

REPORT OF THE DIRECTORS

The Directors hereby present the annual report together with the audited financial statements of the Group for the financial year ended 31 December 2002.

PRINCIPAL ACTIVITIES

The principal activities of the Company and its subsidiaries (the "Group") and its jointly controlled entities are the generation and sale of electricity and heat. All electricity generated by the Group is fed into the Shandong Provincial Grid operated by Shandong Electric Power (Group) Corporation, the former immediate holding company of the Company. Shandong Electric Power (Group) Corporation determines to whom the electricity is then sold.

As the Group is located, and has been operating one single business, in Shandong Province, the People's Republic of China ("PRC"), no segmental reporting was included in the financial statements.

The profit of the Group for the year ended 31 December 2002 and the position of the Group's and the Company's financial affairs as of that date prepared in accordance with International Financial Reporting Standards are set out in the financial statements on pages 41 to 87.

DIVIDENDS

The Board of Directors recommended payment of a final dividend of RMB0.036 per share (totalling RMB189,219,000) for the financial year ended 31 December 2002 (2001: a final dividend of RMB0.17 per share, totalling RMB893,534,000). This dividend distribution proposal is subject to approval by the shareholders of the Company at the forthcoming 2002 Annual General Meeting of the Company.

An interim dividend of RMB0.02 per share (totalling approximately RMB105,122,000) for the six months ended 30 June 2002 was distributed on 30 October 2002 (2001: an interim dividend of RMB0.02 per share, totalling approximately RMB 105,122,000, was distributed on 9 November 2001).

SUBSIDIARIES, ASSOCIATED COMPANIES AND JOINTLY CONTROLLED ENTITIES

Particulars of the Company's subsidiaries, associated companies and jointly controlled entities at 31 December 2002 are set out in notes 19, 20 and 21 respectively on the financial statements.

BANK LOANS AND OTHER BORROWINGS

Details of bank loans and other borrowings of the Group and the Company as at 31 December 2002 are set out in note 27 on the financial statements.

INTEREST CAPITALISED

Details relating to the interest capitalised by the Group during the year of 2002 are set out in note 9 on the financial statements.

PROPERTY, PLANT AND EQUIPMENT

Details relating to movements in property, plant and equipment of the Group and that of the Company during the year of 2002 are set out in note 15 on the financial statements.

RESERVES

Details relating to movements in reserves of the Group and the Company for the year ended 31 December 2002 and details of distributable reserves of the Company as at 31 December 2002 are set out in note 30 on the financial statements.

DONATIONS

During the year of 2002, the Group made donations for charitable purposes in an aggregate amount of approximately RMB141,205(2001: RMB60,000).

EMPLOYEES' RETIREMENT PLANS

Details of the Group's employees' retirement plans are set out in note 32 on the financial statements.

PRE-EMPTIVE RIGHTS

According to the articles of association of the Company and the laws of the PRC, no rule relating to pre-emptive rights exists which requires that the Company shall offer and issue new shares to its existing shareholders in proportion to their respective shareholding interests in the Company.

EMPLOYEES' MEDICAL INSURANCE

During the year of 2002 and before, the Group implemented the rules of electric power industry for staff medical insurance. In accordance with such staff medical insurance rules, the Group was required to pay on behalf of employees basic medical insurance fees, mutual medical fund and supplementary corporate medical insurance calculated as certain percentages of employees' wages.

Since 1 January 2003, the Group began to implement the basic medical insurance rules for staff in accordance with "the Implementing Project to Establish the Basic Medical Insurance Rules for the Urban and Rural Residents in Shandong Province", under the management of the local governments, pursuant to which the basic medical insurance fund will be contributed by the enterprise concerned and its staff. The employees are required to pay medical insurance fees calculated as 2% of their average monthly wages of the previous year, and the Group is required to pay fees ranging between 6% and 8% according to the policies promulgated by the local governments where the enterprise is situated. After implementing such rules pursuant to which the basic medical fund is managed by the local governments, the basis of charging the basic medical insurance fund paid by the enterprises is the same as that before, but the rate of payment is reduced by the range between 2% and 4%.

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The Group anticipates that implementation of such medical insurance rules will not have any significant impact on the business operation and financial position of the Group. Apart from the above contributions, the Group is not required to pay any other medical expenses for its staff.

SHARE CAPITAL

Details of the share capital of the Company are set out in note 30 on the financial statements.

MAJOR CUSTOMERS AND SUPPLIERS

During the year of 2002, details regarding the percentage of the Group's sales and purchases attributable to its major customers and major suppliers, respectively, are as follows:

	Percentage of the Group's Sales	Percentage of the Group's Purchases
The largest customer	98.4%	—
The five largest customers	99.9%	—
The largest supplier	—	93%
The five largest suppliers	—	99.9%

All electricity generated by the Group was sold to Shandong Electric Power (Group) Corporation which was the former immediate holding company of the Company. Save as disclosed above, none of the Directors, their associates and shareholders of the Company (each of which to the knowledge of the Directors owns more than 5% of the Company's share capital) had any interest in these suppliers or customers of the Group at any time during the year of 2002.

SHAREHOLDINGS OF SUBSTANTIAL SHAREHOLDERS

As at 31 December 2002, substantial shareholders who held 10% or more of any class of the share capital of the Company were as follows:

Name of shareholder	Shares	Number of shares held	Percentage of the total number of shares of the Company in issue as at 31 December 2002	Percentage of the total number of domestic shares of the Company in issue as at 31 December 2002	Percentage of the total number of H shares of the Company in issue as at 31 December 2002
Shandong Electric Power (Group) Corporation (note1)	Domestic shares	2,815,075,430	53.56%	73.60%	—
Shandong International Trust and Investment Company Limited	Domestic shares	903,443,970	17.19%	23.62%	—
HKSCC Nominees Limited (Note 2)	H shares	1,416,384,000	26.95%	—	98.98%

Note 1: On 1 April 2003, the entire shareholding interest in 2,815,075,430 domestic shares of the Company which was originally held by Shandong Electric Power (Group) Corporation was transferred by way of administrative allocation to China Huadian Corporation, an enterprise ultimately wholly-owned by the State. After the shareholding reallocation, China Huadian Corporation became the immediate controlling shareholder of the Company holding 2,815,075,430 domestic shares, representing approximately 53.56% of the entire issued share capital of the Company. As both China Huadian Corporation and Shandong Electric Power (Group) Corporation are wholly-owned by the State, there has been no change in the ultimate beneficial ownership of the approximately 53.56% shareholding interest in the Company as a result of the shareholding reallocation. The Company will continue to be principally engaged in the electricity-generating business.

Note 2: According to the records of HKSCC Nominees Limited, the H shares held by it were held on behalf of a number of persons and, to the knowledge of the Company, none of them individually owned or held 10% or more of the total number of the Company's H shares in issue as at 31 December 2002.

Save as disclosed above, the Directors are not aware of any person (other than the Directors, chief executive, senior management or supervisors of the Company) who as at 31 December 2002 was interested in 10% or more of any class of the issued share capital of the Company.

DIRECTORS, SUPERVISORS, CHIEF EXECUTIVE AND SENIOR MANAGEMENT AND THEIR SHAREHOLDING INTERESTS

The following table sets forth certain information concerning the existing Directors, supervisors and senior management of the Company. All Directors and supervisors are currently serving a term of three years, renewable upon re-election and reappointment every three years.

Name	Position with the Company	Change during 2002
He Gong	Chairman of the Board of Directors	(appointed on 15 April 2003)
Da Hongxing	Vice Chairman of the Board of Directors	
Zhu Chongli	Vice Chairman of the Board of Directors	(appointed on 16 April 2002)
Chen Jianhua	Director, General Manager	
Tian Peiting	Director	
Peng Xingyu	Director	(appointed on 15 April 2003)
Zhang Bingju	Director	
Wang Yingli	Director	(appointed on 15 April 2003)
Lin Mingshan	Director	
Wang Guisheng	Director	(appointed on 16 April 2002)
Ding Changhao	Independent Director	
Kung Shaihow	Independent Director	
Feng Lanshui	Chairman of the Supervisory Committee	
Li Changxu	Supervisor	(appointed on 15 April 2003)
Zheng Feixue	Supervisor	
Zhou Lianqing	Company Secretary	
Ding Huande	Deputy General Manager	
Zhong Tonglin	Deputy General Manager	
Wang Wenqi	Deputy General Manager	
Zhu Fangxin	Chief Supervisor of Financial Affairs	

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In view of the expiry of the term for the Second Session (three years for each Session) of the Board of Directors and the supervisory committee of the Company, the Company re-appointed and re-elected the Directors, supervisors and members of the senior management of the Company in 2002. According to the ordinary resolutions passed at the Company's 2001 Annual General Meeting held on 16 April 2002, Mr. Da Hongxing, Mr. Tian Peiting, Mr. Chen Jianhua, Mr. Li Ruge, Mr. Zhang Bingju, Mr. Cui Jianbo, Mr. Henry T.E. Coolidge, Jr., Mr. Lin Mingshan, Mr. Ding Changhao and Mr. Kung Shai-dow were re-appointed as Directors of the Company; Mr. Zhu Chongli, Mr. Wang Guisheng and Mr. Geng Yuanzhu were appointed as new Directors of the Company; and Mr. Feng Lanshui and Mr. Xu Qingzao were re-appointed as supervisors of the Company. According to the Articles of Association of the Company, Ms. Zheng Feixue was re-elected as a supervisor of the Company as the staff representative.

According to the resolutions passed at the first meeting of the Third Session of the Board of Directors held on 16 April 2002, Mr. Da Hongxing was re-elected as the Chairman of the Board of Directors; both Mr. Tian Peiting and Mr. Zhu Chongli were elected as the Vice-chairmen of the Board of Directors; Mr. Chen Jianhua was re-appointed as the general manager of the Company; Mr. Zhong Tonglin and Mr. Wang Wenqi were re-appointed as deputy general managers of the Company; Mr. Zhu Fangxin was re-appointed as the chief supervisor of financial affairs of the Company; and Mr. Zhou Lianqing was re-appointed as the secretary to the Board of Directors.

Mr. Henry T.E. Coolidge, Jr, resigned as a Director of the Company with effect from 8 May 2002.

According to the resolution passed at the fifth meeting of the Third Session of the Board of Directors held on 6 January 2003, Mr. Ding Huande was appointed as a deputy general manager of the Company with effect from 27 December 2002 on which he was nominated by the General Manager.

Mr. Li Ruge, Mr. Geng Yuanzhu and Mr. Cui Jianbo resigned as Directors of the Company with effect from 15 April 2003; Mr. Xu Qingzao also resigned as a supervisor of the Company with effect from 15 April 2003.

According to the ordinary resolution passed at the Company's Extraordinary General Meeting held on 15 April 2003, Mr. He Gong, Mr. Peng Xingyu and Ms. Wang Yingli were appointed as Directors of the Company; Mr. Li Changxu was appointed as a supervisor of the Company.

According to the resolutions passed at the eighth meeting of the Third Session of the Board of Directors held on 15 April 2003, Mr. He Gong was elected as the Chairman of the Board of Directors and Mr. Da Hongxing was elected as Vice-chairman of the Board of Directors.

The Directors' and supervisors' remunerations for the year ended 31 December 2002 are set out in note 10 on the financial statements.

As at 31 December 2002, none of the Directors, supervisors, chief executive or senior management of the Company and their associates had any beneficial interest in the issued share capital or debt securities of the Company and/or any associated corporation, including interest required to be notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

During the year of 2002 and as at 31 December 2002, none of the Directors, supervisors, chief executive or senior management of the Company or any of their respective spouses or children under 18 years of age were granted any right, and the Company had not made any arrangement enabling any of them, to subscribe for any share capital or debt securities of the Company.

The biographical details in respect of the existing Directors, supervisors and senior management of the Company are set out on pages 35 to 38.

DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

No contract of significance or proposed contracts of significance, to which the Company or any of its subsidiaries, holding companies or jointly controlled entities was a party and in which a Director or supervisor of the Company had a material interest, whether directly or indirectly, subsisted at the end of the financial year or at any time during the financial year ended 31 December 2002.

SERVICE CONTRACTS OF THE DIRECTORS AND SUPERVISORS

No Director or supervisor has entered into any service contract with the Company which is not terminable by the Company within one year without payment of compensation (other than statutory compensation).

CONNECTED TRANSACTIONS

During the year of 2002, the Company entered into the following transactions which constituted connected transactions for the Company under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"):

1. Tengzhou Company Agreements

On 9 July 2002, Tengzhou Company, a subsidiary of the Company, entered into the following agreements:

- (a) the Tengzhou Company Construction Agreement with Shandong Electric Power No.3 Construction Engineering Company("No.3 Construction Engineering Company")pursuant to which Tengzhou Company has agreed to engage the No.3 Construction Engineering Company to provide services for the construction work of two 135MW heat and electricity cogenerating units in Tengzhou, Shandong Province for an aggregate consideration of RMB195,000,000 (approximately HK\$184,000,000) (subject to adjustments for variations of the construction work), funded out of the Group's internal resources (the payment terms and the relevant provisions of the agreement are set out in the announcement of the Company dated 10 July 2002); and

- (b) the Tengzhou Company Exploration and Design Agreement with Shandong Electric Power Engineering Consultancy Council (the “Consultancy Council”) pursuant to which Tengzhou Company has agreed to engage the Consultancy Council to provide exploration and design services for the construction of these two above-mentioned cogenerating units for an aggregate consideration of RMB8,370,000 (approximately HK\$7,900,000), funded out of the Group’s internal resources (the payment terms and the relevant provisions of the agreement are set out in the announcement of the Company dated 10 July 2002).

As Shandong Electric Power (Group) Corporation (“SEPCO”) was at that time a connected person of the Company and each of the No.3 Construction Engineering Company and the Consultancy Council is a wholly-owned subsidiary of SEPCO, each of these entities was then considered a connected person of the Company under the Listing Rules. Accordingly, the entering into of each of the Tengzhou Company Construction Agreement and the Tengzhou Company Exploration and Design Agreement constituted a connected transaction of the Company within paragraph 14.23(1) of the Listing Rules.

As the aggregate consideration to be paid by Tengzhou Company under the Tengzhou Company Construction Agreement and the Tengzhou Company Exploration and Design Agreement represents an amount less than 3% of the book value of the relevant net tangible assets of the Group and, therefore, falls within the de minimis provision under paragraph 14.25(1) of the Listing Rules, the entering into by Tengzhou Company of these agreements was required to be disclosed by way of a press announcement but no approval from the shareholders of the Company was required. Details of the transactions are set out in the Company’s announcement dated 10 July 2002.

2. Zibo Company Agreements

On 9 July 2002, Zibo Company, a subsidiary of the Company, entered into the following agreements:

- (a) the Zibo No.1 Construction Agreement with Shandong Electric Power No.1 Construction Engineering Company (“No.1 Construction Engineering Company”) pursuant to which Zibo Company has agreed to engage the No.1 Construction Engineering Company to provide services for the construction work of the principal portion and the public systems of two 135MW heat and electricity cogenerating units in Zibo, Shandong Province (including the installation services involved in the construction of one of these cogenerating units) for an aggregate consideration of RMB168,000,000 (approximately HK\$158,500,000) (subject to adjustments for variations of the construction work), funded out of the Group’s internal resources (the payment terms and the relevant provisions of the agreement are set out in the announcement of the Company dated 10 July 2002); and

- (b) the Zibo No.3 Construction Agreement with the No.3 Construction Engineering Company pursuant to which Zibo Company has agreed to engage the No.3 Construction Engineering Company to provide installation and associated services involved in the construction of one of the two 135MW heat and electricity cogenerating units in Zibo, Shandong Province for an aggregate consideration of RMB42,000,000 (approximately HK\$39,600,000) (subject to adjustments for variations of the construction work), funded out of the Group's internal resources (the payment terms and the relevant provisions of the agreement are set out in the announcement of the Company dated 10 July 2002).

As SEPCO was at that time a connected person of the Company and each of the No.1 Construction Engineering Company and the No.3 Construction Engineering Company is a wholly-owned subsidiary of SEPCO, each of these companies was then considered a connected person of the Company under the Listing Rules. Accordingly, the entering into of each of the Zibo No.1 Construction Agreement and the Zibo No.3 Construction Agreement constituted a connected transaction of the Company within paragraph 14.23(1) of the Listing Rules.

As the aggregate consideration to be paid by Zibo Company under the Zibo No.1 Construction Agreement and the Zibo No.3 Construction Agreement represents an amount less than 3% of the book value of the relevant net tangible assets of the Group and, therefore, falls within the de minimis provision under paragraph 14.25(1) of the Listing Rules, the entering into by Zibo Company of these agreements was required to be disclosed by way of a press announcement but no approval from the shareholders of the Company was required. Details of the transactions are set out in the Company's announcement dated 10 July 2002.

3. Zhangqiu Company Agreements

Zhangqiu Company, a subsidiary of the Company, entered into the following agreements:

- (a) the Zhangqiu Exploration and Design Agreement on 18 April 2000 (i.e., at the time before the Company acquired any equity interest in Zhangqiu Company) with the Consultancy Council pursuant to which Zhangqiu Company has agreed to engage the Consultancy Council to provide exploration and design services for the construction of two 135 MW fuel generating units in Zhangqiu, Shandong Province for an aggregate consideration of RMB7,500,000 (approximately HK\$7,080,000);
- (b) two construction agreements (the "Zhangqiu No.1 Construction Agreements") on 9 July 2002 with the No.1 Construction Engineering Company pursuant to which Zhangqiu Company has agreed to engage the No.1 Construction Engineering Company to provide certain construction and installation services involved in the construction of two 135MW fuel generating units in Zhangqiu, Shandong Province, the PRC for an aggregate consideration of RMB34,830,000 (approximately HK\$32,860,000) (subject to adjustments for variations of the work and services performed), funded out of the Group's internal resources (the payment terms and the relevant provisions of the agreement are set out in the announcement of the Company dated 10 July 2002); and

- (c) the Zhangqiu No.2 Construction Agreement on 9 July 2002 with Shandong Electric Power No.2 Construction Engineering Company (“No.2 Construction Engineering Company”) pursuant to which Zhangqiu Company has agreed to engage the No.2 Construction Engineering Company to provide certain construction and installation services involved in the construction of two 135MW fuel generating units in Zhangqiu, Shandong Province, the PRC for an aggregate consideration of RMB10,250,000 (approximately HK\$9,670,000), funded out of the Group’s internal resources (the payment terms and the relevant provisions of the agreement are set out in the announcement of the Company dated 10 July 2002).

As SEPCO was at that time a connected person of the Company and each of the No.1 Construction Engineering Company, the No.2 Construction Engineering Company and the Consultancy Council is a wholly-owned subsidiary of SEPCO, each of these entities was then considered a connected person of the Company under the Listing Rules. Accordingly, the entering into of each of the Zhangqiu No.1 Construction Agreements and the Zhangqiu No.2 Construction Agreement and the transactions contemplated under the Zhangqiu Exploration and Design Agreement constituted connected transactions of the Company within paragraph 14.23(1) of the Listing Rules.

As the aggregate consideration to be paid by Zhangqiu Company under the Zhangqiu No.1 Construction Agreements, the Zhangqiu No.2 Construction Agreement and the Zhangqiu Exploration and Design Agreement represents an amount less than 3% of the book value of the relevant net tangible assets of the Group and, therefore, falls within the de minimis provision under paragraph 14.25(1) of the Listing Rules, the entering into by Zhangqiu Company of these agreements and the transactions thereunder were required to be disclosed by way of a press announcement but no approval from the shareholders of the Company was required. Details of the transactions are set out in the Company’s announcement dated 10 July 2002.

4. Laicheng Plant Agreement

As mentioned in the 2001 Annual Report of the Group, in 2001, Laicheng Power Plant, a wholly-owned plant of the Company, entered into the Laicheng Plant Phase II Construction Agreements with No.2 Construction Engineering Company and No.3 Construction Engineering Company respectively (these two construction engineering companies are wholly-owned subsidiaries of SEPCO). The entering into of the Laicheng Plant Phase II Construction Agreements and the transactions contemplated thereunder constituted connected transactions of the Company for the purpose of the Listing Rules. The transactions were approved by the Company’s shareholders at the extraordinary general meeting of the Company held on 26 November 2001.

During the financial year of 2002, a majority of the construction work of the third and the fourth generating units of Laicheng Power Plant were provided by No.2 Construction Engineering Company and No.3 Construction Engineering Company pursuant to the above construction agreements. For the year ended 31 December 2002, the total amount paid by the Company to these two construction companies was RMB 242,152,000. The third generating unit of Laicheng Plant formally commenced commercial operation on 19 September 2002. The fourth generating unit is expected to be put into commercial operation in the first half of 2003.

CONNECTED TRANSACTIONS WHICH ARE THE SUBJECT OF EXEMPTION UNDER THE LISTING RULES AND MATERIAL CONTRACT WITH SHANDONG ELECTRIC POWER (GROUP) CORPORATION

Connected Transactions

Apart from the transactions disclosed above, most of the transactions undertaken by the Group and its jointly controlled entities during the year ended 31 December 2002 were entered into with Shandong Electric Power (Group) Corporation (the former immediate holding company of the Company) or entities controlled by it on such terms as have been agreed between the relevant parties. Under the Listing Rules, the above parties were at the material time connected persons of the Company and the relevant transactions constituted connected transactions for the Company. Details of these transactions which are required under the Listing Rules to be disclosed herein are set out below and in note 31 on the financial statements.

	Note	2002 RMB'000	2001 RMB'000
Sale of electricity	i	7,688,975	7,142,341
Interconnection and despatch management fees	ii	79,788	76,185
Repairs and maintenance services	iii	216,372	240,681
Technical supervision, assistance and testing services	iv	17,343	14,812
Electricity consumed	v	20,832	17,865

- (i) All electricity generated by the Group was sold to SEPCO. See note 31 on the financial statements for details.
- (ii) Interconnection and despatch management fees were paid to SEPCO. See note 31 on the financial statements for details.
- (iii) Shandong Electric Power Hong Yuan Electricity Generation Overhaul Company Limited, which is controlled by SEPCO, was responsible for the repair and maintenance works, including major overhauls, of the Group. The amount payable was determined on a cost reimbursement basis.
- (iv) Shandong Electric Power Scientific Research Institute, which is controlled by SEPCO, was responsible for the provision of technical supervision, assistance and testing services to the Group. Such services were charged at a rate of RMB3.66 per KW (including value-added tax) of installed capacity per year.
- (v) The Group purchased electricity from SEPCO at the published tariff rates for use in certain of its operations and for its head office and staff quarters where they are located in areas under the cover of the grid operated by SEPCO.

- (vi) The fuel required for the Group was purchased and supplied by Shandong Luneng Hengyuan Trade Group Corporation Limited (the “Fuel Supply Company”, previously known as Shandong Luneng Fuel (Group) Company Limited), which was previously controlled by SEPCO. After completion of a reorganization of the Fuel Supply Company in December 2001, the Fuel Supply Company ceased to be a connected person of the Company for the purpose of the Listing Rules, and the transactions entered into between the Company and the Fuel Supply Company no longer constitute any connected transaction for the Company.

The independent Directors of the Company have confirmed to the Board of Directors of the Company that they have reviewed the above connected transactions and have concluded that these transactions had been entered into:

- (i) in the ordinary and usual course of business;
- (ii) either on normal commercial terms or on terms no less favourable than those available to (or from) independent third parties; and
- (iii) on terms that are fair and reasonable so far as the shareholders of the Company are concerned.

At the same time, the independent Directors of the Company have also confirmed that the respective aggregate amount of payments involved in the transactions entered into by the Group and each of Shandong Electric Power Hong Yuan Electricity Generation Overhaul Company Limited and Shandong Electric Power Research Institute in 2002 did not exceed an amount representing 3% of the book value of the relevant net tangible assets of the Group for the year. In addition, the Company’s auditors, KPMG, have reviewed these transactions in respect of the provision of repairs and maintenance services and technical supervision, assistance and testing services to the Group mentioned above and confirmed to the Board of Directors that:

- (i) these transactions had been approved by the Board of Directors;
- (ii) these transactions were entered into in accordance with the pricing policies stated in the financial statements of the Company (if any) and the terms of the relevant agreements governing these transactions; and
- (iii) the aggregate consideration paid and payable in 2002 in respect of these transactions did not exceeded 3% of the book value of the relevant net tangible assets of the Group of the year 2002.

After the restructuring of the PRC power assets and the changes in the Company’s controlling shareholding interest on 1 April 2003, under the Listing Rules, SEPCO ceased to be a connected person of the Company and the above transactions between the Group and SEPCO and its controlled entities did not and in future will not constitute any connected transaction for the Company.

MATERIAL CONTRACT WITH SHANDONG ELECTRIC POWER (GROUP) CORPORATION

On 12 January 1999, SEPCO and the Company entered into a letter of undertaking, pursuant to which SEPCO granted to the Company a right to acquire, develop, construct, own and operate, at the Company's option, any or all future power plants in Shandong Province. In addition, SEPCO agreed not to compete with the Company in relation to the acquisition, development, construction and operation of power plants located outside the service area of the Shandong Provincial Grid, but power generated by which will be supplied to Shandong Province.

IMPORTANT MATTERS - POWER INDUSTRY RESTRUCTURING INVOLVING THE COMPANY

Pursuant to the restructuring proposal of the State-owned power assets, the entire shareholding interest in 2,815,075,430 domestic shares in the Company which was originally held by SEPCO was transferred by way of administrative allocation on 1 April 2003 to China Huadian Corporation. As SEPCO, after the shareholding reallocation, ceases to have any shareholding interest in the Company, it has notified the Company to terminate the above-mentioned letter of undertaking in accordance with the terms thereof. In addition, SEPCO is no longer a connected person of the Company. Accordingly, after the shareholding reallocation as described above, any transactions previously entered into between the Group and SEPCO and/or any of its group members cease to constitute connected transactions of the Company. All transactions that may in future be entered into between the Group and SEPCO and/or its group members will not constitute connected transactions of the Company.

On 7 April 2003, China Huadian Corporation, as the new controlling shareholder of the Company, has agreed and undertaken to the Company that, for so long as China Huadian Corporation retains a controlling shareholding interest in the Company:

- (a) the Group is, and will continue to serve as, China Huadian Corporation's primary vehicle for developing power projects and a principal power-generating enterprise, and, in this connection, China Huadian Corporation will support the future business developments of the Group;
- (b) the treatment to be received by the Group with respect to the developments of projects and investment opportunities will, subject to the operation of market principles and on normal commercial terms, be more favourable than the treatment received or to be received by other power stations and departments in the Shandong Province and other areas in which China Huadian Corporation has operation;
- (c) subject to satisfaction of all applicable government and/or other regulatory requirements and to obtaining any applicable third-party consent, the Group shall, at its option, have a preferential right to acquire, develop, construct, own and/or operate China Huadian Corporation's interests in all of its power plants and power projects within the Shandong Province or other areas in which China Huadian Corporation has operation; and
- (d) China Huadian Corporation will not compete with the Group in relation to acquisition and development of power plants and power projects.

INVESTMENT

On 28 November 2002, the Company jointly invested and established Zhongning Company with Ningxia Yinglite Power (Group) Corporation, Ningxia Power Development & Investment Company Limited and Ningxia Power Construction General Corporation, which are interested in 20%, 45%, 20% and 15% of the registered capital of Zhongning Company respectively. The registered capital of Zhongning Company in the first phase was RMB11.2 million, of which RMB2.24 million was injected by the Company in November 2002 in proportion to the equity interest of 20% held by the Company.

Zhongning Company plans to construct two 330MW generating units and has expansion conditions. The total budgeted cost of the project amounts to approximately RMB2,300 million. The two units are expected to commence commercial operation in 2005 and 2006 respectively. The project proposal has been approved by the State Development and Reform Commission. According to its Articles of Association, Zhongning Company has established the General Meeting of Shareholders, the Board of Directors and the Supervisory Committee. The Board of Directors of Zhongning Company consists of eleven Directors, among which two Directors are appointed by the Company. The Supervisory Committee of Zhongning Company consists of five supervisors, of which the Chairman is appointed by the Company.

Investment in Zhongning Company is the first time for the Company to invest the power projects outside Shandong Province so that the Company can achieve the development strategy to expand to other regions. The Ningxia Power grid is an important part of The Northwest China Power grid and an important basis of the northern channel of electricity transmission from the western region to the eastern region of the PRC. In recent years, the power consumption of Ningxia has greatly increased, which results in more development opportunities for the power generating markets. The investment in Zhongning Company will create more cooperation opportunities for the Company to expand the business in the Ningxia market.

REPURCHASE, SALE OR REDEMPTION OF SECURITIES

During the financial year of 2002, neither the Company nor any of its subsidiaries has repurchased, sold or redeemed any of its respective securities (the word “securities” shall have the same meaning as defined in paragraph 1, Part I of Appendix 7 to the Listing Rules).

FINANCIAL SUMMARIES

Summaries of the results and the assets and liabilities of the Group for each of the five years ended 31 December 2002 are set out on page 88.

COMPLIANCE WITH THE CODE OF BEST PRACTICE

The Group has throughout the year of 2002 complied with the Code of Best Practice as set out in Appendix 14 to the Listing Rules.

MATERIAL LITIGATION

The Group was not involved in any material litigation or arbitration during the financial year of 2002. As at 31 December 2002, no litigation or claim of material importance is known to the Directors to be pending or threatened by or against the Group.

PRACTICE NOTE 19

During the financial year of 2002, the Company did not advance any money to any entity which exceeded 25% of the Company's net assets, did not provide any financial assistance or guarantee to affiliated companies which exceeded 25% of the Company's net assets, did not have pledging of shares by the controlling shareholder to secure debts, guarantees or other support of obligations of the Company and did not make any loan agreements imposing specific performance obligations on the controlling shareholder.

DESIGNATED DEPOSITS AND OVERDUE MATERIAL DEPOSITS

As at 31 December 2002, the Group's deposits placed with financial institutions or other parties did not include any designated or trust deposits, or any material deposits which could not be collected upon maturity.

AUDITORS

The Company has not changed its auditors in any of the preceding three years. A resolution for the reappointment of KPMG Huazhen and KPMG as domestic auditors and international auditors of the Company respectively for the financial year ending 31 December 2003 is to be proposed at the forthcoming Annual General Meeting.

On behalf of the Board

He Gong
CHAIRMAN

Jinan, Shandong Province,
The People's Republic of China
15 April 2003