Management Discussion and Analysis

Extrusion continued to be the principal source of income and growth for Asia Aluminum Holdings Limited during the year under review. Meanwhile, the Group's growth aspirations have spurred the development of its new industrial base in Zhaoqing, Guangdong Province, China. This new base will accommodate planned expansion in the aluminum-extrusion market, where the Group currently enjoys significant competitive advantage, and will support its first moves towards tapping the huge potential of the rolled-products market.

THE OPERATING REVIEW

Turnover

For the year ended 30 June 2005, a 16% year-on-year growth in turnover to HK$3,411 million was generated from increased sales to China, Asia Pacific and North America. The sales growth was mainly attributable to increased shipments of the Group's aluminum extrusion products for applications in both architectural and industrial requirements in China and overseas markets.

Sales in mainland China increased 17% year on year to HK$2,773 million on the back of the country's sustained economic progress, as well as due to healthy investments in infrastructure, commercial buildings and residences, both in the public and the private sectors. There was also a remarkable 52% year-on-year increase to HK$193 million in sales to Asia-Pacific and other regions, boosted mainly by increasing shipments to Japan and Australia.

	Group turnover by geographical segments		Net change in turnover for
	2005	2004	**2005**
Mainland China	**81%**	80%	+17%
Hong Kong	**3%**	5%	–32%
North America	**10%**	11%	+14%
Asia Pacific & others	**6%**	4%	+52%

During the reporting year, business segment turnover from aluminum extrusion/panels, and stainless steel contributed 96% and 4% respectively of Group turnover.

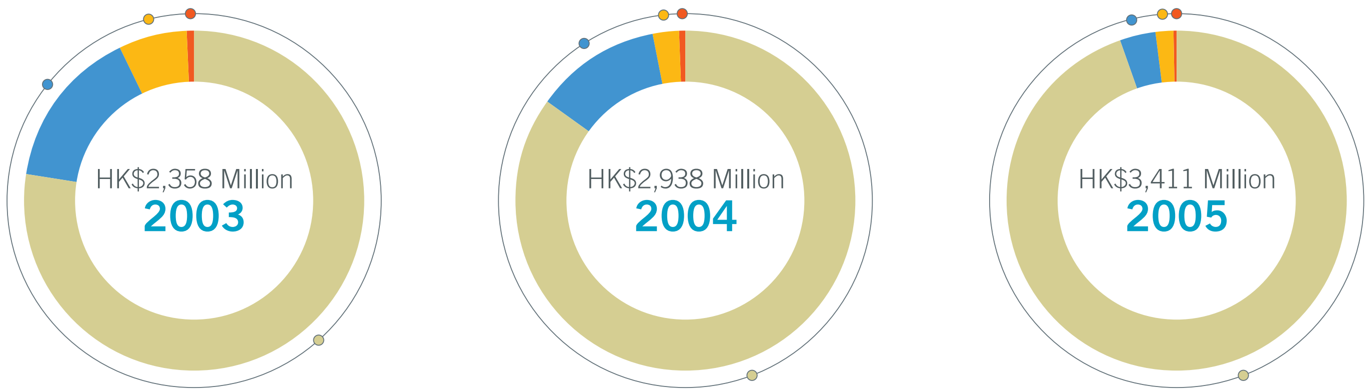
Operating results

Largely in line with the increase in turnover, cost of sales rose 17% during the reporting year to HK$2,624 million, resulting in a gross profit margin of 23.1% (2004: 23.8%). The Group's "cost-plus" pricing policy continued to assist in managing its exposure to risks associated with aluminum price fluctuations. The slight decrease in gross-profit margin was mainly attributable to higher energy and other materials costs which could not be entirely passed on to the Group's customers as is normal practice in the trade. As a result, gross profit edged up by about 13% to HK$787 million and operating profit grew by 11% to HK$589 million.

One item from the reporting year worthy of note was a 182% increase in finance costs to HK$167 million, mostly incurred in connection with the US$450 million senior notes ("Notes") issued in December 2004. A substantial portion of the interest expenses associated with the rolled products project could not be capitalized because most of the Notes' proceeds had not yet been employed during the reporting period as capital expenditure.

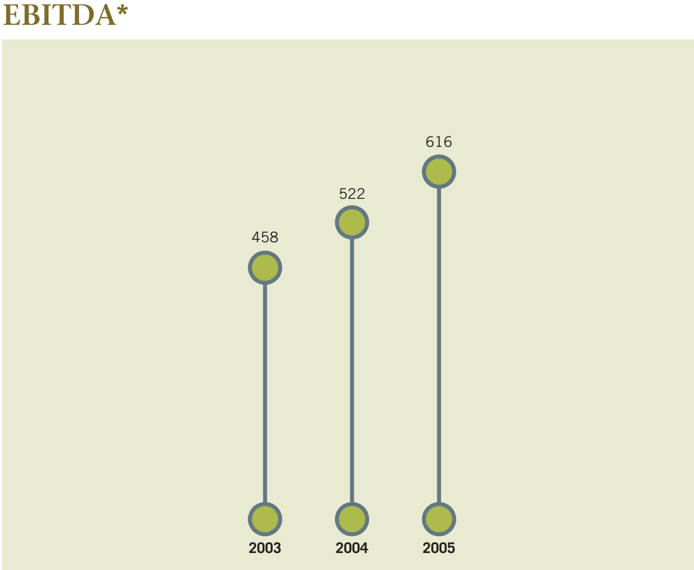
As a result of the foregoing factors, net profit attributable to shareholders for the reporting year incurred a 25% drop to HK$166 million, from HK$223 million the preceding year. On a before tax, interest expenses, depreciation and amortization basis, the 2005 EBITDA of the Group was HK$616 million (2004: HK$522 million), representing a 18% increase over 2004.

TURNOVER BY PRODUCTS



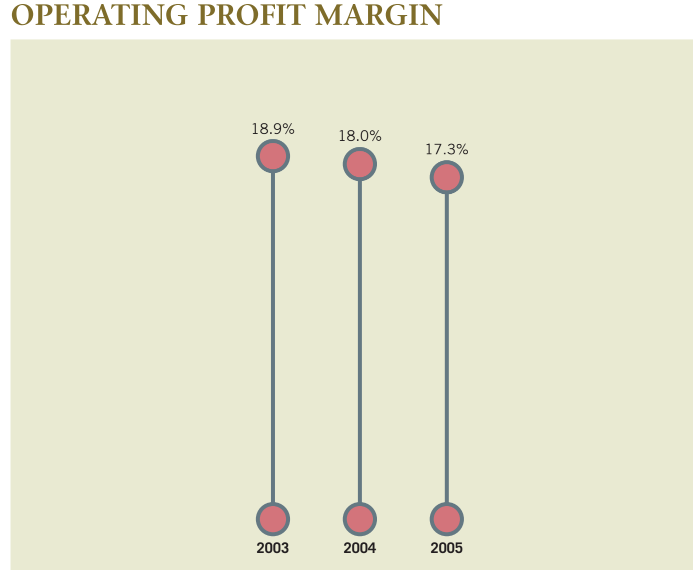
Manufacture and sale of:	2003 %	2004 %	**2005** **%**
aluminum extrusion products	77.5	84.9	**94.6**
stainless steel products	15.3	12.0	**3.4**
aluminum panels	6.5	2.5	**1.7**
Others including:			
provision of design and testing services for aluminum products	0.7	0.6	**0.3**

EBITDA*



* EBITDA — Earnings before interest, tax, depreciation and amortization

OPERATING PROFIT MARGIN



Business components

AAG and its subsidiaries (the "AAG Group") are principally engaged in the provision of aluminum extrusion solutions for the infrastructure, construction, transportation, industrial and home-improvement sectors. The AAG Group continued to be a core profit contributor to the Group in the year to 30 June 2005. Leveraging on our strong foothold and technological lead in the infrastructure and construction segments, the AAG Group has increasingly secured more orders for its extrusion products from the rapidly growing industrial and transport sectors.

a. Aluminum extrusion and panels

The aluminum-extrusion business line continued to perform well during the year with segment turnover reporting a 28% increase to HK$3,287 million (2004: HK$2,568 million), driven by higher demand in China and increased penetration into other Asia Pacific countries. Segment profit rose by a corresponding 23% to HK$577 million (2004: HK$469 million). The Group will continue to seek to identify, explore and extract revenue from the most profitable and fastest growing segments of the aluminum-extrusion business such as the industrial and transportation sectors.

b. Stainless steel

Consistent with the strategy of the Group, turnover from the stainless-steel segment continued on a downward trend, dropping by 67% to HK$117 million (2004: HK$353 million) amidst keen competition and against a background of surging raw material costs. Similarly, segment profit reported a 92% decrease to HK$1 million (2004: HK$12 million). In view of continued falling margins, the Group will continue to redeploy more of its stainless steel processing facilities to aluminum extrusion operations.

c. Design and testing services

Revenue derived from this division dropped by 59% to about HK$7 million (2004: HK$17 million) during the period when our testing-chamber facilities were mostly committed internally to the Group's expansion projects in Zhaoqing.

Growth in production capacity

In view of the scheduled expansion of extrusion capacity at Asia Aluminum Industrial City in Zhaoqing, the Group did not budget for any increase in the current production capacity at the five plants in Nanhai with the exception of normal maintenance and efficiency improvements through rationalization of production flow and product mix. In the year under review, the Group's capacity remained steady at about 150,000 metric tons.

Employees and remuneration policies

At 30 June 2005, the Group had a workforce of some 4,500 full-time management, administrative and production staff in Hong Kong and mainland China. The Group is committed to providing a secure, healthy and fulfilling working environment for its staff as well as competitive remuneration packages, including medical insurance, pension funds (Mandatory Provident Fund Scheme) and other incentives which are reviewed regularly in an open and fair manner. We will continue to inspire our team and call upon each one of them to be part of reshaping the new era in the Group's development.

Environmental performance

The aluminum industry is environmentally friendly, as the metal itself has such positive attributes as being lightweight and recyclable. In addition, the Group pledges to score high in environmental performance through automation and premises design. And to achieve the highest standards in product quality and conservation performance, the Group is equipping the new Zhaoqing facilities with the most advanced aluminum fabrication and treatment technologies. In addition to being the most highly automated aluminum fabrication plant in China, the new Asia Aluminum Industrial City will also achieve green standards exceeding that of comparable facilities in developed nations.

Community initiatives

The community is the cornerstone on which we build our business and the Group is committed to contributing to community programmers where we can add value. Over the past year, our youth development initiative continued with our participation in the school-company partnership programmed organized by the Young Entrepreneurs Development Council in Hong Kong. In addition to acting as a corporate supporter, members of the management team also engaged in interaction with the next generation through a series of workshops, plant visits, mentoring and internships.

At the industry level, our Group is also a keen member and supporter of relevant bodies through which we look forward to contributing to the overall progress of the non-ferrous sector.

Plans and Activities for 2006-2007

The commissioning of Asia Aluminum Industrial City will bring substantial new capacity and new capabilities on stream, leading to about 300,000 metric tons of extrusion and 400,000 metric tons of rolled-products capacity by 2006 and 2007, respectively. This will also enable further vertical integration and diversification of product range, and allow the Group to exploit synergies across business streams by deploying its skill sets Group-wide.

a. *New extrusion facilities*

With the installation of sophisticated new machinery imported from Japan, Italy and the US, the Group is building up Asia's largest and most advanced extrusion facility at its Zhaoqing industrial base. Equipment installation and trial production of the new extrusion plant has already commenced in phases in October 2005. With commercial production slated during the first half of next year, the Group expects to deliver a total extrusion capability of about 300,000 metric tons to meet forecast growth in demand in 2006.

b. Dies and mould workshop

The Group has formed a 40:60 joint venture with an Italian company which is in turn a joint venture of Phoenix Group and Trevisan Cometal Group of Italy to establish and operate an advanced dies and mould workshop in Zhaoqing. The new workshop is scheduled to commence operations in mid-2006. Capitalizing on the two partners' expertise and experience in making a wide range of precision moulds, the Group looks forward to enhancing its mould making capability to support ongoing business development efforts in the transport, industrial and home-improvement sectors.

c. Rolled products project

Civil engineering works are now ongoing in Zhaoqing for the building of the infrastructure of the new rolled-products plant. Over 90% of the contracts have been signed, including the cast house, hot rolling mill, cold rolling mill and various construction-design and project-management contracts. Due to adverse weather conditions and prolonged negotiation of some design and engineering contracts, construction work of the project has been delayed by about seven to eight months. However, the critical path of the project hinges mainly on the delivery of the equipment and engineering contracts where the lead-time is usually longer than the construction schedule. Since the longer lead-time equipment and engineering contracts have been committed much earlier, the Group does not expect any major deviation in the overall project commissioning timeline. Trial production of the rolled products lines is planned to run from second half of 2006 to early 2007 with full commissioning taking place during 2007.

Shareholders' value

The Group continues to listen to and communicate with our shareholders through regular meetings and timely announcements. Our short, medium and long-term objectives have been consistently pursued and are all well known to our investors. The Notes issue in December 2004 has also helped further our efforts in upholding corporate governance and transparency standards.

Planning and investment in the aluminum processing business is long-term in nature, with considerable lead-times for the new industrial base from conception to completion. While we are confident of the future profitable growth of our Group on the back of additional capacity and strengthened capability, as well as recognized market demands, the Group's performance in the interim will inevitably be affected by the increase in finance and initial start-up costs. Looking back, the Notes were issued in a window of highly favorable market conditions, during a period when interest rates were close to 30 years low. The Group expects the interim high finance costs be more than compensated for when the new industrial base becomes operational by 2006/2007 and begins to contribute to substantially higher profitability and shareholders' value.

FINANCIAL REVIEW

Group earnings and dividend policy

For the financial year 2005, basic earnings per share ("EPS") of the Group decreased 33% to HK5.19 cents (2004: HK7.78 cents), in line with the decline in net profits attributable to shareholders. The Board resolved not to declare any dividend for the year ended 30 June 2005 (2004: Interim: HK1.2 cents; Final: HK1.8 cents) in order to maintain flexibility to support further investment in the future, including the expansion in the Asia Aluminum Industrial City in Zhaoqing. Guangdong Province, China.

Capital structure and treasury policy

As at 30 June 2005, the Group had total assets of approximately HK$9,421 million, representing a 68% increase over preceding year's HK$5,620 million, mainly due to addition of fixed assets in relation to the expansion in the Asia Aluminum Industrial City and deposits held in escrow account pending for utilization under the Notes. Total assets are comprised of non-current assets of approximately HK$5,432 million and current assets of approximately HK$3,989 million, which were financed by current liabilities, non-current liabilities, minority interest and shareholders' funds of approximately HK$1,566 million, HK$4,212 million, HK$665 million and HK$2,978 million respectively.

The business operation of the Group, in particular the capital expenditure programmes relating to its new extrusion and rolled products project in the Asia Aluminum Industrial City, have been funded by cash flow from operations, issuance of capital stock and bank loans from Hong Kong and the PRC, as well as the US$450 million Notes.

As at the financial year-end 2005, the Group had cash and bank deposits of HK$2,727 million, deposits held in escrow account of HK$1,654 million and deposits held in collateral account of HK$175 million, against total borrowings of HK$4,324 million, of which about 81% or HK$3,499 million was the HK$ equivalent of the US$450 million Notes and 19% or HK$825 million was the aggregate of trust receipts loans, interest-bearing loans and finance lease payables. With the exception of the Notes, a majority of the Group's banking facilities are for trade finance and working capital purposes and are denominated in US dollars and Renminbi. Likewise, majority of the bank deposits was denominated in U.S. Dollars and Renminbi.

The net proceeds of the Notes amounted to HK$3,373 million, of which HK$1,654 million was held as bank deposits in escrow account as at 30 June 2005. The remaining portion of the Notes proceeds of HK$1,719 million was employed in the following manner during the reporting period: HK$590 million was used to repay the syndicated loan (non-current interest-bearing bank and other loans) plus interests, HK$954 million was spent as capital expenditure and HK$175 million was held as bank deposits as at 30 June 2005.

Total debt to total capital (debt/shareholders' funds) of the Group as at 30 June 2005 was 145% (2004: 52%), sharply higher than previous year due to the Notes issue.

As at 30 June 2005, the Group had contingent liabilities of about HK$39 million as at 30 June 2005 (2004: HK$30 million), comprising approximately HK$28 million bills discounted with recourse and HK$11 million guarantees for certain banking facilities respectively.

The overall treasury and funding policy of the Group is to manage exposure to fluctuation in foreign currency exchange rates and interest rates on specific transactions. The Group will use appropriate financial instruments, including forward foreign exchange contracts, currency swaps and interest rate swaps, to manage its exposure to foreign currency and interest rate risks with an objective to minimize the impact of exchange rate and interest rate fluctuation on earnings, assets and liabilities. Derivative instruments are used solely for hedging purposes, and speculation is strictly prohibited.

Commodity Risks

The Group generally applies a 'cost plus' pricing policy to its aluminum product sales to customers. In essence, the selling price is quoted according to the aluminum spot or forward price of the London Metal Exchange or other referenced exchanges in the PRC on either the contract date or the delivery date, plus a processing fee for different products. While this approach gives the Group an advantage in managing exposure to risks associated with aluminum price fluctuations, in some cases, the Group's customers have not adequately managed such risks, as was the case with the 2004 incident when the Group elected to absorb part of the increased cost in aluminum in order to strengthen key customer relationships and further penetrate key market segments, thereby affecting margins in the first half of financial year 2004. Although aluminum prices remained volatile at times during 2005, the market has adjusted to such volatility and no major impact was noted on the industry or our customers during the period.

Liquidity and Financial Resources

The Group's liquidity position remains strong with available undrawn banking facilities together with unpledged bank deposits of HK$774 million and HK$2,675 million respectively as at 30 June 2005. The financial resources available will provide a source of funding for the Group to meet its substantial capital commitment for the new extrusion and rolled products projects as well as its daily operational requirements.

As at 30 June 2005, the Group had aggregate banking facilities of approximately HK$1,426 million which were secured by the Group's tangible fixed assets with net book value totaling HK$28 million and bank deposits of about HK$39 million. In addition, the Company has provided corporate guarantees for a total amount of HK$1,956 million. As at the same day, the Group had utilized a total of approximately HK$825 million of the aforesaid banking facilities and HK$677 million of the corporate guarantees.

The current ratio was 2.5 as at the balance sheet date, similar to the previous year's figure. Of the total borrowings as at 30 June 2005, about 15% are repayable within one year. The financial obligations of the Group are primarily serviced through its recurrent cash flow from operations. The Directors believe that the Group has adequate financial resources to sustain its working capital requirement and committed capital expenditures and meet its foreseeable debt repayment requirements.

The Group will continue to follow its prudent and conservative policy in financial and treasury management.