

# Management Discussion and Analysis

The following discussion and analysis should be read in conjunction with the audited financial statements of the Company for 2003 and 2002 and the notes thereto included elsewhere in this report. Such financial statements have been prepared in accordance with IFRS. For a discussion of certain differences between IFRS and US Generally Accepted Accounting Principles ("US GAAP"), please refer to note 46 to the financial statements contained herein or the Company's annual report on Form 20-F filed with the Securities and Exchange Commission of United States of America, which will be provided to any Shareholder upon written request.

## **YEAR ENDED 31ST DECEMBER, 2003 COMPARED WITH YEAR ENDED 31ST DECEMBER, 2002**

The Company's realised net sales increased by RMB592.5 million, or 9.3%, to RMB6,948.9 million in 2003 from RMB6,356.4 million in 2002, among which realised net sales of coal increased by RMB580.4 million, or 9.3%, to RMB 6,794.3 million in 2003 from RMB 6,213.9 million in 2002. The increase was mainly due to an increase of coal sales volume of 12.4%, resulting in an increase of net sales of coal by RMB773.1 million, and a decrease of average coal price of 2.8%, resulting in a decrease of net sales of coal by RMB192.7 million. The Company's net income from railway transportation service was RMB154.6 million, representing an increase of RMB12.114 million, or 8.5%, from RMB142.5 million in 2002. Such increase was principally due to an increase in the volume of coal deliveries where transportation expenses were calculated on ex-mine basis and were borne by the customers.

Cost of sale and railway transportation service increased by RMB392.1 million, or 11.7%, to RMB3,755 million in 2003, as compared to RMB3,362.9 million in 2002. The cost of coal sales was RMB3,687.4 million, representing an increase of RMB 377.5 million, or 11.4%, as compared to RMB3,309.9 million in 2002, principally due to an increase of coal production. The unit cost of coal sales was RMB93.57, representing a decrease of RMB0.87, or 0.9%, as compared to RMB94.44 in 2002. This was mainly because the strengthened management and the enlargement of production scale by the Company, resulting in the unit cost of coal sales being effectively under control.

Sale, general and administrative expenses of the Company were RMB1,264.9 million in 2003, increased by RMB33.799 million, or 2.7%, from RMB1,231.1 million in 2002. This increase was mainly due to: (1) an increase in retirement benefits scheme contributions of RMB15.257 million; (2) an increase in resources compensation fees of RMB11.179 million; (3) an increase in research and development expenses of RMB15.487 million; (4) an increase in allowance for doubtful debt of RMB14.068 million over that of last year; (5) and a partial set-off of the said factors resulting in the increase of fees/expenses by the effective control on the sale, general and administrative expenses through strengthened management .

Other operating income increased by RMB2.116 million, or 2.0%, to RMB105.8 million in 2003 from RMB103.7 million in 2002.

Operating income increased by RMB168.8 million, or 9.0%, to RMB2,034.9 million in 2003 from RMB1,866.1 million in 2002.

Interest expenses of the Company decreased by RMB57.963 million, or 49.2%, to RMB59.966 million in 2003 from RMB117.9 million in 2002. This was principally due to a partial repayment of long-term bank loan.

Income before income taxes increased by RMB226.7 million, or 13.0%, to RMB1,974.9 million in 2003 from RMB1,748.2 million in 2002.

Net income increased by RMB164.7 million, or 13.5%, to RMB1,386.7 million in 2003 from RMB1,222 million in 2002.

Total assets increased by RMB985.8 million, or 7.6%, to RMB13,909.8 million as at 31st December, 2003 from RMB12,924.0 million as at 31st December, 2002. This was principally because the Company's production and operation activities resulted in an increase in assets value.

Total liabilities decreased by RMB101.3 million, or 3.5%, to RMB2,822.8 million as at 31st December, 2003 from RMB2,924.1 million as at 31st December, 2002. This was principally due to: (1) the Company made a repayment of RMB600 million of long-term loan during the period in this report; (2) an increase in advances from customers of RMB443.2 million; (3) an increase in taxes payable and others liabilities of RMB55.588 million.

Shareholder's equity increased by RMB1,088.2 million, or 10.9%, to RMB11,083.2 million as at 31st December, 2003 from RMB9,995.0 million as at 31st December, 2002. This was principally because the operation activities realised profits, resulting in an increase in Shareholder's equity.

## LIQUIDITY AND CAPITAL RESOURCES

In 2003, the Company's principal source of capital was cash flow from operations. The Company's principal uses of the capital include payment for operating expenses, purchase of property, plants and equipment, including the investment in the first phase of Jining Sihe Coal Port, payment of Shareholders' dividends and partial repayment of long-term bank loan.

As at 31st December, 2003, the balance of bills and accounts receivable of the Company were RMB1,239.4 million, representing an increase of RMB436.5 million, or 54.4%, from RMB802.9 million as at 31st December, 2002. Bills receivable increased by RMB417.1 million, or 173.8%, to RMB657.1 million from the RMB240.0 million as at 31st December, 2002, principally due to the increase in bank bills as a result of an increase in coal sales volume. Accounts receivable increased by RMB19.379 million, or 3.4%, to RMB582.3 million from RMB562.9 million as at 31st December, 2002, principally due to an increase of coal sales volume.

As at 31st December, 2003, inventories decreased by RMB74.551 million, or 12.9%, to RMB502.0 million from RMB576.6 million as at 31st December, 2002. Strengthened management and tightened control reduced the inventories of auxiliary materials, spare parts and small tools.

Prepayment and other current assets decreased by RMB221.5 million, or 29.3%, to RMB534.5 million as at 31st December, 2003, from RMB756.0 million as at 31st December, 2002. The decrease was mainly due to a decrease of prepayment and the partial collection of VAT export rebate receivable.

As at 31st December, 2003, total bills and accounts payable decreased by RMB175.1 million, or 29.1%, to RMB427.6 million from RMB602.7 million as at 31st December, 2002, among which bills payable decreased by RMB101 million and accounts payable decreased by RMB74.135 million.

Other accounts payable and provisions increased by RMB540.0 million, or 85.1%, to RMB1,174.8 million as at 31st December, 2003 from RMB634.8 million as at 31st December, 2002, principally due to an increase in advances from customers.

Long-term liabilities decreased by RMB810.4 million, or 64.3%, to RMB450.9 million as at 31st December 2003 from RMB1,261.3 million as at 31st December, 2002. This was principally due to the partial repayment of long-term bank loan.

# Management Discussion and Analysis (Cont'd)

The Company's capital expenditure for the purchase and construction of property, machinery and equipment was RMB837.8 million and RMB1,288.1 million in 2002 and 2003, respectively. The Company invested RMB250.2 million in the construction of the first phase of Jining Sihe Coal Port in 2003.

According to the Acquisition Agreement of Jining III Coal Mine, the Company has paid its parent company, Yankuang Group Corporation Limited (the "Parent Company") RMB13.248 million for mining right during the period of this report.

According to the Acquisition Agreement of Railway Assets, the Company has paid RMB40 million to the Parent Company during the period in this report. Details are set out in note 35 to the financial statements prepared in accordance with the IFRS contained herein.

As at 31st December, 2003, the Company's debt to equity ratio was 5.9%, which was calculated based on the Shareholder's equity and the total amount of loan amounting to RMB11,803.2 million and RMB605.9 million, respectively.

The Directors of the Company recommended a cash dividend of RMB327.2 million (before tax) or RMB0.114 (before tax) per share in accordance with the Company's consistent dividend policy and an additional special cash dividend of RMB143.5 million (before tax) or RMB0.05 (before tax). The said dividends totally amount to RMB470.7 million (before tax) or RMB0.164 (before tax) per share.

Taking into account the cash in hand and existing abundant capital sources, the Company believes that it will have sufficient capital for its operational requirements.

## TAXATION

The Company is still subject to an income tax rate of 33% on its taxable profits in 2003.

## US GAAP RECONCILIATION

The Company's audited financial statements are prepared in compliance with IFRS, which differs in certain respects from accounting principles generally accepted in the United States of America ("US GAAP"). Please refer to note 46 to the financial statements contained herein for a description of the differences between IFRS and US GAAP, and the adjusted net income for the year ended 31st December, 2003 and the Shareholders' equity as at 31st December, 2003 after reconciliation made in accordance with US GAAP.