Management Discussion and Analysis

OVERVIEW

2006 marked the first full calendar year of operations for Minmetals Resources after the acquisition of the alumina and aluminium businesses from its parent company in October 2005. The injected businesses provided significant contribution to the Group for the year and emerged as the key driving force for our growth.

With the contribution from the injected businesses, the Group reported significant increase in turnover and net profit over the past year. Turnover increased by 285% from HK$3,332.8 million in 2005 to HK$12,829.3 million in 2006. Net profit attributable to equity holders of the Company increased by 376% from HK$181.7 million in 2005 to HK$865.3 million in 2006. Basic earnings per share were HK$0.505 for 2006, compared to HK$0.209 for 2005.

FINANCIAL REVIEW

Turnover

Assets and businesses injections provided growth momentum for the year. As set out in the table below, all business segments showed remarkable growth in turnover in 2006.

	2006 HK$ million	2005 *HK$ million*	**Increase** *HK$ million*	
Trading	**9,286.4**	2,086.5	7,199.9	345%
Aluminium fabrication	**1,519.7**	1,252.9	266.8	21%
Copper fabrication and plica tubes production	**2,233.4**	30.2	2,203.2	7,295%
Port logistics services and other industrial operations	**6.5**	3.3	3.2	97%
Inter-segment elimination	**(216.7)**	(40.1)		
Total	**12,829.3**	3,332.8	9,496.5	285%

Trading business, with full-year contribution from the injected businesses in October 2005, continued to act as the Group's most important income generating engine. Turnover of the trading segment increased by 345% during the year, roughly in line with the increase in the trading volume of alumina, a growth of 375% from approximately 406,000 tonnes in 2005 to approximately 1,927,000 tonnes in 2006.

Another fast-growing segment was copper fabrication and plica tubes production. Starting from April 2006, turnover of this segment included the proportionate consolidated turnover derived from a jointly controlled entity engaging in copper rods production. This jointly controlled entity was owned as to 36% by the Group, of which 11% was acquired in March 2006 and 25% was previously held.

Management Discussion and Analysis

FINANCIAL REVIEW *(cont'd)*

Gross profit

During the year, gross profit increased by HK$1,134.8 million or 373%, representing a higher percentage increase than that of the turnover. Overall gross profit margin raised from 9.1% in 2005 to 11.2% in 2006, reflecting more emphasis on and higher contribution from the trading business, the most significant profit contributor of the Group.

Selling expenses

The Group's selling expenses mainly included port expenses relating to unloading, storing and packing of alumina, inspection fee, transportation costs and employees' costs. Selling expenses increased from HK$63.1 million in 2005 to HK$104.7 million in 2006, primarily due to the increase in port expenses and inspection fee as a result of the increase in trading volume of alumina. However, as benefited from economies of scale, when expressed as a percentage of the Group's turnover, selling expenses decreased from 1.9% in 2005 to 0.8% in 2006.

Administrative expenses

The Group's administrative expenses increased from HK$70.4 million in 2005 to HK$153.2 million in 2006, representing an increase of HK$82.8 million. The increase was mainly attributable to: (i) additional administrative expenses of HK$42.2 million were incurred in 2006 for the alumina trading business (expenses for 12-month's operation in 2006 versus expenses for less than 3-month's operation in 2005); (ii) share-based payments of HK$21.6 million were booked in 2006 in respect of the share options granted by the Company in April 2006; and (iii) additional legal and professional fees were incurred for the Group's capital reduction and corporate governance enhancement projects.

In terms of percentage to the Group's turnover, administrative expenses decreased from 2.1% in 2005 to 1.2% in 2006.

Assessment of alumina purchasing rights and provision for sales contract obligations

In response to the decline in alumina prices in the third quarter of 2006, an re-assessment on the valuation of the alumina purchasing rights and provision for sales contract obligations was made on 30 September 2006. Based on independent valuation results, provision for impairment of HK$877.6 million and a write-back of provision of HK$288.4 million were made in respect of the alumina purchasing rights and the sales contract obligations respectively. These resulted in a write-back of deferred income tax liabilities of HK$643.8 million during the year. The overall effect of the above has a net positive impact of approximately HK$54.6 million on the Group's results.

Other losses – net

Other losses – net decreased by HK$40.8 million from HK$133.2 million in 2005 to HK$92.4 million in 2006. The decrease was mainly attributable to the gain on disposal of available-for-sale financial assets. During the year, to partially lock up the gains resulting from the hiking gold prices, the Group disposed certain equity securities in Sino Gold Limited, a gold mining company listed in Australia, with secondary listing in Hong Kong since 16 March 2007. This produced after-tax gains of approximately HK$32.0 million.

Management Discussion and Analysis

FINANCIAL REVIEW *(cont'd)*

Other losses – net *(cont'd)*

During the year, the Group incurred net aggregate losses of HK$135.5 million on derivative financial instruments. Included in these net aggregate losses were net losses of HK$138.1 million incurred for aluminium forward contracts, aluminium options and copper futures contracts entered into by the Group to hedge against the commodity price risk arising from its alumina trading, aluminium fabrication and copper fabrication businesses. Such derivative transactions, while the objective is for hedging purposes under the Group's risk management policies, have not qualified for hedge accounting treatment under the relevant accounting standards. The remaining net gains of HK$2.6 million was related to the ineffective hedge portion for the foreign exchange forward contracts and the interest rate swaps entered by the Group.

Finance costs – net

With enlarged operating scale and assets base, the Group's net finance costs increased by HK$14.8 million from HK$14.4 million in 2005 to HK$29.2 million in 2006. Such increase was resulted from the increase in interest expenses of HK$47.1 million (net of the gain on interest rate swaps), after netting off the increase in interest income from bank deposits of HK$32.3 million.

During the year, the Group earned gain on interest rate swaps of HK$23.0 million, which helped to reduce the Group's interest expenses amid the hiking interest rates in 2006.

Share of profits less losses in associates

Among the associates of the Group, Changzhou Jinyuan Copper Company Limited ("Changzhou Jinyuan") and Sino Nickel Pty Ltd ("Sino Nickel") provided the majority of profit contribution during the year. Changzhou Jinyuan and Sino Nickel contributed after-tax profit of HK$8.6 million and HK$19.8 million respectively to the Group in 2006.

Starting from April 2006, Changzhou Jinyuan was reclassified as a jointly controlled entity of the Group and no longer treated as an associate. Sino Nickel is owned as to 40% by the Group and is primarily involved in sourcing mineral resources, especially nickel and copper, from Australia for exportation to the PRC market.

Income tax credit/(expense)

The Group reported income tax credit of HK$343.1 million in 2006 and income tax expense of HK$24.5 million in 2005. Current income tax increased by HK$155.1 million from HK$25.6 million in 2005 to HK$180.7 million in 2006, mainly due to the increase in profit of the trading operation. The Group's deferred income tax credit increased by HK$522.6 million from HK$1.1 million in 2005 to HK$523.7 million in 2006. It was mainly attributable to the write-back of deferred tax liabilities amounting to HK$643.8 million as a result of the reassessment of alumina purchasing rights and provision for sales contract obligations during the year.

Management Discussion and Analysis

SEGMENTAL ANALYSIS

The Group's business comprises four main business segments: (1) Trading; (2) Aluminium fabrication; (3) Copper fabrication and plica tubes production; and (4) Port logistics services and other industrial operations.

Trading

In the year under review, trading business accounted for 71% of the Group's turnover (2005: 62%) and contributed 91% (2005: 18%) of the Group's operating profit. Alumina remained the major trading item for the year. About 82% turnover in this segment was derived from alumina trading.

In 2006, alumina prices experienced volatile changes. Around April and May, the imported alumina sale prices of the Group reached historical new high of approximately RMB6,500 (or US$804) per tonne. However, after that, prices dropped vigorously in the latter part of the year and stated at approximately RMB2,500 (or US$309) per tonne near the year end.

The supply of PRC domestically produced alumina increased sharply in 2006, causing a drop in the demand of imported alumina and eroding the importers' market share. In PRC, the volume of imported alumina dropped slightly by 1.5% to approximately 6,910,000 tonnes in 2006.

Competition and negative market sentiment intensified in the last few months of 2006, consequently caused the ease back in the Group's alumina sales volume and average alumina sales price in the second-half of the year. Nevertheless, with about half of its sales for 2006 were secured by long-term contracts, the Group still maintained a leading position in the market.

		Year Ended 31 December 2006		
Alumina Trading		**First six months**	**Last six months**	**Full year**
Sales volume	*('000 tonnes)*	1,042	885	1,927
Turnover	*(HK$ million)*	4,553	3,071	7,624
Average sales price	*(HK$ per tonne)*	4,369	3,470	3,956
	(US$ per tonne)	560	445	507

During the year, the Group also engaged in the trading of other non-ferrous metals. Approximately 77,000 tonnes of aluminium ingots and approximately 9,600 tonnes of copper concentrates were sold, which together accounted for approximately 18% of the turnover in this segment.

Management Discussion and Analysis

SEGMENTAL ANALYSIS *(cont'd)*

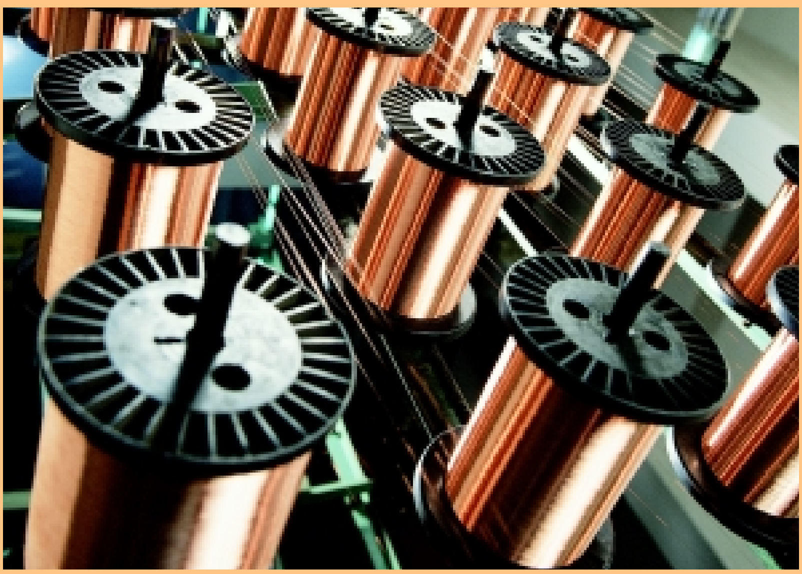
Aluminium Fabrication

Aluminium fabrication business accounted for 12% (2005: 38%) of the Group's turnover and contributed 10% (2005: 17%) of the Group's operating profit for 2006.

During the year, the Group had implemented measures to enhance the production yields of its manufacturing processes and rationalise the product and sales mix, thereby maintaining its competitive edge in the market. Sales volume of aluminium foils and extrusion products reached a new high of 63,282 tonnes in 2006, representing a 6% increase over previous year. Increase in sales volume and higher aluminium prices lead to a 21% increase in turnover.

Copper Fabrication and Plica Tubes Production

This segment accounted for 17% (2005: 1%) of the Group's turnover and contributed 5% (2005: 6%) of the Group's operating profit for 2006.



For copper fabrication, the Group operated copper rods production through a jointly controlled entity, which was owned as to 36% by the Group as at 31 December 2006. Since April 2006, the Group has proportionately consolidated the results of this jointly controlled entity. Sales

Management Discussion and Analysis

SEGMENTAL ANALYSIS *(cont'd)*

Copper Fabrication and Plica Tubes Production *(cont'd)*

volume of this entity was about 151,000 tonnes in 2006. In 2006, copper rods business faced both threats and opportunities. Surging copper prices not only drove up the production cost but also tightened the working capital of the business. However, it also helped to speed up the market consolidation by excluding out small-scale and less competitive producers. By strengthening cost controls, the copper rods business sustained a reasonable margin of return and contributed operating profit of approximately HK$24.0 million to the Group during the year.

For plica tubes production, despite competition from new entrants into the market, sales volume of the Group can still be managed to boost by 26% from 1.55 million metres in 2005 to 1.95 million metres in 2006. Contribution to operating profit from plica tubes operation amounted to HK$5.0 million in 2006.

OTHER FINANCIAL INFORMATION

Financial Resources and Liquidity

The Group continued to maintain a strong financial and liquidity position in 2006. Total assets increased by HK$600.2 million to HK$8,124.7 million and total equity increased by HK$1,161.5 million to HK$4,445.6 million during the year. As at 31 December 2006, the current ratio was 1.8, based on current assets of HK$4,414.8 million and current liabilities of HK$2,501.7 million.

As at 31 December 2006, the Group had approximately HK$2,706.3 million liquid funds in cash (including cash and cash equivalents and pledged bank deposits). Even after setting off with the total bank borrowings of HK$1,072.2 million and convertible bonds of HK$980.1 million, the Group would still in a net cash surplus position of HK$654.0 million. Hence, gearing ratio (defined as total borrowings less cash and cash equivalents and pledged bank deposits, divided by capital and reserves attributable to the Company's equity holders) is not applicable.

Increase in the Group's cash liquid funds during the year was mainly due to the issuance of convertible bonds in December 2006 and the profits generated from operations. Save for those reserved for general working capital purposes, the Group intends to use the funds for future acquisition of alumina-related or aluminium-related businesses and/or other projects.

About 45% and 33% of the Group's cash and cash equivalents at 31 December 2006 were denominated in Hong Kong dollars and Renminbi respectively, while the remaining balance was mainly denominated in US dollars.

The Group's total bank borrowings, of which 53% bears interest at floating interest rate and 47% bears interest at fixed interest rate, reduced by 7% to HK$1,072.2 million at 31 December 2006. About 58% and 42% of the Group's bank loans were denominated in US dollars and Renminbi respectively. All bank borrowings at 31 December 2006 are repayable within one year. The Group is preparing to refinance a bank loan of HK$569.4 million (which has been used to finance the initial payment of alumina purchasing rights and becoming due in June 2007) on a long-term basis.

Management Discussion and Analysis

OTHER FINANCIAL INFORMATION *(cont'd)*

Significant Investments Held and Material Acquisitions and Disposals

(a) *Investment securities*

As mentioned above, the Group partially disposed the equity securities it held in Sino Gold Limited and realised after-tax gains of approximately HK$32.0 million during the year. As at 31 December 2006, the market value of the remaining securities held amounted to HK$450.9 million, showing an appreciation of about 125% during the year.

(b) *Increase in interest in Changzhou Jinyuan*

Near the end of March 2006, the Group increased its equity stake in Changzhou Jinyuan from 25% to 36%. The purchase consideration for the 11% interest acquired was HK$18.7 million and was settled by the Group's internal funds. Due to the change in shareholding structure and the composition of board of directors, the classification of Changzhou Jinyuan has been changed from associate to jointly controlled entity since April 2006.

(c) *Bauxite and alumina joint venture*

In relation to the Group's proposed establishment of a joint venture to develop a bauxite mine and an associated alumina refining facility in Jamaica, an initial pre-feasibility study to assess the quality and quantity of the bauxite reserves is now in progress. Preliminary assessment result is expected to be available in the second-half of 2007.

Issuance of Convertible Bonds

In December 2006, the Group issued zero coupon guaranteed convertible bonds of an aggregate principal amount of HK$1,000,000,000 (with maturity date on 7 December 2011) and raised net proceeds of approximately HK$976.1 million. The net proceeds are intended to be used by the Company for future acquisition of alumina-related or aluminium-related businesses such as Guangxi Huayin Aluminium Company Limited, Sherwin Alumina L.P. and/or other projects.

Capital Expenditure and Commitments

The Group's capital expenditure for 2006 amounted to approximately HK$29.7 million. It was mainly used for the expansion and upgrade of the production facilities in the aluminium fabrication operation.

As at 31 December 2006, the Group had capital commitments of approximately HK$180.2 million in relation to the expansion of production facilities and the proposed acquisition of additional equity interests in an existing non-wholly owned subsidiary of the Group.

Charge on Assets

As at 31 December 2006, the following assets of the Group had been pledged to certain banks for the banking facilities granted to the Group:

(a) All the equity interests of a wholly owned subsidiary, Sino Mining Alumina Limited ("Sino Mining") and all the assets of Sino Mining;

Management Discussion and Analysis

OTHER FINANCIAL INFORMATION *(cont'd)*

Charge on Assets *(cont'd)*

(b) Property, plant and equipment, land use rights and inventories of the Group with a total carrying amount of approximately HK$382.7 million; and

(c) Bank deposits of approximately HK$38.2 million.

Contingent Liabilities

As at 31 December 2006, the Group had unsettled tax payables in respect of certain properties in the PRC which may result in additional charges. No provision has been made by the Group since the amount of additional charges, if any, cannot be reliably determined. It is estimated that the potential additional charges will not exceed HK$1.5 million (2005: HK$1.4 million).

Events After the Balance Sheet Date

In January 2007, the Company filed a petition to the high court of the Hong Kong Special Administrative Region to seek the court's confirmation of the cancellation of the special capital reserve account of the Company and the reduction of the share premium account of the Company for the purpose of eliminating the accumulated losses of the Company as at 31 October 2006. On 13 February 2007, the court ordered that the cancellation of the special capital reserve account of approximately HK$125,374,000 and the reduction of the share premium account from approximately HK$3,503,362,000 to approximately HK$2,738,934,000 was confirmed.

Risk Management

The Group does not and is prohibited to enter into derivative contracts for speculative purpose. All derivative instruments are only used for the purpose of mitigating the risks arising from operating activities. The Group's major risk exposures and the related hedges are as follows:

(a) *Commodity price risk*

The Group's major exposure to commodity price risk includes the price fluctuation in relation to: (i) alumina purchases and sales in its trading operation and (ii) aluminium ingots used in the production process for its aluminium fabrication operation. In 2006, the Group entered into aluminium forward contracts and options to hedge against these risks. Under no circumstances, the Group had entered into derivative contracts that were greater than the actual physical stocks that it purchased or sold during the year. At 31 December 2006, the Group's open position was as follows:

Maturity profile	**Aluminium forward sales contract** *Tonnes*
2007	33,330
2008	7,500
Total	40,830

Management Discussion and Analysis

OTHER FINANCIAL INFORMATION *(cont'd)*

Risk Management *(cont'd)*

(b) *Foreign exchange risk*

The Group's major businesses are conducted in United States dollars ("USD"), Renminbi ("RMB") and Australian dollars ("AUD"). Given the exchange rate peg between Hong Kong dollars ("HKD") and USD, it is not foreseen that the Group will be exposed to significant exchange rate risk exposure for the transactions conducted in USD/HKD. For 2006, 82% of the Group turnover was denominated in RMB. At 31 December 2006, the total net assets shared by the Group in its PRC subsidiaries, associates and jointly controlled entity amounting to HK$1,464.0 million were denominated in RMB. Fluctuation of the exchange rate between RMB and USD/HKD could affect the Group's performance. Exchange rate fluctuation between AUD and USD/HKD will partially affect the purchase cost of alumina under a long-term purchase contract with a quantity of 400,000 tonnes per year until 2027. The Group has hedged against this AUD exchange exposure by using forward contracts.

(c) *Interest rate risk*

The Group's interest rate risk mainly arises from bank borrowings. At 31 December 2006, 53% of the Group's bank borrowings amounting to HK$569.4 million bore interest at floating interest rate. To stabilise its interest expenses against interest rate movements, the Group had arranged interest rate swaps to hedge against the risk, which covered about 94% of the Group's floating rate bank borrowings.

Dividend

As at 31 December 2006, the Company was still in accumulated losses and had no available profits for distribution purpose. Hence the Board does not recommend the payment of a final dividend for the year.

On 13 February 2007, the High Court of the Hong Kong Special Administrative Region made an order confirming the capital reduction of the Company. Credits arising from the cancellation of the special capital reserve account and the reduction of the share premium amount of the Company were then used to set off against the Company's accumulated losses. These adjustments will be reflected in the Company's financial statements for the year ending 31 December 2007.

Since the above court's order date, the Company has a capital structure that would permit the payment of dividends. However, at this stage, there is no assurance that a dividend will be declared or paid in future.

Human Resources

At 31 December 2006, the Group (not including the jointly controlled entity and associates) employed a total of 2,420 employees, of which 16 were based in Hong Kong, 2,392 in mainland China and 12 in Australia. The total staff costs, including the directors' emoluments and share-based payments for the share options granted, amounted to HK$109.3 million for 2006. During the year, the Company's directors and certain eligible employees of the Group were awarded share options of the Company for their past and potential contributions to the Group.

The Group has adopted salary policies in line with market practice and motivated its staff with performance-based remuneration. Besides, to cope with its business development, the Group has organised in-house training, knowledge sharing and skills transfer activities for its staff as and when appropriate.