# Management Discussion and Analysis

## OPERATING REVIEW

### Operating Results

The Group's total turnover decreased by 2.2% to HK$716.5 million (2002: HK$732.4 million). Despite the increase of tariff revenue as a result of increased electricity sales volume, the aggregate amount of additional fuel cost surcharges received for the year decreased more markedly as compared with previous year. The Group's total cost of sales increased by 17.9% to HK$639.3 million (2002: HK$542.3 million), mainly attributable to the increase in electricity sales and the drastic increase of fuel oil cost for the year. Gross profit was reduced significantly by 59.5% to HK$77.1 million (2002: HK$190.2 million) and gross profit margin deteriorated from 26.0% to 10.8%. Despite the reduction of administrative expenses by 22.2% to HK$22.5 million (2002: HK$28.9 million), profit from operations decreased by markedly 85.7% to HK$19.1 million (2002: HK$133.5 million) while operating profit margin also fell from 18.2% to 2.7%. Although finance cost continued to fall, by 23.7% to HK$26.4 million (2002: HK$34.6 million), the Group incurred loss attributable to shareholders of HK$17.6 million (2002: profit of HK$49.6 million). Loss per share was 2.12 Hong Kong cents (2002: earnings per share of 5.98 Hong Kong cents).

### Electric Power Market

Driven by robust economic activities, electricity demand of Guangdong Province, in particular fast-growing cities in the Pearl River Delta Area like Foshan Municipality, experienced unprecedented strong growth of the recent years. The unexpected severe hot weather during the summer season also stimulated the province's overall electricity consumption. For several times during the year, the maximum electricity demand load of both Guangdong Province and Foshan Municipality recorded new highs. However, electricity supply growth has been relatively slow which is mainly due to the inefficient addition of new capacity in the past. At the same time, due to the relatively dry weather in the recent past period, electricity supplies from hydro power stations in the province were markedly reduced. Supplies from some thermal power plants were also reduced as a result of the increased energy cost, such as coal and fuel oil. Even though new power plants were being developed in the province, electricity productions have yet to provide sufficient supplies which will only increase gradually in the coming years. As electricity consumption of major inland provinces also increased on the back of rapid economic growth, electricity supplies of the 西電東送 (West-to-east Transmission) Project recorded slower growth. As a result, aggregate electricity supply from the provincial grid became extremely tight and electricity shortage on provincial-wide scale prevailed. Electricity rationings were not uncommon during peak load demand periods. Retail tariffs to some categories of electricity consumers were raised during peak load demand periods while there was also potential for upward adjustment in respect of producers' on-grid tariffs for some thermal power plants including oil-fired power plants.

### Electricity Sales

During the year, the Group continued to strengthen its low-cost operating structure to concentrate on improving the operating efficiency and enhancing the cost effectiveness of 佛山市沙口發電廠有限公司 (Foshan Shakou Power Plant Co. Ltd.) ("Shakou JV"). Despite the slight interruption to normal production caused by the major overhaul of its power generating facilities in the first quarter of the year, Shakou JV achieved marked growth in electricity sales volume in the remaining period of the year. After the completion of the major overhaul and upgrade, Shakou Power Plant's production efficiency achieved improvement. Power generating facilities were able to operate in optimal conditions throughout the year without any significant breakdown and major mechanical failure. The unfortunate SARS (Severe Acute Respiratory Syndrome) incident during the year had no significant impact on the Group's business and operations. Throughout the SARS period, the Group adopted contingency measures in its headquarters and power plant premises to ensure minimal impact on the Group's operations. Electricity sales volume of Shakou JV increased by 7.5% to 1.43 billion kilowatt-hours ("kwh") (2002: 1.33 billion kwh). The average plant utilization rate for the year of Shakou Power Plant in Shakou JV improved from the previous 50.6 % to 54.3%. During the year, Shakou JV sustained its market position as a dominant local power plant operator in Foshan Municipality, providing a significant portion of the local electricity supply. All electricity produced during the year was sold to 廣東省廣電集團有限公司佛山供電分公司 (Guangdong Guan-Dian Electric Power Grid Group Co. Ltd., Foshan Branch) ("Guang-Dian Power Group Foshan") at the per-unit tariff of Renminbi 0.5051 (exclusive of value added tax). In addition, Shakou JV negotiated with Guang-Dian Power Group Foshan and received an aggregate amount of additional fuel cost surcharges of Renminbi 45.6 million (equivalent to HK$42.6 million) (2002: Renminbi 100 million (equivalent to HK$94.0 million)) to partially compensate for the increased fuel cost during the year.

### Fuel Oil Prices

Heavy oil cost accounted for approximately 78.9% (2002: 77.5%) of the Group's total cost of sales. During the year, fuel oil prices surged to almost record high levels of the recent years and hovered at high levels, which was mainly due to the warfare in Iraq. As a result, the weighted average cost of heavy oil consumed by Shakou JV increased markedly by 15.3% to Rmb 1,798 per tonne (exclusive of value-added tax) (2002: Rmb 1,560 per tonne). The unit fuel cost of electricity supplied by Shakou JV increased by 11.4% to Rmb0.39 (2002: Rmb 0.35) per kwh.

### Disposal of Fixed Assets

During the year, the Group disposed two transformer units of Shakou JV to an independent third party in the PRC for approximately HK$ 1.6 million on an arm's length basis. These assets were purchased about 10 years ago and have become obsolete. Pursuant to the transaction, a loss on disposal of fixed assets of HK$6.5 million (2002: Nil) was recorded.

### Employees and Remuneration Policies

As at year end, the Group employed a total of approximately 200 staff (2002: 220 staff). Remuneration packages principally comprised salary and performance bonuses based on individual merits. The Group's total remuneration for the year was approximately HK$21.3 million (2002: HK$25.2 million).

## FINANCIAL REVIEW

### Liquidity and Financial Resources

The Group continued to fund its operation principally by internal cash inflow generated from operating activities. Compared with the previous year, net cash from operating activities decreased by 27.7% to HK$177.2 million (2002: HK$245.2 million). Notwithstanding the loss from ordinary activities before taxation of HK$7.3 million (2002: profit of HK$98.8 million), decrease of trade and other receivables grew from HK$35.6 million to HK$71.4 million. Accounts receivable turnover (turnover as a percentage of accounts receivable) improved from the previous 6.0 to 13.1 and the average collection period shortened from the previous 61 days to 28 days. At the same time, net cash used in investing activities was significantly reduced from HK$121.6 million to net cash inflow of HK$1.0 million as significant amount was used in the purchase of components for the major overhaul in previous year. Cash expenditure on other tangible fixed assets for the year was HK$2.2 million (2002: HK$5.2 million). Net cash used in financing activities grew from HK$96.5 million to HK$125.9 million. Total amount of cash and cash equivalents as at balance sheet date therefore increased from HK$167.9 million to HK$220.3 million. As at 31 December 2003, the Group's total current assets decreased by 4.0% to HK$295.6 million (2002: HK$307.8 million) which primarily comprised cash & cash equivalents of HK$220.3 million (2002: HK$167.9 million) and trade and other receivables of HK$56.8 million (2002: HK$128.2 million). Total current liabilities decreased by 29.6% to HK$251.2 million (2002: HK$356.7 million) which comprised mainly the current portions of long-term loans of an aggregate amount of HK$65.3 million (2002: HK$113.6 million), trade & other payables of HK$123.0 million (2002: HK$117.2 million) and short-term bank loans of HK$50.5 million (2002: HK$84.2 million). As at 31 December 2003, the Group's short-term liquidity position significantly improved with net working capital surplus of HK$44.4 million (2002: deficit of HK$49.0 million). Current ratio improved from the previous 0.86 to 1.18.

### Committed Banking Facilities

As at 31 December 2003, the Group had committed short-term Renminbi banking facilities from two banks in the PRC for an aggregate amount of Renminbi 180.0 million (equivalent to HK$168.4 million) (2002: Renminbi 116.0 million (equivalent to HK$108.6 million)). As at the balance sheet date, the aggregate outstanding balance of bank borrowings under the short-term Renminbi banking facilities was Renminbi 54.0 million (equivalent to HK$50.5 million) (2002: Renminbi 90.0 million) (equivalent to HK$84.2 million)). These bank loans bear interest at annual rate of 4.536%. The Group also had committed a three year Renminbi term loan facility from a PRC bank for Renminbi 30.0 million (equivalent to HK$28.1 million) (2002: Nil). As at the balance sheet date the outstanding balance of such term loan facilities was Renminbi 30.0 million (equivalent to HK$28.1 million) (2002: Nil) and the loan bears interest at annual rate of 4.941%. Save as disclosed herein, the Group had no other bank borrowings or committed banking facilities.

### Charge on Group Assets

As at 31 December 2003, the Group's power generating facilities of an aggregate amount of HK$1.2 billion (2002: HK$1.1 billion) were charged to three banks in the PRC to secure the respective banking facilities for Shakou JV's working capital requirements. Apart from such, no other part of the Group's assets has been charged to banks, financial institutions or other enterprises.

### Contingent Liabilities

As at 31 December 2003, the Group had contingent liabilities of approximately HK$43 million (2002: HK$43 million), details of which has been disclosed in the section headed "Contingent Liabilities" under "Notes on the Accounts" in this report.

### Capital Structure and Gearing Ratio

The Group financed its non-current assets principally by a mix of long-term debts and shareholders' equity. The Group's long-term debts (including their current portions) decreased by 9.7% to HK$404.9 million (2002: HK$448.2 million). Total long-term debts mainly comprised: (1) the aggregate outstanding balance of the unsecured long-term Renminbi loans due to Shakou JV's PRC joint-venture partner and its associate of HK$376.8 million (2002: HK$448.2 million); and (2) a three years Renminbi term loan due to a PRC bank of HK$28.1 million (2002: Nil). The long-term Renminbi loans due to Shakou JV's PRC joint-venture partner and its associate were primarily employed to re-finance Shakou JV's investment in its fixed assets, principally power generating facilities, and were repayable within 10 years commencing in 1997 and 1998. The applicable loan rates for the year were 5.76% (2002: 5.76%) per annum. During the year, the Group made partial payment by internal cash flow generated from its operating activities. Furthermore, Shakou JV negotiated with its PRC joint-venture partner and its associate to reschedule certain overdue principal repayments and current portions of the long-term loans due for repayments within 2004 of an aggregate amount of HK$66 million, extending the expiry for about 18 months. Gearing ratio, being the aggregate amount of bank loans and other loans (including current portion) as a percentage of shareholders' fund, decreased modestly from the previous 35.7% to 31.2%.

### Net Assets

The Group's net assets amounted to HK$1.46 billion (2002: HK$1.49 billion). The net book value of goodwill arising from acquisition of subsidiaries was HK$609.9 million (2002: HK$641.6 million). Net assets per share decreased negligibly from the previous HK$1.80 to HK$1.76 while net tangible assets per share remained at the previous level of approximately HK$1.03.

### Exchange Risk

The Group's revenue, operating costs, finance costs, debt servicing and capital expenditure were substantially denominated in Renminbi. Currently the exchange rate of Renminbi against Hong Kong dollars has been relatively stable. No financial instrument has been used for the purpose of hedging exchange rate risk during the year.

## OUTLOOK

It is expected that Guangdong Province's electricity demand growth will accelerate in the coming years primarily driven by the province's robust economic activities. As one of the fastest growing cities in Guangdong Province, Foshan Municipality is expected to sustain strong electricity demand growth. The directors of the Company (the "Directors") believed that the maximum electricity demands for both Guangdong Province and Foshan Municipality will experience record highs and electricity shortage will persist in the coming years. In fact, electricity rationings and temporary electricity supply suspensions have become more frequent since the beginning of 2004. In addition, high demand seasons of the year also have commenced in earlier months than previous year. Foshan Municipality has already adopted contingency measures to ration electricity during high demand periods while certain production and commercial activities was requested to shift to low demand periods. Local power plants in Foshan

Municipality, including Shakou Power Plant, have been requested by the relevant authority of the Foshan Municipal Government to operate at their maximum available capacity during the peak demand periods. The Directors believe that Shakou Power Plant will improve its total electricity sales volume and achieve a higher utilization rates in the coming year. However, the Group's profitability may still fluctuate largely as a result of the uncertain fuel oil price movements in short term. As fuel oil prices may continue to hover at the recent high level and remain uncertain in the short-term, the Group will continue to closely monitor the fuel oil price movement and explore more effective fuel-purchasing strategy to minimize the Group's overall operating costs. The Group will endeavor its best effort to negotiate with the relevant PRC authorities and to solicit additional fuel cost surcharges from its customer. In the long run, the Group will commence preliminary feasibility study in respect of making technological innovation to its existing power generating facilities to consume liquefied natural gas as an alternative energy source in the future to reduce the Group's susceptibility on fuel oil prices. In order to meet surging electricity demand, the relevant authorities of Foshan Municipal Government have recently approved new power plant projects to be built in Foshan Municipality. These new power plant facilities are being developed by certain PRC parties. The Directors would obtain further information in respect of the technical and financial feasibility of these projects and explore the possibility to invest in these projects.

**SITU Min**
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**HE Haochang**
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