

# Management's Discussion and Analysis



## OPERATING RESULTS

Comparison of operating results between the years ended 31st December 2002 and 2001.

### Summary

During the year ended 31st December 2002, the Company successfully carried out a number of acquisitions. On 1st July 2002, the Company completed the acquisition of all the assets and liabilities of Changxing Power Plant, 70% equity interest in Shidongkou First Power Plant, 70% equity interest in Taicang Power Plant and 44.16% equity interest in Huaiyin Power Plant. Subsequently on 31st December 2002, the Company further acquired the remaining 30% equity interest in Shidongkou First Power Plant, 5% equity interest in Taicang Power Plant and 19.48% equity interest in Huaiyin Power Plant. In addition, on 18th June 2002, the Company acquired the remaining 25% minority interest of Jining Power Plant, which then became a 100% owned power plant of the Company. Furthermore, Dezhou Power Plant Phase III, the expansion project with a capacity of 2x660 MW, was put into commercial operation in 2002. These acquisitions and the expansion project enabled the Company to expand its scale of operation, increase its market share and enhance its geographical coverage and competitiveness.

The total assets and liabilities of the four new power plants were included in the consolidated balance sheet as at 31st December 2002, the operating revenue and operating expenses of Huaiyin Power Plant were not included in the consolidated income statement of the Company and its subsidiaries, but equity accounting was applied for the original 44.16% equity interest purchased from 1st July 2002 through 31st December 2002. All of the revenue and expenses of Changxing Power Plant, Shidongkou First Power Plant and Taicang Power Plant have been consolidated in the consolidated income statement of the Company and its subsidiaries since a controlling stake of more than 50% was acquired.

In 2002, the power output of the Company and its subsidiaries increased by 24.45% to 67.3316 billion kWh from 54.1053 billion kWh in 2001. Accordingly, net operating revenues and net profit were increased significantly when compared to 2001. In addition, because of the Company's consistent effort on cost control measure, the Company achieved its cost control target on fuel costs and other costs.

## Net Operating Revenues

Net operating revenues represent operating revenues net of value-added tax and deferred revenue. For the year ended 31st December 2002, the consolidated net operating revenues of the Company and its subsidiaries were Rmb18.4745 billion, representing an increase of 16.99% over the net operating revenues of Rmb15.7914 billion of last year. When compared to the net operating revenues before deferred revenue, it had increased 18.34% over last year. Deferred revenue represents the excess of the major repair and maintenance expenses determined on the basis of 1% of the fixed asset cost recoverable through the tariff setting process over the major repair and maintenance expenses actually incurred. Because the excess of repair and maintenance expenses had been recovered through the tariff but not yet incurred, the Company had recorded such excess as deferred revenue since 2002 and deducted the same amount from the major repair and maintenance expenses (i.e. the major repair and maintenance expenses were recorded as operating expenses based on the amount actually incurred).

The significant increase of net operating revenues was primarily caused by increase of power output over last year. Before considering the four power plants acquired in 2002, the power output of the original twelve power plants of the Company and its subsidiaries increased by 11.94% over last year.

The lower growth rate of operating revenue, when compared with that of power output, was due to the decrease of the average tariff rate. The average tariff rate decreased from Rmb342.03 per MWh to Rmb325.38 per MWh in 2002. The decrease of the average tariff rate was due to the adjustment of approved tariff rates and the increase of percentage of excess generation portion as the total power output increased. In addition, the tariff rates of the newly acquired power plants were lower than that of the original power plants of the Company, which also affected the average tariff rate.

### Dalian Power Plant

Dalian Power Plant's net operating revenues increased by 5.35% to Rmb1.5870 billion in 2002 from Rmb1.5065 billion of last year. The average tariff rate was Rmb280.53 per MWh in 2002, which was decreased by 3.72% from Rmb291.38 per MWh in 2001. The output of Dalian Power Plant increased by 11.81% to 6.7632 billion kWh in 2002 when compared to 2001.

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## **Fuzhou Power Plant**

Fuzhou Power Plant's net operating revenues increased by 15.61% to Rmb1.8890 billion in 2002 from Rmb1.6340 billion of last year. The average tariff rate was Rmb327.80 per MWh in 2002, which was decreased by 7.34% from Rmb353.77 per MWh in 2001. The output of Fuzhou Power Plant was increased by 27.21% to 6.8742 billion kWh in 2002 when compared to 2001.

## **Shangan Power Plant**

Shangan Power Plant's net operating revenues decreased by 1.64% to Rmb1.9241 billion in 2002 from Rmb1.9561 billion of last year. The average tariff rate was Rmb315.65 per MWh in 2002, which was decreased by 4.04% from Rmb328.95 per MWh in 2001. The decrease of average tariff rate was mainly caused by the adjustment of the approved tariff rate. However, the power output of Shangan Power Plant increased by 3.53% to 7.2030 billion MWh in 2002, which partially offset the impact of tariff adjustment.

## **Nantong Power Plant**

Nantong Power Plant's net operating revenues increased by 5.10% to Rmb1.9546 billion in 2002 from Rmb1.8598 billion of last year. The average tariff rate was Rmb309.54 per MWh in 2002, which was decreased by 2.78% from Rmb318.38 per MWh in 2001. The output of Nantong Power Plant was increased by 9.70% to 7.5042 billion kWh in 2002 when compared to 2001.

## **Shantou Oil-fired Power Plant**

Shantou Oil-fired Power Plant's net operating revenues increased by 14.45% to Rmb113.9 million in 2002 from Rmb99.5 million of last year. The average tariff rate was Rmb621.02 per MWh in 2002, which was increased by 0.45% from Rmb618.24 per MWh in 2001. The output of Shantou Oil-fired Power Plant was increased by 8.13% to 0.2037 billion kWh when compared to 2001.

## **Shantou Coal-fired Power Plant**

Shantou Coal-fired Power Plant's net operating revenues increased by 3.28% to Rmb1.4870 billion in 2002 from Rmb1.4397 billion of last year. The average tariff rate was Rmb455.95 per MWh in 2002, which was decreased by 3.78% from Rmb473.85 per MWh in 2001. The output of Shantou Coal-fired Power Plant was increased by 9.02% to 3.8714 billion kWh when compared to 2001.

## **Shidongkou Second Power Plant**

Shidongkou Second Power Plant's net operating revenues decreased by 2.57% to Rmb2.1056 billion in 2002 from Rmb2.1612 billion of last year. The average tariff rate was Rmb345.90 per MWh in 2002, which was decreased by 1.95% from Rmb352.78 MWh in 2001. The decrease of average tariff rate was mainly caused by the adjustment of the approved tariff. However, the power output of Shidongkou Second Power Plant increased by 2.54% to 7.2681 billion kWh in 2002, which partially offset the impact of tariff adjustment.

### **Dandong Power Plant**

Dandong Power Plant's net operating revenues increased by 11.20% to Rmb754.3 million in 2002 from Rmb678.3 million of last year. The average tariff rate was Rmb273.70 per MWh in 2002, which was decreased by 8.45% from Rmb298.96 per MWh in 2001. The output of Dandong Power Plant increased by 26.77% to 3.365 billion kWh when compared to 2001.

### **Nanjing Power Plant**

Nanjing Power Plant's net operating revenues increased by 13.32% to Rmb934.3 million in 2002 from Rmb823.7 million of last year. The average tariff rate was Rmb304.07 per MWh in 2002, which was decreased by 4.56% from Rmb318.60 per MWh in 2001. The output of Nanjing Power Plant increased by 19.20% to 3.6083 billion kWh when compared to 2001.

### **Dezhou Power Plant**

Dezhou Power Plant achieved net operating revenues of Rmb2.2855 billion in 2002, which was increased by 21.30% from Rmb1.8842 billion of last year. The average tariff rate was Rmb339.64 per MWh, which decreased by 0.20% from Rmb340.33 per MWh in 2001. The output of Dezhou Power Plant increased by 21.45% to 7.8733 billion kWh when compared to 2001. Dezhou Power Plant Phase III, the expansion project, was put into commercial operation in 2002, with power output of 1.7650 billion kWh.

### **Jining Power Plant**

The net operating revenues of Jining Power Plant increased by 5.58% to Rmb422 million in 2002. The average tariff rate was Rmb275.15 per MWh, which was increased by 2.93% from Rmb267.31 per MWh of last year. The output of Jining Power Plant increased by 2.08% to 1.8052 billion kWh when compared to 2001.

### **Changxing Power Plant**

Changxing Power Plant had become a wholly owned plant of the Company effective from 1st July 2002. The net operating revenues of Changxing Power Plant from July to December were Rmb233.5 million. The power output and average tariff rate of Changxing Power Plant were 0.8635 billion kWh and Rmb316.93 per MWh, respectively.

### **Shidongkou First Power Plant**

The Company acquired 70% equity interest in Shidongkou First Power Plant on 1st July 2002 and the remaining equity interest of 30% on 31st December 2002. Hence, it became a wholly owned power plant of the Company as at the same date. The net operating revenues of Shidongkou I Power Plant from July to December were Rmb813.0 million. The power output and average tariff rate of Shidongkou First Power Plant were 3.7930 billion kWh and Rmb252.97 per MWh, respectively.

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## **Taicang Power Plant**

The Company acquired 70% equity interest in Taicang Power Plant on 1st July 2002 and additional 5% of equity interest on 31st December 2002. The net operating revenues of Taicang Power Plant from July to December were Rmb566.4 million. The power output and average tariff rate of Taicang Power Plant were 2.1095 billion kWh and Rmb317.52 per MWh, respectively.

## **Weihai Power Plant**

The Company owns 60% equity interest in Weihai Power Plant. The net operating revenues of Weihai Power Plant was Rmb1.4051 billion, which was increased by 4.18% from Rmb1.3486 billion of last year. The average tariff rate was Rmb393.74 per MWh, which was increased by 0.77% from Rmb390.72 per MWh in 2001. The output of Weihai Power Plant was increased by 3.38% to 4.2255 billion kWh when compared to 2001.

## **Operating Expenses**

The total operating expenses of the Company and its subsidiaries increased by 19.66% to Rmb12.8965 billion in 2002, over the Rmb10.7773 billion of last year (when comparing the operating costs with the repair and maintenance expenses determined on the basis of 1% the fixed assets cost, the operating expenses would have been increased by 21.64%). As a result of the effective cost control measure implemented by the Company, the rate of increase of operating expenses was lower than that of power output.

The primary operating expenses of the Company and its subsidiaries was fuel cost. The fuel cost increased by 34.36% to Rmb6.9160 billion in 2002, when compared to Rmb5.1474 billion in last year. Before considering the four power plants acquired in 2002, the weighted average unit price of natural coal of the original twelve power plants increased by 5.29% to Rmb232.34 per ton in 2002 from Rmb220.66 per ton of last year. The unit fuel cost per MWh increased by 6.41% to Rmb101.20 per MWh. The higher unit fuel cost per MWh of the four power plants acquired than that of the original twelve power plants resulted in the increase of unit fuel cost of the Company and its subsidiaries to Rmb102.71 per MWh in 2002.

## **Maintenance Expense**

The maintenance expenses incurred by the Company and its subsidiaries was Rmb608.0 million in 2002 (if the repair and maintenance expenses were determined on the basis of 1% the fixed assets cost, the maintenance expenses would have been increased by 7.2% from Rmb765.7 million of last year). The maintenance expenses of the original twelve power plants and the four power plants acquired in current year amounted to Rmb535.3 million and Rmb72.7 million, respectively.

## Depreciation and Amortization

The depreciation and amortization of the Company and its subsidiaries was Rmb3.5336 billion in 2002. The depreciation and amortization of the original twelve power plants and the headquarter of the Company was Rmb3.3133 billion, which was increased by 1.60% from Rmb3.2610 billion of last year. The depreciation and amortization of the four power plants acquired in current year was Rmb220.3 million.

## Labor Cost

The labor cost of the Company and its subsidiaries was Rmb1.0357 billion in 2002, which increased by 28.32% from Rmb 807.1 million of last year mainly due to the increase in the number of employees for the four power plants acquired.

## Transmission Fees

Transmission service fees paid to Shandong Electric Power Group Corporation by Dezhou Power Plant, Weihai Power Plant and Jining Power Plant were Rmb35.8 million in 2002, which decreased by 3.17% from Rmb36.9 million of last year.

## Service Fee to HIPDC

The service fee paid to HIPDC refers to a fee for the use of its grid connection and transmission facilities based on reimbursement of cost plus a profit.

In 2002, the Company incurred the service fee in relation to the grid connection and transmission facilities for Fuzhou Power Plant Phase I, Shidongkou Second Power Plant, Shangan Power Plant, Shantou Coal-fired Plant (HIPDC had transferred the ownership of transmission and transformation facilities of Fuzhou Power Plant Phase I and Shanghai Shidongkou Second Power Plant to Fujian Electric Power Company and Shanghai Power Corporation, respectively, on 1st July 2002. The Company was not required to pay the service fee for these two plants since the transfer). The service fee to HIPDC decreased by 14.19% to Rmb263.7 million in 2002, when compared to Rmb307.3 million of last year.

## Other Expenses

Other expenses of the Company and its subsidiaries was Rmb503.6 million in 2002, which was increased by 11.46% from Rmb451.9 million of last year. Other expenses mainly comprised environmental protection fee, general and administrative expenses and other miscellaneous expenses. The increase of other expenses was mainly due to the inclusion of other expenses of four power plants acquired in current year. Before considering the four power plants acquired in current year, the other expenses of original twelve power plants was decreased by 12.68% to Rmb394.5 million, despite the increase of total power output. This indicated the effectiveness of the cost control measures.

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## Profit from Operation

The profit from operation of the Company and its subsidiaries increased by 11.25% to Rmb5.5780 billion in 2002 from Rmb5.0140 billion of last year.

## Financial Expenses

The financial expenses of the Company and its subsidiaries was decreased by 35.91% to Rmb510.3 million in 2002 from Rmb796.2 million of last year. The financial expense of the original twelve power plants was Rmb492.0 million which decreased by 43.29% from Rmb867.5 million of last year. The overall reduction of financial expenses was mainly due to the significant decrease of debt balances of the Company and its subsidiaries in 2002. In addition, in order to reduce the interest expenses, the Company grasped the opportunity of declining market interest rate and borrowed loans with lower interest rate to refinance the high interest rate loans. As a result, the financial expense of the relevant loans was decreased by USD9.5 million in 2002.

## Income Tax Expenses

Pursuant to the relevant tax regulations, the Company is a sino-foreign joint venture and enjoys the relevant tax holiday. Each of the power plants of the Company is exempted from PRC income tax for two years starting from the first profit-making year after covering any accumulated deficits followed by a 50% reduction of the applicable tax rate for the next three years. In addition, as confirmed by the State Tax Bureau, the Company's wholly owned power plants pay their respective income tax to local tax authorities, although they are not separate legal entities. The consolidated income tax expenses of the Company and its subsidiaries were Rmb980.9 million in 2002. The income tax expenses for the original twelve power plants and the four power plants acquired in current year amounted to Rmb873.5 million and Rmb107.4 million, respectively.

Jining Power Plant and Changxing Power Plant became wholly owned power plants of the Company in 2002. As approved by the relevant tax authorities, the income tax rate of Jining Power Plant was decreased from 33% to 15% effective from 1st September 2002, and the income tax rate of Changxing Power Plant was decreased from 33% to 16.5% effective from 1st July 2002.

## Net Profit

The consolidated net profit of the Company and its subsidiaries increased by 13.63% to Rmb3.9210 billion from Rmb3.4507 billion of last year. The increase was primarily due to the increase of power output, the decrease of the financial expenses and the profit contributed by the four power plants acquired in current year.

The net loss of Dangdong Power Plant was Rmb104.4 million in 2002, which was decreased by 48.20% when compared to last year as the power output was substantially increased in 2002. The net loss of Shantou Oil-fired Power Plant was Rmb16.1 million in 2002, which was decreased by Rmb12.9 million.

## Comparison of Key Financial Ratios

	The Company and its subsidiaries	
	2002	2001
Current ratio	<b>1.00</b>	1.21
Quick ratio	<b>0.88</b>	1.13
Ratio of liabilities and shareholders' equity	<b>0.56</b>	0.65
Multiples of interest earned	<b>8.28</b>	5.35

After the acquisition of Shidongkou First Power Plant, Taicang Power Plant, Huaiyin Power Plant and Changxing Power Plant, the Company still maintained its strong debt repayment ability.

As at 31st December 2002, the loans denominated in foreign currencies of the Company and its subsidiaries amounted to approximately USD1.122 billion (including USD20 million liability component of convertible notes), of which USD262 million was repayable within one year. The Company and its subsidiaries will closely monitor the fluctuation in the foreign exchange market and cautiously assess the exchange rate risk.

Most of the long-term loans of the Company and its subsidiaries were fixed-rate loans. As at 31st December 2002, the balance of the floating-rate loans of the Company and its subsidiaries amounted to approximately USD433 million according to the loan agreements. The Company and its subsidiaries made use of interest rate swap contracts, when appropriate, to manage the risk of interest rate fluctuations.

Calculation formula of the financial ratio:

Ratio of liabilities to shareholders' equity	=	balance of liabilities at the end of the year/balance of shareholders' equity at the end of the year
Current ratio	=	balance of current assets at the end of the year/ balance of current liabilities at the end of the year
Quick ratio	=	(balance of current assets at the end of the year - net amount of inventory at the end of the year)/balance of current liabilities at the end of the year
Multiples of interest earned	=	(profit before taxation + interest expenses)/interest expenditure (including capitalised interest)

## Dividend Payable

On 12th March 2003, the Board of Directors proposed a dividend of Rmb0.34 per ordinary share, totaling approximately Rmb2.040 billion for the year ended 31st December 2002. The proposed dividend distribution is subject to shareholders' approval in their next general meeting.