



Discussion and Analysis

of the Group's Performance

FINANCIAL REVIEW

The Group recorded remarkable results in 2003. During the year, the Group sold 952.1 million kWh on grid, representing an increase of approximately 2.7 times as compared to the corresponding period last year. The increase was primarily contributed from the strong market demand in power and from the expanded capacity of Fuhuade Power Plant. Driven by the strong economic growth, the increasing demand in power was substantial. In 2003, Guangdong Province generated 178.3 billion kWh of power and imported 26.6 billion kWh from its neighbouring provinces. This represented a growth of more than 18% and 31.5% over the previous year respectively. In May 2003, Fuhuade Power Plant completed the expansion and was currently equipped with a total installed capacity of 305,000 kilowatt, an increase of 3.3 times over the previous capacity. In line with the increase in capacity, Fuhuade Power Plant achieved a consolidated turnover of HK\$559.8 million and a profit contribution of HK\$80.5 million to the Group.

The direct operating expenses also increased in line with the power generation to approximately HK\$415.5 million. The primary component of the direct operating expenses was fuel cost. During the year, the Group incurred a total fuel cost of HK\$350.6 million. The increase in unit fuel cost was mainly attributable to the soaring world oil price this year due to the uncertainties in the Middle East. To cope with this scenario, the Group had carried out various remedial measures, including the strengthening of fuel procurement and inventory control policies, and had been successful in minimizing the impact to the Group as a whole.

The finance costs were primarily attributable to the bank borrowings for the expansion of Fuhuade Power Plant. During the year, the finance costs were increased by 2.2 times over last year. The increase was in line with the additional financing borrowed during the year.

During the year, the Group disposed of its last investment property and had discontinued its business in properties investment. A loss of HK\$10,000 was incurred on discontinuing business in properties investment.

The Group recorded a net profit attributable to shareholders of HK\$57.5 million. This is a major improvement as compared to a net loss of HK\$85.7 million in last year. The encouraging performance was the result of the increase in power generating capacity and the management's effective cost control measures. Based on the weighted average of 333,610,723 shares in issue during the year, the basic earning per share was HK17.23 cents.

PROFIT GUARANTEE ON ACQUISITION OF FUHUADE POWER PLANT IN 2002

Despite a minor delay to the commencement of the commercial operation of the new generating units, Fuhuade Power Plant recorded a net profit after taxation of RMB122.9 million in 2003. Adding to the net profit after taxation of RMB 15.8 million recorded in year 2002, Fuhuade Power Plant achieved a total net profit of RMB 138.7 million for the two years ended 31 December 2003. The profit guarantee as provided by Sinolink Worldwide Holdings Limited to the Company in relation to the acquisition of Fuhuade Power Plant in 2002 was achieved.

BUSINESS PROSPECT

There will be an ever-increasing demand for power in response to the strong growing economy in China. Energy shortage has become a critical constraint for China's continuing economic development. As a result, the development of alternative energy sources is inevitable. To ride such wave, Enerchina will strengthen its effort to explore new investment opportunities in alternative energy fields, such as power generation, coal mining and coal based chemical processing, actively participating in the development of China energy and utility sector, so as to enhance the business strength of the Group for higher profitability and to sustain further growth.

FINANCIAL POSITION

As at 31 December 2003, total assets of the Group were HK\$1,417.8 million, representing an increase of 40.4% over that of the previous year. Total liabilities amounted to approximately HK\$756.8 million and were 3.7% over the previous year. The overall gearing ratio, which is calculated as the total borrowings over total assets of the Group, was 53.4%.

The Group had bank borrowings of approximately HK\$485.5 million. In addition, the Group had a loan from its shareholder of HK\$75 million. The bank borrowings are denominated in RMB and in US dollars, and are primarily used to finance the expansion project and the daily operation of Fuhuade Power Plant and are all borrowed at floating interest rate. The Group will make use of exchange forward contracts, when appropriate, to manage the risk of foreign exchange fluctuations. As at 31 December 2003, the Group had approximately HK\$13.9 million bank deposit pledged with the bank for the bank facilities. In addition, fixed assets amounting HK\$566.5 million was also pledged with the bank for the bank borrowings.

As at 31 December 2003, the Group had cash and cash equivalents amounted to HK\$362.7 million, which were denominated in Hong Kong dollars, RMB and US dollars.

A supplier filed an arbitration in August 2003 against Fuhuade Power Plant claiming for additional contract price in the amount of HK\$28,015,000. The arbitration is still in progress and the outcome of such cannot be ascertained. No provision for the amount claimed has been made by Group as at 31 December 2003. Save as the outstanding arbitration, the Group has no material contingent liabilities at the end of the financial year.

RIGHTS ISSUE OF SHARES AND PLACING OF SHARES

On 19 December 2002, the Board proposed a rights issue of shares in the proportion of three rights shares for every two existing shares at HK\$0.02 each. Sinolink, through its wholly owned subsidiary, acted as the underwriter of the rights issue. The total number of rights shares allotted was 5,448,368,349 shares, and the Company raised approximately HK\$106 million from the rights issue. The rights issue was completed on 6 March 2003.

Subsequent to the rights issue, the Company carried out a share reduction by consolidating every forty issued and unissued shares of the Company of HK\$0.01 each into one consolidated share of HK\$0.40 each, and by reducing the nominal value of each consolidated share from HK\$0.40 to HK\$0.01. The capital reduction was completed and be effective on 22 April 2003.

The credit arising from the capital reduction of approximately HK\$88.5 million was transferred to the contributed surplus account of the Company.

On 26 September 2003, the Company entered into a placing agreement with Guotai Junan Securities (Hong Kong) Limited, acting as the placing agent, to place 45,400,000 shares of the Company at a price of HK\$0.60 per placing shares. The Company raised approximately HK\$27.2 million from the placing of shares.

On 31 October 2003, the Board proposed another rights issue of shares in the proportion of nine rights shares for every five existing shares at HK\$0.40 each. Sinolink, through its wholly owned subsidiary, acted as the underwriter of the rights issue. The total number of rights shares allotted was 490,347,621 shares, and the Company raised approximately HK\$191 million from the rights issue. The rights issue was completed on 19 December 2003.

On 19 February 2004, the Board proposed an open offer of shares in the proportion of two offer shares for every existing share at HK\$0.40 each. Sinolink, through its wholly owned subsidiary, acted as the underwriter of the open offer as well. The total number of offer shares allotted was 1,525,525,936 shares, and the Company raised approximately HK\$600 million from the open offer. The open offer was completed on 19 April 2004.

The proceeds received from the rights issues and placing of shares are primarily for the expansion of Fuhuade Power Plant and further development of the Group's utility and energy business.

EMPLOYEE AND REMUNERATION POLICIES

The Group recognizes the importance of high calibre and competent staff and has a strict recruitment policy and performance appraisal scheme. Remuneration packages are largely in line with industry practice. Bonus and other merit payments are linked to the performance of the Group and of the individuals as incentive to optimize performance. In addition, share options have been granted to certain eligible directors and employees of the Group in accordance with the terms of the approved share option scheme adopted by the Group.