

## MANAGEMENT DISCUSSION AND ANALYSIS

### 1. DISCUSSION AND ANALYSIS OF OVERALL OPERATION IN THE REPORTING PERIOD

During the reporting period, the Company succeeded in grasping opportunities, overcoming difficulties, strengthening management, controlling costs vigorously and refining the product structure proactively despite fierce market competition, thereby easing the impact that rising prices of raw materials and other factors had on the Company, and enabling the Company to maintain stability and orderly progress in production and sales. During the reporting period, the Company recorded an income from sales of about RMB148,010,000, and a net profit of about RMB7,300,000. Net profit increased by 75.6% over the same period last year.

### 2. OPERATION DURING THE REPORTING PERIOD

#### (1) Principal business and its operation

##### 1. Principal business, industry and the status of the Company

The Company and its subsidiaries are the major base of manufacturing, research and export of electrical transmission and transformation equipment in China and the major supplier of electrical transmission and transformation equipment used for Three Gorges Project and electricity network transformation in cities and towns. The Company's principal business is the manufacture and sale of system protection and transmission equipment including power capacitors and closed busbars.

##### 2. Operating results for the reporting period

- (i) The Company recorded an income from principal operations of RMB148,008,208 and cost of principal operations of RMB111,064,263. Gross profit margin and net profit were 24.96% and RMB7,298,583 respectively.

Classification by business and product of products contributing over 10% (including 10%) to principal operations' income and profit:

Business / Product	Income from principal operations	Costs of principal operations	Gross profit margin (%)	Increase/ (decrease) in income from principal operations compared with last year (%)	Increase/ (decrease) in costs of principal operations compared with last year (%)	Unit: RMB
						Increase/ (decrease) in gross profit margin compared with last year (%)
Electric transmission and transformation	133,647,332	99,127,349	25.83	(59.38)	(54.76)	-7.57 percentage points
Accommodation, catering and entertainment	14,360,876	11,936,914	16.88	2.5	0.3	+1.8 percentage points
Of which: connected transactions	—	17,666,009	—	—	—	—
High voltage switch, circuit breaker	25,360,171	23,319,060	8.05	(89.55)	(85.67)	-24.9 percentage points
Power capacitor	95,168,724	65,816,886	30.84	30.66	36.25	-2.84 percentage points
Closed busbar	13,118,437	9,991,403	23.84	(3.11)	23.05	-16.19 percentage points

Pricing principle of connected transactions : Pricing is determined by reference to the fair market price

Description of the necessity and continuity of connected transactions : Geographical proximity and maintaining long-term relationships with suppliers

(1) Principal business and its operation (continued)

2. Operating results for the reporting period (continued)

Region of principal operations

Region	Income from principal operations	<i>Unit: RMB'000</i> Increase/(decrease) in income from principal operations compared with last year (%)
Domestic	14,673	(56.85)
Overseas	128	(83.67)

- (ii) Explanation for material changes in profit composition, principal business and its structure and profitability in the reporting period when compared with the previous reporting period.

Starting October 2003, Shenyang High-voltage Switchgears Company Limited, formerly a wholly-owned subsidiary, was excluded from the Company's scope of consolidation of financial statements and thus resulting in the material changes in the relevant indicators of principal operations when compared with the previous reporting period. In the meantime, profit composition in the reporting period did not include the gains arising from the disposal of part of the Company's interest in Shenyang High-voltage Switchgears Ltd. and Shenyang Guhe Cables Ltd.

- (iii) During the reporting period, there was no other operating activity that would have a significant impact on the Company's profit.

- (iv) Business nature, major products or services and net profit of investee companies with investment income contributing over 10% (including 10%) to the Company's net profit.

New Northeast Electric (Shenyang) High-voltage Switchgears Ltd. mainly engages in the manufacture and sale of totally closed composite electric appliances and high-voltage circuit breakers of 110KV or more. Its registered capital is US\$29,980,000 and its registered address is Hua Hai Road, Economic and Technological Development Zone, Shenyang. During the reporting period, that company, in which the Company holds a 20.8% stake, recorded a net profit of RMB28,560,000.

*Unit: RMB*

Name of investee company	:	New Northeast Electric (Shenyang) High-voltage Switchgears Ltd.
Investment income contributed for the period	:	5,940,000
Percentage of the Company's net profit	:	81%
Scope of business of investee company	:	Manufacture and sale of closed composite electrical appliances and high-voltage circuit breakers with voltage of 110KV and above
Net profit of investee company	:	28,560,000

- (v) Explanation for material changes in profit constituents

The material changes in the Company's profit from principal operations, expenses and indicators of operating profit were due to a change in the scope of consolidation. In the first half of the year, non-operating expenses included an anticipated debt amounting to RMB30,990,000 arising from external guarantee, and investment income included a gain on the disposal of a subsidiary of RMB47,390,000. This was the cause of the material changes in non-operating expenses and investment income when compared with last year.

**(1) Principal business and its operation (continued)**

2. Operating results for the reporting period (continued)

(vi) Problems and difficulties in operation and measures therefor

Despite that the State has carried out macro-economic control to constrain the rise in the price of raw materials, the Company will continue to face certain pressure and influence in its production and operation in the short term. To protect and raise its profitability under such difficult situation, the Company has taken the following measures:

- 1) Modifying its business mindset by shifting the focus to production cost, product mix and type instead of output;
- 2) Strengthening management, exercising a strict control over and reducing the purchasing cost and volume of raw materials, with the ultimate goal of reducing costs;
- 3) Restructuring the product mix and improving the production and sales of products with relatively high gross profit margin; and
- 4) Grasping opportunities and enhancing sales and marketing efforts to expand market share of products.

**3. INVESTMENT OF THE COMPANY**

**(1) The use of proceeds during the reporting period**

No proceed was used during the reporting period or used during the previous reporting period and subsisted in the reporting period.

**(2) The circumstances and actual progress for non-fundraising investment project**

1. Re-establishment of Northeast Electric (Hong Kong) Company Limited

As approved by the Ministry of Commerce of the State, the Company invested RMB7,460,000 in Northeast Electric (Hong Kong) Company Limited in 2003 in Hong Kong, representing 9% of its shareholdings. In accordance with relevant approval document, the Company re-incorporated a solely owned company in Hong Kong in April 2004. The name of this company remained as Northeast Electric (Hong Kong) Company Limited with a registered capital of US\$900,000 (the original name has been changed).

2. For details of other investments, please refer to item 1 “Asset Disposal and Acquisition” of the Section entitled “Significant Events”.

#### 4. ANALYSIS OF THE COMPANY'S FINANCIAL STATUS UNDER GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN HONG KONG

As at the end of the reporting period, the balance of monetary fund was RMB13,830,000.

There is no obvious seasonal principle in the Company's funding requirements.

The funds are mainly satisfied by 1) the cash flow from the Company's operation and capital operation and 2) the borrowings from financial institutions.

As at the end of the reporting period, the Company had bank loans amounting to RMB220,510,000, representing 21.21% of the total assets. These bank loans bear fixed interests.

The Company's asset to liability ratio was 38.61% (asset to liability ratio = total bank loans / total share capital and reserve X 100%).

As at the end of the reporting period, the Company had net assets of RMB37,270,000 used as security.

Please refer to Note 19 to the Financial Statements for details of the Company's contingent liabilities.

##### Staff

###### The Company's occupational structure is as follows:

Sales staff	:	133 persons
Technical staff	:	100 persons
Financial staff	:	60 persons
Administrative staff	:	206 persons
Production staff and others	:	806 persons

###### The Company's educational background is as follows:

Bachelor degree or higher	:	129 persons
College	:	357 persons
Technical certificate	:	787 persons
Others	:	32 persons

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Total : 1,305 persons

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As at the end of the reporting period, the Company had 1,305 staff members and 394 retirees, for whom the Company had to commit expenses.