

# MANAGEMENT DISCUSSION AND ANALYSIS

The following discussion and analysis should be read in conjunction with the audited financial statements of the Company for 2004 and 2005 and the notes thereto included elsewhere in this report. Such financial statements have been prepared in accordance with IFRS. For a discussion of certain differences between IFRS and US Generally Accepted Accounting Principles (“US GAAP”), please refer to the supplemental information contained herein or the Company’s annual report on Form 20-F filed with the Securities and Exchange Commission of United States of America, which will be provided to any Shareholder upon written request.

## YEAR ENDED 31ST DECEMBER, 2005 COMPARED WITH YEAR ENDED 31ST DECEMBER 2004

The Company’s realised net sales in 2005 was 11,516.9 million, increased by RMB941.8 million, or 8.9%, compared with RMB10,575.1 million in 2004, among which: (1) realized net sales of coal was RMB11,353.5 million, increased by RMB999.1 million, or 9.6%, compared with RMB10,354.3 million in 2004. The increase was mainly due to: an increase of average coal prices of 28.3%, which resulted in an increase of net sales of coal by RMB2,502.9 million; and a decrease of coal sales volume of 14.5%, which resulted in the decrease of net sales of coal by RMB1,503.8 million; (2) net income from railway transportation service (calculated on ex-mine basis and on the basis of transportation expenses being borne by the customers) was RMB163.4 million, representing a decrease of RMB57.334 million, or 26.0%, from RMB220.8 million in 2004. Such decrease was principally due to the decrease of coal sales volume resulting from the Company’s decrease of raw coal output and the decrease in the volume of coal deliveries where transportation expenses were calculated on ex-mine basis and were borne by the customers.

Cost of sales and railway transportation service of the Company increased by RMB736.9 million, or 16.2%, to RMB5,288.6 million in 2005, as compared to RMB4,551.7 million in 2004. The cost of coal sales was RMB5,184.8 million, representing an increase of RMB722.5 million, or 16.2%, as compared to RMB4,462.3 million in 2004, principally due to an increase in commodity prices, an increase in employees’ wages, a reduction of the rate of export VAT rebate and an increase in the safety inputs. The unit cost of coal sales was RMB159.61, representing an increase of RMB42.23, or 36.0%, as compared to RMB117.38 of 2004. This was principally due to (1) objective factors increasing the unit cost of coal sales by RMB15.79 among which, the reduction of the rate of export VAT rebate resulted in the increase of unit cost of coal sales by RMB2.60; the increase of prices of raw materials resulted in the increase of unit cost of coal sales by RMB2.09; the increase in subsidence fees as a result of the increase in commodity prices and the strengthening measures to resettle the villages located within the coal field of the Company resulted in the increase of unit cost of coal sales by RMB11.10; (2) an increase of unit cost of coal sales by RMB9.43 as a result of the increase of employees’ wages; (3) an increase of the unit coal sales by RMB2.85 as a result of an increase of expenses from the implementation of the “Four Optimizations” for sales of coal; (4) an increase of the unit coal sales by RMB1.20 as a result of an increase in safety inputs; (5) an increase of the unit cost of coal sales by RMB14.65 as a result of the increase in fixed costs resulting from the decrease of 5.52 million tonnes of sales when compared to the sales in the previous year; (6) the partial set-off of part of the said cost-increasing factors which resulted in the increase of unit cost of coal sales by the Company’s tightening of cost control measures.

Sales, general and management expenses of the Company were RMB1,918.8 million in 2005, increased by RMB438.9 million, or 29.7%, from RMB1,479.9 million of 2004. This increase was mainly due to: (1) the increase of RMB114.2 million as payment of retirement pension scheme; (2) the increase in wages and employee welfare by RMB114.3 million; (3) the increase in initial cost of Yancoal Australia Pty Ltd by RMB121.8 million; (4) increase in currency conversion losses by RMB98.681 million resulting from the fluctuation of exchange rate.

## MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

Other income of the Company decreased by RMB30.694 million, or 18.5%, to RMB135 million in 2005 from RMB165.7 million in 2004. This was mainly due to: (1) interest income decreased by RMB16.082 million; (2) a provision for devaluation instead of amortization as stipulated in the newly revised IFRS adopted by the Company in 2005, the negative goodwill amortization decreased by RMB27.62 million in 2005 compared with that of 2004.

Interest expenses of the Company decreased by RMB11.331 million, or 31.5 %, to RMB24.611 million in 2005 from RMB35.942 million in 2004. This was principally due to the partial repayment of bank loans.

Income before income taxes of the Company decreased by RMB253.3 million, or 5.4%, to RMB4,420 million in 2005 from RMB4,673.3 million in 2004.

Income attributable to the equity holders of the Company decreased by RMB272.8 million, or 8.6%, to RMB2,881.5 million in 2005 from RMB3,154.3 million in 2004.

Total assets increased by RMB2,917.7 million, or 15.9%, to RMB21,254.4 million as at 31st December, 2005 from RMB18,336.7 million as at 31st December 2004. This was principally due to the increase of the appreciation of asset value from the Company's production and operation activities.

Total liabilities increased by RMB797.8 million, or 28.4%, to RMB3,607.1 million as at 31st December, 2005 from RMB2,809.3 million as at 31st December, 2004. This is mainly due to (1) accounts payable to the Parent Company and the Parent Company's subsidiary increased by RMB508.3 million (2) tax payable increased by RMB118.0 million (3) deferred tax liabilities increased by RMB123.2 million.

Equity attributable to equity holders of the Company increased by RMB2,094.8 million, or 13.5%, to RMB17,618.6 million as at 31st December, 2005 from RMB15,523.8 million as at 31st December, 2004. This was principally due to profit realized by operation activities.

### LIQUIDITY AND CAPITAL RESOURCES

In 2005, the Company's principal source of capital was the cash flow from operations. The Company's principal uses of the capital include payment for operating expenses, purchase of property, machinery and equipment, repayment of Shareholders' dividends.

As at 31st December 2005, the balance of bills and accounts receivable were RMB2,224.8 million, representing an increase of RMB1,001 million, or 81.8%, from RMB1,223.8 million as at 31st December, 2004. Bills receivable increased by RMB1,202.9 million, or 135.2%, to RMB2,092.9 million as at 31st December, 2005 from the RMB890 million as at 31st December, 2004, principally due to the increase in bank bills of exchange from the sale of coal. Accounts receivable decreased by RMB201.8 million, or 60.5%, to RMB131.9 million as at 31st December, 2005 from RMB333.7 million as at 31st December, 2004, principally due to the reduction of newly occurred accounts receivable in this reporting period and the Company's enhanced efforts of collecting the previous accounts receivable.

As at 31st December, 2005, inventories of the Company decreased by RMB14.928 million, or 3.1%, to RMB470.5 million as at 31st December, 2005 from RMB485.4 million as at 31st December, 2004. The decrease was due to the decrease in coal inventories.

Other loans receivable decreased by RMB210 million, or 24.7%, to RMB640 million as at 31st December 2005, from RMB850 million as to 31st December 2004. During the reporting period, the Company withdrew an entrusting bank loan of RMB160 million to Shandong Longxiang Industrial Co. Ltd and an entrusting bank loan of RMB50 million entrusting bank loan to Shandong Cement Co. Ltd.

Prepayment and other current assets increased by RMB14.121 million, or 7.5%, to RMB202.4 million as at 31st December, 2005, from RMB188.3 million as at 31st December, 2004.

## MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

As at 31st December, 2005, bills and accounts payable increased by RMB19.385 million, or 4.1%, to RMB497.7 million from RMB478.3 million as at 31st December, 2004.

Other accounts payable and provisions increased by RMB238.3 million, or 17.8 %, to RMB1,575.9 million as at 31st December, 2005 from RMB1,337.6 million as at 31st December, 2004 principally due to (1) accounts receivable in advance increased by RMB48.456 million (2) wages payable increased by RMB55.133 million (3) accounts payable for purchase of property, machinery and equipment, material increased by RMB43.157 million (4) accounts payable to the Parent Company increased by RMB81.514 million.

Long-term liabilities decreased by RMB86.055 million, or 32.6%, to RMB178.1 million as at 31st December 2005 from RMB264.2 million as at 31st December, 2004. This was principally due to (1) bank borrowing above one year decreased by RMB200 million (2) deferred tax liabilities accrued by provision expenses including land subsidence fees and safety production expenses increased by RMB123.2 million.

The Company's capital expenditure for the purchase and construction of property, machinery and equipment was RMB830.2 million and RMB1,290.5 million in year 2004 and 2005 respectively.

According to the Acquisition Agreement of Jining III Coal Mine, the Company has paid the Parent Company RMB13.248 million for mining right during this reporting period.

As at 31st December, 2005, the Company's debt to equity ratio was 1.3%, which was calculated on basis of the equity attributable to equity holders of the Company and total amount of borrowings amounting to RMB17,618.6 million and RMB231.8 million, respectively.

The Company's estimated capital expenditure for year 2006 is RMB4,817 million. This is mainly due to: (1) the capital expenditure for purchase of property, machinery and equipment for the existing operating 6 coal mines and railway assets of approximately RMB1,262 million; (2) the capital expenditure for external projects development is approximately RMB3,555 million, including: investment in the construction of Yanzhou Astar Coal Mine in Australia of approximately RMB1,513 million; investment in 600,000 tonnes methanol project and new coal mine project in Shanxi Province of approximately RMB1,352 million; and investment in Heze Zhaolou Coal Mine of about RMB690 million. The capital resource for the above capital expenditure is mainly from the Company's cash in hand.

Taking into account the cash in hand and existing abundant capital sources, the Company believes that it will have sufficient capital to satisfy for its operational and developmental requirements.

### TAXATION

The Company is still subject to an income tax rate of 33% on its taxable profits in 2005.

### US GAAP RECONCILIATION

The Company's audited financial statements are prepared in compliance with IFRS, which differs in certain respects from accounting principles generally accepted in the United States of America ("US GAAP"). Please refer to supplemental information contained herein for a description of the differences between IFRS and US GAAP, and the adjusted net income for the year ended 31st December, 2005 and the Shareholders' equity as at 31st December, 2005 after reconciliation made in accordance with US GAAP.