauxite and strengthen the procurement and management of bauxite, the Company established Bauxite Branch at the beginning of 2005 so as to centralize the procurement and allocation of bauxite resources.

Operating Profit

Total operating income of alumina segment increased by 83.4% from RMB 5,109.5 million in 2003 to RMB9,371.6 million in 2004. The proportion of operating income of the alumina segment to the Company's sales of goods increased from 33.1% in 2003 to 40.0% in 2004.

Primary Aluminum Segment

Sales of Goods

The Group's total sales of goods for the primary aluminum segment increased by RMB2,148.5 million to RMB12,994.1 million in 2004, up 19.8% over 2003. This was mainly attributable to an increase in the average selling price of primary aluminum as well as the adjustment in product mix which increase the production of higher value-added aluminum products, leading to the increase in sales value. The sales volume of ordinary aluminum ingots in 2004 is basically close to that of previous year, whereas sales of other aluminum increased by 10.8% over last year.

Cost of Goods Sold

The total cost of goods sold for the Group's primary aluminum segment increased by 26.5% from RMB9,884.0 million in 2003 to RMB12,501.8 million in 2004, mainly due to the increase in the production cost of primary aluminum. As the Group's internal sales of alumina were carried out in line with market price, the price of alumina increased significantly in 2004, resulting in the significant increase of 10.7% in the unit production cost of primary aluminum. Resulting from the increase by 10.6% of power tariff in the second half of 2004, the unit production cost of primary aluminum increased by 4.1%. Meanwhile, the Company improved the production facilities continuously, renovated some of the low efficiency aluminum production lines, leading to the greater improvement in production effectiveness. The management mode of rationalization was applied in production which prevented unnecessary consumption and lowered the material consumption for each tonne of primary aluminum, offsetting the impact imposed by the rising prices of certain raw materials.

Operating Profit (Loss)

The primary aluminum segment recorded a loss of RMB32.2 million as compared with the profit of RMB445.2 million in 2003. This is mainly attributable to a higher growth in the unit production cost than that in the selling price of primary aluminum.

Based on the Group's careful analysis of the current operation of primary aluminum, the history data and the prospect, the directors believe that the slight loss in the primary aluminum segment for the year falls within their estimation. Accordingly, the Company will not change its strategy of "Develop aluminium selectively". In view of the escalating domestic demand for primary aluminum, the Company will continue to align its product mix to improve cost effectiveness and reduce unit consumption level, so as to further improve operating profit from the primary aluminum segment.

Corporate and Other Services Segment

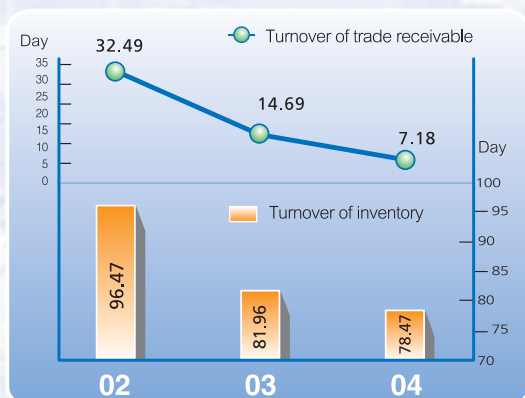
The Group's corporate and other services segment reflected the expenses of the Company's corporate segment and research and development services and product sales of the Group's research institute to external customers. This segment recorded an operating loss of RMB76.91 million for the year ended December 31, 2004, basically the same as the losses of RMB78.34 million of last year.

Working Capital, Liabilities and Capital Commitments

Working Capital

As of December 31, 2004, the Group's current assets amounted to RMB14,356.6 million, representing an increase of RMB5,718.0 million over RMB8,638.6 million of 2003.

- the Group's inventories amounted to RMB5,231.9 million, representing an increase of RMB1,106.1 million over the previous year's RMB4,125.8 million. The increase was mainly attributable to the increase in the price and reserve volume of raw materials, resulting in the increase in inventories of raw materials by RMB1,081.9 million.
- the Group's account receivables amounted to RMB1,786.8 million, representing an increase of RMB998.9 million as compared with RMB787.9 in 2003. Of which, bills receivables amounted to RMB1,524.2 million, representing an increase of RMB1,121.3 million over previous year. Trade receivables amounted to RMB262.6 million, representing a decrease of RMB122.4 million from RMB 385 million last year.



Current Liabilities

As of December 31, 2004, the Group's current liabilities amounted to RMB13,193.5 million, representing an increase of RMB2,922.1 million as compared with RMB10,271.4 million in 2003. The increase was mainly attributable to certain amount of premium charged by the Company to customers engaged in the Company's long-term contract of alumina and the prepayment made by some of the customers, resulting in the increase in account received in advance amounted to RMB810.8 million. Due to the increase of projects of capital expenditure, the construction payable increased by RMB824.7 million. Income tax increased as a result of the corresponding increase in the profit of the Company. The Company has been approved by the State to settle and pay its income tax aggregately. According to the requirement of tax laws, in general, income tax of a year shall be paid before 30 April in the following year. Thus, income tax payable increased by RMB513.9 million as of December 31, 2004.

Our gearing ratio (the ratio of total liabilities to the sum of total liabilities and owner's equity) decreased to 30.5% as of December 31, 2004 from 34.9% as of December 31, 2003, which is mainly attributable to an increase in retained earnings.



The Group's net current assets amounted to RMB1,163.1 million as of December 31, 2004. This represented an increase of RMB2,795.9 million over the net current liabilities as of December 31, 2003 which was to RMB1,632.8 million. The increase was mainly attributable to the improvement in financing sources and capital structure under the prudent financial policies of the Company.

Capital Expenditures and Capital Commitments

As of December 31 2004, the Group's capital expenditures amounted to RMB10,282.3 million, which mainly consists of the investment of 280,000 tonnes Alumimun project in the establishment of the aluminum project of an associated company Shanxi Huaze Aluminum and Electricity Co., Ltd. (山西華澤鋁電有限公司), together with the project of 800,000 tonnes of alumina project in Shanxi, the project of 700,000 tonnes of alumina project in Henan and the project of 300,000 tonnes of alumina project in Zhongzhou as well as the project of technological renovation for the Company's production plants etc. At present, those projects are in smooth progress and the expected results will be reached.

As of December 31, 2004, the Group's capital commitments amounted to RMB8,696.9 million, which mainly consists of the Company's proposed investment in the greenfield and brownfield projects of alumina and primary aluminum production lines. Major projects include alumina projects in Shanxi, Henan and Zhongzhou as well as aluminum projects in Guizhou, Qinghai and Shanxi, together with the projects of technological renovation for outdated equipments.

By virtue of its credit standing and the domestic capital availability, the Group is able to finance its capital expenditure projects and related expenditures through cash generated from operating activities, short-term and long-term borrowings and the proceeds from its global offering.

In light of its long-term development strategy of "Prioritize alumina first, develop aluminum selectively, and boost aluminum fabrication", the Group expects to gradually expand the production capacity of alumina and primary aluminum by investment in new production lines and acquisition of domestic aluminum production lines in good operations. The Group will strive to explore market share and enhance its market competitiveness, so as to improve operating results for better return to shareholders.

Cash and Cash Equivalents

Cash and cash equivalents of the Group as of December 31, 2004 (including foreign currency-denominated deposits) totaled RMB6,223.8 million, comprising US dollars 55.54 million and HK dollars 250,000.

Net Cash Flow from Operating Activities

Net cash from operations increased by 37.7% from RMB6,002.5 million for the year of 2003 to RMB8,265.2 million for the year of 2004. The increase was primarily the result of the increase of the Company's operating profit. Of the net cash from operating activities, RMB456.3 million was used for interest payment and RMB1,736.2 million was used for PRC income tax payment.

Cash Flows from Investing Activities

The Group's cash outlays for capital expenditure projects amounted to RMB5,352.8 million and RMB8,972.4 million in 2003 and 2004 respectively. The capital expenditure in 2004 contributed to the increase of 520,000 tonnes of alumina production capacity.

Cash Flows from Financing Activities

Net cash inflows from financing activities amounted to RMB4,418.0 million in 2004, which was mainly derived from the proceeds of RMB3,250.7 million from the issue of shares in January 2004, additional bank loans of RMB1,884.5 million and the payment of dividends for 2003 amounting to RMB1,060.8 million. The Group has also established standby credit facilities with domestic banks for an aggregate of RMB32,798.0 million to finance any capital shortfall related to its alumina and primary aluminum projects and for relevant working capital purposes.

Foreign Exchange Rate Risk

The Group conducts its business primarily in Renminbi.

Renminbi is not a freely convertible currency. The restrictions on foreign exchange imposed by the PRC government may result in the material differences between future exchange rate and the current exchange rate or historical exchange rate. The changes in the exchange rate of Renminbi will impact our ability in carrying out operations related to foreign exchange. Those changes will also impact our ability in payment of dividend in HK dollars and in payment of dividend of American Depository Shares in US dollars. The Company believes that it is able and will be able to obtain sufficient foreign exchange to implement the above-mentioned operations.