

# Chairman's Statement

Dear Shareholders,

I am pleased to present the report of Hunan Nonferrous Metals Corporation Limited (“HNC” or the “Company”) for the period from 1 September 2005 to 31 December 2005 and of the Company and its subsidiaries (the “Group”) for the year ended 31 December 2005 to the shareholders for their review. On behalf of the Board of Directors and all the employees of the Company, I would like to express our sincere gratitude to all our shareholders for their consideration and support for the Group.

## RESULTS AND DIVIDEND

In 2005, the Group achieved a turnover of RMB9,291 million, representing an increase of 27.1% compared to 2004; the profit attributable to equity holders the parent was RMB426 million, representing a decrease of 23.2% to 2004. Basic earnings per share of the Company was RMB20.15 cents.

After the Company made a special dividend payment of RMB230,980,000 to HNG in March 2006, the Company has no current plan to pay any dividends for the year of 2005.

## BUSINESS DEVELOPMENT

In 2005, the Group relied on effective management, thoughtful organisation and employees' commitment, took advantage of the favourable conditions created by the strong market demand, and realized steady growth in production volume and earnings by capitalizing on its advantages in resources, vertically integrated production chain and economies of scale.

- In 2005, the Group produced 4,519 tons of cemented carbides, 206,514 tons of zinc products (excluding Zhuye Torch's production for the first five months as it was not consolidated between 1 January 2005 to 31 May 2005), 25,317 tons of antimony products and 96,037 tons of lead products.
- In 2005, to become more self-sufficient in the supply of nonferrous concentrates and to stabilize the supply of raw materials for the mid and downstream business, the Group implemented various projects involving 2,000 tons/day polymetals mining and processing and the exploration of zinc and lead mines; in the meantime, the Group formulated and implemented measures to manage the internal supply of mineral resources and incorporated a vertically integrated supply chain of nonferrous raw materials.

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- In 2005, to enhance the production efficiency of the smelted nonferrous products, the Group carried out an upgrade of the zinc smelting system which enabled an increase in the metal recovery rate, reduced the raw material and energy unit product consumption, thus creating a greater return from economies of scale. Such projects also resulted in expansion of electrolytic zinc capacity.
- In 2005, to further improve the product mix, increase the proportion of high value-added products in the overall product mix and increase profitability, the Group strived to develop value-added processing and high value-added products. The Group also implemented various projects involving high performance cemented carbides tools engineering, upon completion of which, the production capacity of 605,000 units of cutting tools, 480 tons of cutting blades, 2,320 tons of high performance cemented carbides products and 20,000 units of rock bits can be achieved. In the meantime, various refinery and value-added processing of nonferrous metals projects such as the ITO (indium tin oxide) processing production line, powder production line and high purity metals (indium, arsenic, gallium, tin, antimony) were all progressing well. The construction of the abovementioned projects progressed satisfactorily.
- In line with the reinforced internal integration and improved operational efficiency, the Group proposed and implemented a series of internal control systems, including a financial management system, an external investment projects management system and fixed assets investment management methods. To enhance management efficiency and improve the capital structure and profit margin, the Group strengthened control over subsidiaries and finance so as to make the gradual integration of internal resources possible.
- We inaugurated integration of nonferrous metals resources in Hunan. At the end of 2005, the Group started to formulate mid and long-term development plans for the production chains of tungsten, zinc, antimony and lead, so as to build up a development mode which is more resource efficient, environmentally friendly, and allows for greater returns.
- With the help of national technology centres, post-doctorate research centers and provincial technology centres, the Group implemented strategies for technology upgrade which focused on the exploration and development of resources, reduction of energy consumption, improvement of product mix, commencement of the research and application of new skills, new technology, new products and new equipment and enhancement of core competitiveness.
- The Group not only strived to increase sales volume and stabilize customer base, but also worked hard to lower purchase costs.
- The Group attached great importance to basic management, and further developed the corporate culture in the midst of the rapid development of our business. The Group maintained a good record of production safety and environmental protection. With the improvement in techno-economic indicators, the Group achieved the planned target of reducing energy consumption.

## REVIEW OF THE PRODUCT MARKET

The world's economy grew steadily in 2005, with steady growth in western developed countries and strong growth in the emerging markets such as the PRC and India. This created a strong demand for basic raw materials such as nonferrous metals and supported an increase in the prices of tungsten, zinc, antimony and lead products. The following data are quoted from the Antaike website ([www.metalchina.com](http://www.metalchina.com)). The relevant prices of these products include value-added taxes.

### Tungsten Market

In 2005, the price of tungsten continued to grow rapidly. The average prices of Ammonium Paratungstate Products ("APT") in the European and the U.S. markets were US\$216.27 and US\$203.26 per metric ton unit respectively, representing an increase of 159.1% and 152.2% respectively from 2004. In January 2005, the price of tungsten concentrates in the PRC was approximately RMB42,800 per ton. Despite the fluctuation, the price surged to approximately RMB120,000 in June and remained at a high level of approximately RMB100,000 per ton in December, showing a strong demand for tungsten in the market in 2005.

In 2005, the production volume of tungsten concentrates (65% WO<sub>3</sub>) in the PRC was about 73,403 tons, representing a decrease of 14.0% compared to 2004. Global consumption of tungsten amounted to approximately 59,390 tons, representing an increase of 4.0% compared to 2004. Consumption of tungsten in the PRC amounted approximately to 18,190 tons, representing a slight decrease of 2.0% compared to 2004, which was mainly attributable to more stringent government regulation, the surge in tungsten price and a decrease in the production volume of cemented carbides, where tungsten is mostly used, after the adjustment in the product mix by major cemented carbides producers.

### Zinc Market

In 2005, the price of zinc reached a record high. The average spot price of zinc as quoted by London Metal Exchange ("LME") for the year was US\$1,381 per ton, representing an increase of 31.9% compared to 2004; the average price for three-month commodity futures of zinc was US\$1,393 per ton, representing an increase of 30.9% compared to 2004. The zinc price in the domestic market remained stable during the first half of the year while the trend showed a rapid growth in the second half of the year; the average price of 1# zinc ingots for 2005 was RMB13,509 per ton, representing an increase of 20.7% compared to 2004; the average price of 0# zinc ingots for the year was RMB13,665 per ton, representing a premium of RMB156 per ton over 1# zinc ingots.

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In 2005, the estimated global zinc production volume was approximately 10.404 million tons, representing an increase of approximately 0.7% compared to 2004; the global production volume of zinc only grew slightly due to strikes and suspension of production caused by accidents. In 2005, PRC's production of zinc was estimated to be 2.745 million tons, representing an increase of 1.1% compared to 2004. The supply of concentrates, environmental factors, electricity, transportation and credit all affected the production of zinc, which resulted in a slight increase in zinc production volume. The estimated global zinc consumption volume in 2005 was 10.79 million tons, representing an increase of 3.4% compared to 2004, when zinc consumption of the western countries stood at 7.25 million tons, representing a decrease of 0.2 million tons compared to 2004. The growth in global zinc consumption was derived from Asia, especially PRC and India. According to a preliminary estimate, PRC's consumption of zinc was 3.08 million tons, representing an increase of 9.2% compared to 2004.

### **Lead Market**

In 2005, the international lead market showed a positive trend, with the price of lead reaching the highest point in 15 years. The average spot price of lead as quoted by LME was US\$976 per ton; the highest spot price was US\$1,155 per ton; the highest price for three-month commodity futures was US\$1,121 per ton, the highest level of three-month commodity futures in 1990s. Compared to the international price, the fluctuation of lead prices in the PRC was not significant in 2005. Lead prices remained at around RMB9,500 per ton at the beginning of the year and increased rapidly only in mid-December and came close to RMB10,000 per ton at the end of the year.

In 2005, global production volume of refined lead was approximately 7.57 million tons, representing an increase of 10.0% compared to 2004. The increase, however, still could not meet the demands of the market; the amount of refined lead demanded globally in 2005 was approximately 7.60 million tons, representing an increase of 7.1% compared to 2004. In 2005, with a consumption volume of 1.74 million tons, PRC surpassed the U.S. and became the largest consumer of refined lead in the world. The growth in the world's consumption of refined lead in 2005 mainly originated from the PRC.

### **Antimony Market**

Since 2003, the antimony market was no longer suffering from the long-term depression and the production of antimony was stimulated in the PRC. In 2005, the trading companies and producers adopted the policy of limiting supply, leading to a continuous decrease in supply in the international market. The price increased steadily, with the average price reaching US\$3,473 per ton for the year, representing an increase of 22.1% compared to 2004. The price of antimony reached its highest point in 10 years and the target of US\$4,000 per ton was reached by the end of 2005.

PRC is the largest producer and consumer of antimony in the world, with its production volume exceeding 75% of the world's production volume. The PRC's production and export of antimony products has a decisive influence on the supply and demand and the price trend of the global antimony market. In 2005, the production volume of antimony in the PRC was approximately 0.1 million tons, representing an increase of approximately 11.0% compared to 2004. In 2005, PRC exported approximately 53,000 tons of antimony oxide. Although the amount of exports dropped by 2.0% compared to 2004, the amount represented 63.9% of the total amount of antimony export, making antimony oxide the major product in the export of antimony products in the PRC. Meanwhile, there was a material increase in the export of refined antimony, with the amount of exports reaching 29,800 tons and a growth of 38.8% compared to 2004.

## BUSINESS PROSPECTS AND OUTLOOK

It is anticipated that the global economy will continue to grow steadily in 2006, and strong economic development in the PRC will lead to strong global demand for tungsten, zinc, antimony and lead. However, the continuous increase in the price of raw materials, fierce competition in the product and resource markets and changes in finance and tax regulations such as the policy on export tax rebate will also put pressure on the development of the Group.

To overcome the above challenges, the Group will continue to adhere to scientific research and development and will aim to build upon its image as the leading nonferrous company in the PRC. Scientific planning, coordinated development and innovative management will be the focus in our attempt to lay a sound foundation for the development of the Group. We will endeavour to accomplish the following:

- Implement a resource strategy, increase our control and autonomy over resources; speed up the process of acquisition of domestic and international resources, geological exploration and construction of mines; increase nonferrous resources reserves so as to achieve high self-sufficiency with regards to the supply of concentrates and raw materials and stabilize the supply of raw materials for the vertically integrated production chain.
- According to the development strategy of the Group, we will seize any opportunities available to adjust the product mix; promote the building of production chains for tungsten, zinc, antimony and lead products, strengthen the research and development of new products; continue to speed up the construction of investment projects relating to the refinery of nonferrous metals and value-added processing of products; increase the proportion of high value-added products in our product mix to increase the core competitiveness of the Company.
- Accelerate the internal integration and the construction of an information system, thus paving the way for modernized management of the Group and to enhance the management standards and operational efficiency.

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- Strengthen our financial controls by focusing on financial management, and increasing emphasis on the supervision of the production process and cost management to improve our profitability.
- Monitor the market trends closely and carry out research and analysis of market trends; strengthen market research and analysis concerning the Group's products and major raw materials; analysis of product sales trends in order to capitalize upon the opportunities that may appear in the market in order to generate greater returns.
- Strengthen fundamental management practices; increase safety standards; improve employee welfare and development through training programs and health benefits; cultivate a corporate culture and build a harmonious Hunan Nonferrous Metals Corporation Limited.

Through the joint efforts of the Directors as well as our senior management and employees, I am confident that the Company will continue to achieve sustainable growth and provide better products and services to our customers, thereby providing satisfactory returns to our shareholders.

Finally, I would like to take this opportunity to express my appreciation for the support of our customers and shareholders as well as the dedication of all Directors and employees over the past year.

**He Renchun**

*Chairman*

Shenzhen, PRC

25 April 2006