

# Questions Frequently Asked by Investors

## 1. Please explain the present situation and future growth trends of power demand in the areas served by the Company.

At present, the Company's operations mainly focus on northern China, of which the BTT Area is the heartland. The BTT Area, including Beijing, is one of the most dynamic economies since the beginning of China's open reforms in the 1980s. Both the GDP and power demand in the BTT Area have been outgrowing the national average throughout the past decade. In 2002, the BTT Area achieved a GDP growth of 10.28% over the Previous Year, which was 2.28 percentage points higher than the national average. Growth in power consumption in the same period was 11.80%, which was 0.1 percentage point higher than the country's average. Industrial demand dominates the market and accounts for about 60% of the total power demand. In 2002, the industrial power demand in the BTT Area had a substantial growth of 13.80%, and was the major driving force for the general increase in power demand. At the same time, commercial and residential demand for electricity has also been on the rise and is becoming a major growth point. In 2002, commercial and residential demand for electricity accounted for 11.50% and 15.54% of the total demand respectively. Overall, the average growth rate of power demand in the BTT Area has been exceeding that of installed capacity in the past few years. As a result, the amount of excess capacity during peak seasons remained at zero in last two consecutive years. Supply shortage was obvious and severe during such time.

According to power demand forecasts for the North China region released by the State Power Resources Dispatching Centre, taking into account the capacity of newly installed generation units and external power supply, there will be a power supply shortage of approximately 3,000MW in the BTT Area during peak seasons in 2003. It is estimated that the shortage will be covered by lifting the utilisation rates of existing generation units. With commencement of operation of two 600MW units of Datang Tuoketuo Power during the Year, and by actively

improving the utilisation rates of its existing units, the Company is likely to see a boost in its electricity sales in 2003.

Looking ahead, power demand in the BTT Area will maintain its upward trend, driven by continued economic growth of the region. In addition, Beijing's successful bid for the 2008 Olympics is expected to be translated into huge investments in infrastructure construction and projects improvement. This will provide another impetus for the region's economic growth in the coming years and will stimulate its consumption of electricity. Furthermore, the power demand structure is improving along with structural changes of various sectors in the BTT Area. Residential and commercial power consumption is on the rise. Power demand stability is strengthened. As a result, the impact of cyclical fluctuations on the sales revenue of the Company can also be contained.

## **2. How did the Company manage to eliminate the adverse effects of the tight supply of coal on its profitability in 2002? What is the future outlook for the coal market?**

Supply shortages in the PRC coal market occurred since the fourth quarter of 2001, when market demand and exports are rising and some of the coal mines have been closed due to safety reasons. This situation continued in 2002. At the beginning of that year, contract prices of coal increased by more than 5% nationwide compared to the Previous Year. However, owing to its established relationships with leading domestic coal mines, the Company successfully renewed the coal supply agreements with its major coal suppliers for another year, and effectively locked the prices of 85% of its coal purchases at the budgeted rates. As a result, the increase in coal prices paid by the Company was limited to within 4%, lower than the national average.

Fuel costs accounted for 46% of the total operating cost of the Company, as substantially all the operating units of the Company are coal-fired units. During the Year, the Company introduced and strengthened a series of initiatives to lower fuel costs, with a view to achieving the overall cost control target. Firstly, through its established relationships with coal suppliers, with initiatives in containing coal purchase costs by contract-purchasing 80% to 85% of its coal, and through optimising the coal supplier mix, the Company endeavours to minimise the combined cost of coal and transportation. Secondly, the Company also sourced coal from certain small- and medium-sized mines. With the premises of stabilising coal supply for production, the Company worked to optimise the coal supplier mix by consolidating the consumption plans of different power plants. Minimisation of coal costs was also realised through the introduction of stringent tendering and quality inspection systems. Thirdly, development of energy-saving technologies was implemented to help strengthen cost control. As a result, the Company managed to substantially increase its power generation whilst reducing unit coal consumption rate for electricity generation by 2.03g/kWh. Lastly, the Company also suppressed the growth trend of unit fuel cost through various measures, including enhancing production safety, rationalising maintenance programmes for generation units, optimising the power generation structure and increasing the utilisation rates of those units which had lower unit fuel costs.



As a result of the effective implementation of the above initiatives, the Company managed to control the rise in unit fuel costs at 5.93%, which was relatively low against the industry standard, despite surging coal prices in the domestic market in 2002. This has demonstrated the Company management's ability in controlling costs and diffusing market risks.

Looking into 2003, the coal market will be characterised by the two features below:

1. The overall shortage in supply will be gradually relieved with the market reaching equilibrium in the year. In the middle of 2002, many small- to medium-sized mines previously closed were allowed by relevant State authorities to resume production as a result of improved safety conditions. This, together with the increased transportation capacity of China's railway system and an anticipated growth in coal imports, is expected to bring a significant increase in coal supply. Despite continued increase of demand from various heavy coal consumption industries such as power, metallurgy and petrochemicals, it is unlikely that supply shortages will persist in 2003.
2. The pressure from rising coal prices will remain but the increase is not expected to be substantial. According to statistics, the general level of coal prices in the coal market at the end of 2002 reached a record-high since the upward adjustment started in 1997. Taking into account the transportation cost, the price of domestic coal is approximately equal to that of imported coal. Increase in coal imports will help relieve the tight supply and bring down coal prices. In view of this, there will be limited room for further rises even though coal prices may fluctuate along with changes in supply and demand during the year. It is estimated the overall increase in the Company's coal cost in 2003 will be bound within 3% compared to the Year.

**3. Please outline the Company's diversification strategy of investing in new projects of varied generation sources (with dual emphasis on coal-fired power and hydropower), and explain its implications.**

From now on, the Company will stick to its diversification strategy in developing new projects with dual emphasis on coal-fired power and hydropower. This strategy was formulated in light of technical and economic characteristics of coal-fired power and hydropower and the development needs of the power market that the Company is facing. In comparison, coal-fired power plants are characterised by modest construction costs, shorter construction periods, relatively secure fuel supply and higher utilisation rates. Coal-fired power plants are generally chosen as the major power supply infrastructure. Hydropower plants have lower variable costs and a long operating life, utilise re-usable energy sources and are free of environmental pollution, while having the government's policy support. As long as a selected project incurs only modest investment and effective measures are adopted to shorten the project's construction period, the total cost of hydro power will be lower than that of coal-fired power, which is conducive for enhancing the Company's overall competitiveness. The strategic implications of our diversification policy are as follows: (1) the Company can achieve a more stable and higher return on investment through optimisation of its investment and cost structures by taking advantage of the characteristics of coal-fired and hydro power plant projects in

terms of their respective costs and investment periods; (2) the Company can consolidate and expand its market share by means of complementing the advantages of different forms of power generation. By taking a dual emphasis, the Company can take advantage of the characteristics of coal-fired power and hydropower, in terms of their respective operating costs, utilisation rates, construction periods and seasonal fluctuations, to optimise the portfolio structure and utilisation efficiency of its power generation assets so as to maximise the Company's market shares; (3) the Company can diversify and reduce its exposure to fuel market risks, and avert the operating risks arising from a volatile coal supply market had the Company adopted a single fuel source strategy; (4) the Company can optimise its generation cost structure and lower its consolidated power generation cost, which is beneficial for building the Company's long-term competitiveness vis-a-vis a much more competitive power market; and (5) the Company can participate in the development of clean and sustainable energy, which is being nurtured and encouraged by the State's industry policies, and will be beneficial for the sustained growth of the Company.

Further to the Datang Huaze Hydropower Project in Hebei, the Company announced another three hydropower projects in Yunnan in October 2002. Owing to their superior technical and economic conditions, these projects, with an aggregate installed capacity of 829MW, have promising future prospects. They also marked a new stage in the progress of the implementation of the Company's diversification strategy.

#### **4. Please explain the significance of the Company's intensified efforts in developing new projects.**

During 2002, the Company commenced construction of a number of new projects involving a total installed capacity of over 3,000MW. The Company has intensified its efforts in developing new projects for the following reasons: (1) To meet power demand growth and to increase market share. During 2002, there was an acute shortage of electricity supply in many regions nationwide, and there was no reserve capacity in the BTT Area during peak seasons. Timely commencement of the Company's new projects will help satisfy power consumption demand while increasing the Company's market share of the regional grid at the same time. (2) To maintain a market leadership position in the ownership of new high-efficiency, large-capacity generation units. The ever-growing power demand will certainly bring about a new platform of power infrastructure development. New generation units are more likely to be large-capacity, high-efficiency units that are superior to older units in terms of economic efficiency and safety. In intensifying its development of this type of new units, the Company will be able to stay ahead in the market, improve safety and its other operating benchmarks, and enhance its competitiveness. (3) To reduce the operating costs of the Company over the long term. Currently, both capital costs and equipment costs are at a historic low in the domestic market. Commencing new projects now will help reduce construction costs, thereby lowering the fixed costs over the whole operating life of a generation unit. This will in turn enhance profitability given the same tariff system and market environment. (4) To increase return on equity of the Company. Newly constructed projects normally carry a debt ratio high than the Company's current asset-to-

liability ratio. Provided that the Company will ensure a reasonable interest multiple, a higher debt ratio will help lift the Company's return on equity, thereby enhancing shareholder value.

## 5. Please illustrate the initial results of the structural reforms of China's power industry and its impact on the Company.

Major breakthroughs have been achieved in the structural reforms of the power industry in 2002. In March 2002, the "Proposal for Structural Reforms of the Power Industry" was approved by the State Council. Then in April, the SDPC announced details and objectives of the Proposal, namely: to eliminate monopoly, uplift efficiency, lower cost, optimise pricing mechanism and resources allocation, promote industry development and carry out a nationwide integration of power grids; and to establish under government supervision a power market which can develop healthily with orderly competition in a fair and open environment which upholds the principle of separation of corporate and state governance. On 29th December, initial results of the structural reforms were achieved and 11 new power corporations were established, including five power generation companies, two grid management companies and four auxiliary services companies. The five power generation companies were established under the restructuring and reorganisation of the power generation assets of the former State Power Corporation in accordance with modern corporation models. These five companies are of similar size and have comparable shares of assets distributed all over the country. The two grid companies are State Grid Corporation and China Southern Power Grid Company Limited, State Grid Corporation comprises five regional grid companies serving northern, northeastern, eastern, central and northwestern China respectively, while China Southern Power Grid Company Limited was formed by combining the grid assets in Guangdong, Guangxi, Yunnan, Guizhou and Hainan.

The above reorganisation was conducted at the level of the Company's parent company. CDT, one of the five new nationwide power groups, has replaced NCPGC to become the Company's new parent company and will hold 35.43% shares in the Company. The difference between CDT and NCPGC is that the former is a pure power generation company and does not own any grid assets. The power generation assets of CDT are of a substantial scale and scatter nationwide. After the reorganisation, the principal power operations and asset portfolio of the Company will remain unchanged. The power purchase and sale relationship originally established between the Company and NCPGC will stay intact. The power purchase and sale agreements and other major commercial agreements will remain effective.

The above structural reforms have material implications for the Company as it has laid down a clear framework for the development of China's power industry and has created a new environment for orderly competition between the participants. At the same time, the uncertainties associated with the reforms facing the Company are being cleared. In addition, the nationwide distributed assets of CDT's will definitely provide a solid platform facilitating an inter-regional expansion of the Company. All this will have positive influence on the Company in enhancing the formulation and implementation of its development strategies in line with the Company's actual needs as well as future market demand.

