

ALUMINA

In the first quarter of 2006, alumina prices continued to increase. While the alumina FOB price in the international market reached a high of US\$630 per tonne, the spot retail price of imported alumina in China rose to RMB6,500 per tonne, both reaching historical new highs. Due to rapid growth of domestic-made alumina and reduced purchases from the international spot market, the international alumina spot price began to decline in the second quarter of 2006. At the end of June, the alumina FOB price in the international market dropped to US\$500 per tonne while the spot retail price of imported alumina in China fell to below RMB5,000 per tonne. In the first half of 2006, the average spot price of alumina of the Company was approximately RMB5,332 per tonne.

In the first half of 2006, global alumina production amounted to 32,970,000 tonnes with a consumption of 32,180,000 tonnes, representing year-on-year increases of 9.2% and 5.8% respectively. During the period, alumina supply increased due to the establishment of a number of domestic alumina enterprises that are not related to the Group. Notwithstanding the contribution of such new enterprises, demand continued to exceed supply by 32%. In the first half of 2006, China produced 5,950,000 tonnes of alumina, representing a year-on-year increase of 49%; the consumption of alumina amounted to 8,710,000 tonnes, representing a year-on-year increase of 14.3%. In the first half of 2006, China imported 3,330,000 tonnes of alumina, representing a year-on-year decrease of approximately 10%.

BUSINESS REVIEW

In the first half of 2006, the Group closely monitored and studied market trends for market opportunities to expedite the Group's development. Effective measures were formulated to enhance safety, efficiency, quality and reduce unnecessary consumption. Staff members were unified and worked hard, focusing on management fundamentals and technological upgrades. As a result, in the first half of 2006, the Group recorded a new high in operating results and made great progress in the Group's development.

1. With comprehensive analysis on the production situation and in line with safe production and management, the Group carefully implemented its production plans with strengthened regulation, direction and management on production. For alumina, the Group took efforts to tap potentials for increases in production and efficiency. For aluminum, the Group captured favorable opportunities from market mergers and acquisitions, and took measures to save energy and reduce unnecessary consumption. Satisfactory results were achieved in production volume. During the first half of this year, the production volume of alumina amounted to 4,330,000 tonnes, representing an increase of 24.1% over the corresponding period last year. The production of alumina chemicals, namely alumina hydrate and multi-variety alumina, was 510,000 tonnes, representing an increase of 9.7% compared to the same period last year. The production of primary aluminum products amounted to 780,000 tonnes (inclusive of the 86,000 tonnes representing the total output of Lanzhou Aluminum Co., Limited ("Lanzhou Aluminum")), in which the Company holds a 28% stake), representing an increase of 67.8% over the corresponding period last year.

2. To enhance its core competitiveness, principal businesses and industry chain, the Group has adopted a quantum expansion model to increase production capacity. The Group promoted the rapid realization of production in newly-built projects and made timely adjustments to development strategies in light of the changing product and market.
- Construction has commenced on three 800,000-tonne-capacity alumina expansion projects at Guizhou Zunyi, Chongqing Nanchuan and phase III of Guangxi branch.
 - In the primary aluminum segment, the Group took advantage of mergers and acquisitions and as a result, as of the end of August 2006, the smelting capacity of primary aluminum increased by approximately 970,000 tonnes (inclusive of the 272,000 tonnes smelting capacity representing total capacity of Jiaozuo Wanfang Aluminum Company Ltd., (“Jiaozuo Wanfang”), in which the Company holds a 29% stake) from that of 2005.
 - In December 2005, the Group and Shanxi Guanlv Company Ltd. (“Shanxi Guanlv”) entered into a joint venture agreement for the establishment of Shanxi Huasheng Aluminum Company Ltd. (“Huasheng Aluminum”). The total registered capital of Huasheng Aluminum is RMB1 billion, of which the Group invested RMB510 million in cash and Shanxi Guanlv contributed net assets of RMB490 million. The Group holds 51% of the share capital of Huasheng Aluminum. The primary aluminum smelting capacity of Huasheng Aluminum is 220,000 tonnes, and has officially commenced production in March 2006. The acquisition was completed in March 2006.
 - In March 2006, the Group entered into a share transfer contract with Liaoning Fushun Aluminium Plant, pursuant to which the Group acquired the entire equity interest of Fushun Aluminum Company from Fushun Aluminium Plant for a cash consideration of RMB500 million. Fushun Aluminum Company is mainly engaged in the production of primary aluminum and carbon products, and had a smelting capacity of 140,000 tonnes in 2005. As at the end of acquisition date, the total assets and net assets of Fushun Aluminum Company were valued at RMB1.27 billion and RMB503 million respectively. The acquisition was completed in March 2006.
 - In May 2006, the Group entered into a share transfer agreement with Jiaozuo Wanfang Group Company Ltd. in relation to the transfer of shares of Jiaozuo Wanfang. Pursuant to the agreement, the Group will acquire 139,251,064 state-owned legal entity shares of Jiaozuo Wanfang from Jiaozuo Wanfang Group, representing approximately 29% of the issued shares of Jiaozuo Wanfang. As a result, the Group will become the largest shareholder of Jiaozuo Wanfang. The Group will pay RMB247 million as consideration for the acquisition. The transfer of shares is subject to approval by the relevant authorities. Jiaozuo Wanfang’s smelting capacity of primary aluminum is approximately 272,000 tonnes.

- In June 2006, the Group entered into a cooperation agreement with nine companies, namely Guizhou Wujiang Hydropower Development Co., Ltd. (“Wujiang Hydropower”), Zunyi Municipal State-owned Assets Investment Management Co., Ltd., Zunyi County State-owned Assets Investment Management Co., Ltd., Guizhou Provincial Resource Development Corporation, China Non-ferrous Metal Industry (Guiyang) Corporation, Guizhou Qianneng Enterprise (Group) Corporation, Guizhou Aluminum Plant, China Orient Asset Management Corporation and Zunyi Municipal Resource Development Corporation; pursuant to which Chalco acquired a proportion of the equity interests in Zunyi Aluminum Co., Ltd. (“Zunyi Aluminum”) from Wujiang Hydropower and the entire equity interests in Zunyi Aluminum from the other eight companies. Upon completion of the acquisition, the Group will hold 66.4% equity interests in Zunyi Aluminum. The principal assets of Zunyi Aluminum include the smelting production line with an annual smelting capacity of 113,000 tonnes and its ancillary facilities. As of December 31, 2005, its total assets were valued at approximately RMB1,023 million and net assets at approximately RMB307 million. The consideration paid by the Group for the acquisition was RMB219 million. The acquisition was completed in August 2006.
- In July 2006, the Group entered into an agreement with Shandong Linyi Jiangtai Aluminum Co. Limited (“Linyi Jiangtai”) and Shandong Huasheng Jiangquan Thermal & Power Co. Ltd. (“Huasheng Jiangquan”) in respect of the transfer of equity in Shandong Huayu Aluminum Power Co. Ltd. (“Huayu Aluminum Power”), pursuant to which the Group acquired 40.69% and 14.31% equity interests in Huayu Aluminum Power from Linyi Jiangtai and Huasheng Jiangquan respectively. Upon completion of the acquisition, the Group will hold 55% equity interests in Huayu Aluminum Power, while Linyi Jiangtai and Huasheng Jiangquan will hold the remaining 25% and 20% equity interests, respectively. The principal assets of Huayu Aluminum Power include the aluminum smelting production line with an annual smelting capacity of 100,000 tonnes and its ancillary facilities as well as two 13.5 MW power-generator. As of December 31, 2005, its net assets were valued at approximately RMB899 million. The total consideration payable by the Group for the acquisition is RMB412 million.
- In August 2006, the Group entered into an agreement with Baiyin Nonferrous Metal (Group) Co., Ltd. (“Baiyin Nonferrous”) and Baiyin Honglu Aluminum Co., Ltd. (“Baiyin Honglu”) in respect of the transfer of equity in Gansu Hualu Aluminum Co., Ltd. (“Hualu Aluminum”), pursuant to which the Group acquired 51% equity interest in Hualu Aluminum held by Baiyin Honglu, which may transfer to Baiyin Nonferrous in the future. Upon completion of the acquisition, the Group will become the controlling shareholder and the remaining 49% equity will be held by Baiyin Honglu. The principal assets of Hualu Aluminum include the aluminum smelting production line with an annual smelting capacity of 127,000 tonnes and its ancillary facilities. The registered capital of Hualu Aluminum is RMB529 million. As of December 31, 2005, its total assets and net assets were valued at RMB1,590 million and RMB529 million respectively. The total consideration payable by the Group for the acquisition is RMB270 million.
- The Group has established a special working team to carry out relevant work relating to aluminium fabrication.

3. Capital operations were successfully accomplished and shareholders' approvals obtained:
 - In May 2006, the Company successfully completed the placement of 600,000,000 new H shares for net proceeds of approximately HK\$4,390 million.
 - In May 2006, the Company successfully issued short-term bonds with a total principal amount of RMB3 billion with a par value of RMB100 each, bearing an effective rate of 3.53% and a maturity period of 1 year, for net proceeds of approximately RMB2,988 million.
 - At the annual general meeting of the Company held on May 10, 2006, the Company obtained approval for a one year extension of the submission of the applications to the China Securities Regulatory Commission for the issuance of a maximum of 1,500,000,000 A shares to the public in China, and to the Shanghai Stock Exchange for listing of its A shares thereon. Preparations for the said application are currently in progress.
4. The Group focused on the development of measures for reuse and recycling of materials, energy and other resources and managing a resource-efficient enterprise to promote the evolution of the growth of the industry and our Group. In addition to commencing a number of energy-saving, water-saving and comprehensive resource utilization projects, it took advantage of opportunities to reduce consumption in existing production lines. As a result, the Company saved energy equivalent to 560,000 tonnes of standard coal.
5. Addressing the changing market demands, the Group proactively and effectively carried out various work relating to product positioning, technological research, market guidance and industrialization implementation, with a view to medium or long term development. Technology planning projects focused on exploitation, development and utilization of bauxite resources, energy saving and consumption reduction, product mix adjustment and enhancement of core competitiveness. The Group also proactively carried out basic applied research of new techniques, new technologies, new products and new facilities. The industrial application of technological and scientific achievements were carried out smoothly, with results already achieved in certain projects.
6. The Group continued to promote and accelerate its overseas development projects, which have been proceeding smoothly. Currently, projects in Brazil, Vietnam, Australia and Guinea are continually progressing and being actively carried out.
7. The Group strengthened and enhanced management fundamentals. Systems of quality, safety and environmental protection were effectively implemented. Progressive achievements were seen in standardized quantitative management and the new model for facilities management focusing on sampling inspection. A production and management model focusing on planned management secured efficient production. Production and investment procedures were under effective control through comprehensive budget management. With a focus on capital management, the Group achieved operational risk management objectives. During the period, the Group successfully integrated the operations of the newly-acquired enterprises.

8. The Group is focused to expedite the completion of the Section 404 internal control compliance project. In accordance with the requirements under Section 404 of the Sarbanes — Oxley Act, the Company has set up a project management office and task force team, which is responsible for the design, implementation testing and evaluation of the Company's internal controls over financial reporting, including, among others, the establishment and implementation of anti-fraud and risk management programs. The Company is currently implementing and improving the newly established internal control system, and evaluating its operation effectiveness as well as remediating identified deficiencies. At the same time, it is also in the process of finalizing its evaluating documentation in accordance with the requirements under Section 404.
9. ERP information system aims to facilitate the integrated management of finance and operation, and to provide a unified platform for the centralised management of the Company. Currently, all hardware and related environment have been set up at all locations; all branches and certain subsidiaries are online.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion and analysis should be read in conjunction with the Group's financial information together with the notes thereto as contained elsewhere in the interim report. The condensed interim consolidated financial information has been prepared in accordance with HK GAAP, which may materially differ in certain respects from US GAAP. A discussion of the material differences is set out in the supplementary information of the interim report.

OVERVIEW

The Group is engaged principally in alumina refining and primary aluminum smelting. The Group organizes and manages its 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 chemicals (including alumina hydrate and alumina chemical products), and gallium.
- Primary aluminum segment, which consists of procuring alumina and other raw materials, supplemental materials and electricity, production and selling of almost all primary aluminum to external customers. In addition, this segment includes production and sales of carbon products and small amount of aluminum-fabricated products.
- Corporate and other services segment, which includes the headquarter's operations, research conducted by the Group's research institutes, provision of the Group's research and development services and product sales to third parties.