

REPORT OF THE DIRECTORS



The Directors hereby present the annual report together with the audited financial statements of the Company and its subsidiaries (the "Group") for the financial year ended 31 December 2004.

PRINCIPAL ACTIVITIES

The Group is principally engaged in the generation and sale of electricity and heat. All electricity generated is supplied to the provincial grid companies where the plants are located.

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

The profit attained by the Group for the year ended 31 December 2004 and the position of the Group's and the Company's financial affairs as of that date prepared in accordance with IFRS are set out on pages 38 to 87 of the annual report.

DIVIDENDS

The Board recommended the payment of a final dividend of RMB0.035 per share (totalling approximately RMB210,738,000) for the financial year ended 31 December 2004 (2003: a final dividend of RMB0.035 per share, totalling approximately RMB183,963,000). This dividend distribution proposal is subject to the approval by the shareholders of the Company at the 2004 Annual General Meeting.

An interim dividend of RMB0.02 per share (totalling approximately RMB105,122,000) for the six months ended 30 June 2004 was distributed on 15 October 2004 (2003: an interim dividend of RMB0.02 per share, totalling approximately RMB105,122,000, was distributed on 26 September 2003).

RESOLUTIONS PASSED AT THE BOARD MEETINGS IN 2004

In 2004, the Board convened altogether 5 meetings, details of which are summarized as follows:

- (i) On 9 February 2004, the 14th meeting of the third session of the Board was convened and held in Jinan. The 12 directors were all eligible and attended the meeting with the 3 supervisors in present as non-voting participants. The meeting was held in compliance with the PRC Company Law and the Articles of Association of the Company. At the meeting, the following matters were considered, resolved and approved:
1. approving the proposal for establishment of Huadian International Shandong Materials Company Limited
 2. approving the proposal for establishment of Huadian International Shandong Project Management Company Limited
 3. approving the proposal for appointment of Sun Qingsong as the Deputy General Manager of the Company

REPORT OF THE DIRECTORS (*continued*)



- (ii) The 15th meeting of the third session of the Board was held and concluded in Beijing on 28 March 2004. All 12 directors attended the meeting in person or by proxy with the 3 supervisors in present as non-voting participants. The meeting was held in compliance with the PRC Company Law and the Articles of Association of the Company. At the meeting, the following matters were considered, resolved and approved:
1. approving the report of the General Manager
 2. approving the development report of the Company
 3. approving the reports on 2003 final accounts and financial budget for 2004
 4. approving the Company's 2003 profit distribution plan
 5. approving the proposed remuneration for independent directors
 6. approving the report of the Directors
 7. approving the Company's 2003 annual results announcement
 8. approving the proposal for reappointments of KPMG and KPMG Huazhen as the international auditors and domestic auditors of the Company for 2004
 9. approving the proposal in respect of the Company's A share issue
 10. approving the report in respect of the Company's continuing connected transactions and other connected transactions in 2003
 11. approving the proposal in respect of application to foreign banks for loans in US dollars
 12. approving the proposal in respect of establishment of the Company's Audit Committee and its working rules
 13. approving the proposal in respect of establishment of the Company's Remuneration Committee and its working rules
 14. approving the proposal in respect of establishment of the Company's Strategic Committee and its working rules
 15. approving the proposal in relation to examination and incentive mechanisms for senior management for 2003
 16. considering the proposal regarding the then possible acquisition of equity interests in Anhui Chizhou Jiu Hua Power Generation Company Limited from China Huadian Corporation
 17. approving the proposed amendments to the Articles of Association of the Company
 18. considering the proposal for convening the 2003 Annual General Meeting

REPORT OF THE DIRECTORS (*continued*)

- (iii) On 13 May 2004, the 16th meeting of the third session of the Board was convened in Jinan. The 12 directors were all eligible and attended the meeting in person or by proxy with the 3 supervisors in present as non-voting participants. The meeting was held in compliance with the PRC Company Law and the Articles of Association of the Company. At the meeting, the following matters were considered, resolved and approved:
1. considering and approving the proposal for the Company's A share issue
 2. considering and approving the proposal for the possible connected transaction in respect of the then proposed issue of shares to China Huadian Corporation pursuant to the Company's A share issue
 3. considering and approving the proposal in respect of the then proposed use of proceeds from the Company's A share issue
 4. considering and approving the proposal for amendments to the Articles of Association to accommodate the Company's A share issue
 5. considering and approving the proposal for the possible connected transaction between the Company and China Huadian Corporation regarding the then proposed acquisition of equity interests in Anhui Chizhou Jiuhua Power Generation Company Limited from China Huadian Corporation
 6. considering and approving the proposal in respect of annual remuneration scheme for General Manager and incentive and assessment measures for senior management for 2004
 7. proposing and approving the proposal for convening the Company's 2003 Annual General Meeting on 29 June 2004
- (iv) The 17th meeting of the third session of the Board was convened and concluded in Beijing on 17 August 2004. The 12 directors were all eligible and attended the meeting in person or by proxy with the 3 supervisors in present as non-voting participants. The meeting was held in compliance with the PRC Company Law and the Articles of Association of the Company. At the meeting, the following matters were considered, resolved and approved:
1. approving the proposal for submission of feasibility report on Zouxian Project Phase IV
 2. approving the proposal for submission of feasibility report on Qingdao Project Phase II
 3. approving the proposal for the preliminary work in respect of the Huadian Sichuan Luding Hydropower Station project
 4. approving the proposal for the Company's 2004 interim financial report
 5. approving the Company's 2004 interim results announcement
 6. approving the Company's interim dividend distribution plan for 2004
 7. approving the proposal for updating reporting documents to CSRC in respect of the Company's A share issue

REPORT OF THE DIRECTORS *(continued)*

- (v) On 16 November 2004, the 18th meeting of the third session of the Board was convened in Jinan. The 12 directors were all eligible and attended the meeting with the 3 supervisors in present as non-voting participants. The meeting was held in compliance with the PRC Company Law and the Articles of Association of the Company. At the meeting, the proposal for the then possible investment in Sichuan Luzhou Power Plant ("Luzhou Plant") was passed. The proposed investment by the Company for 40% equity interest in Luzhou Plant in respect of its construction of two 600MW generating units was approved, and the Company's General Manager was authorised to execute the relevant joint venture agreement, the articles of association and other relevant documents for incorporation of the joint venture. The preliminary preparation for the construction was also approved.

Details of the relevant transactions mentioned above which were proceeded with and/or completed in 2004 are set out in the section headed "Significant events" below.

SUBSIDIARIES, ASSOCIATED COMPANIES AND JOINTLY CONTROLLED ENTITY

Particulars of the Company's subsidiaries, associated companies and jointly controlled entity as at 31 December 2004 are set out in notes 18, 19 and 20 respectively of the financial statements prepared in accordance with IFRS included in this annual report.

BANK LOANS AND OTHER BORROWINGS

Details of bank loans and other borrowings of the Group and the Company as at 31 December 2004 are set out in note 26 of the financial statements prepared in accordance with IFRS included in this annual report.

INTEREST CAPITALISED

Details relating to the interest capitalized by the Group during the year of 2004 are set out in note 8 of the financial statements prepared in accordance with IFRS included in this annual report.

PROPERTY, PLANT AND EQUIPMENT

Details relating to movements in property, plant and equipment of the Group and those of the Company during the year of 2004 are set out in note 14 of the financial statements prepared in accordance with IFRS included in this annual report.

RESERVES

Details relating to movements in reserves of the Group and the Company for the year ended 31 December 2004 are set out in the consolidated statement of changes in equity and statement of changes in equity in the financial statements prepared in accordance with IFRS included in this annual report.

DONATIONS

During the year of 2004, the Group made donations for charitable purposes in an aggregate amount of approximately RMB2,570,900 (2003: RMB1,421,000).

EMPLOYEES' RETIREMENT PLANS

Details of the employees' retirement plans of the Group are set out in note 31 of the financial statements prepared in accordance with IFRS included in this annual report.

REPORT OF THE DIRECTORS *(continued)*

EMPLOYEES' MEDICAL INSURANCE

i) Basic medical insurance

Since 1 January 2003, the management of basic medical insurance has been transferred from the industry sector to the local government in accordance with “the Implementing Proposal to Establish the Basic Medical Insurance Rules for the Urban and Rural Employees in Shandong Province”, under the management of local governments, pursuant to which the basic medical insurance fund will be jointly contributed by the enterprise concerned and its staff. The employees are required to pay medical insurance fees calculated as 2% of their total wages of the previous year. The Group is required to pay such fees ranging from 6% to 8% of the total wages of its employees of the previous year according to the policies promulgated by the local government where the enterprise is situated. Such fees are paid out of the welfare fund.

ii) Supplementary corporate medical insurance

Apart from participating in the basic medical insurance, the Group began to establish supplementary corporate medical insurance for its staff from 1 January 2003 in accordance with “the Decision of the State Council regarding Establishment of the Basic Medical Insurance Rules for the Urban and Rural Employees”. The required fund is paid out of the welfare fee payable by the enterprise concerned as calculated as 4% of the total wages of employees of the previous year. Any shortfall in the welfare fees shall be directly charged to cost of production as costs of labour insurance fee.

The Group anticipates that implementation of the above medical insurance 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.

PRE-EMPTIVE RIGHTS

Under 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.



REPORT OF THE DIRECTORS (continued)

SHARE CAPITAL

Details of the share capital of the Company for the year 2004 and as at 31 December 2004 are set out in the Company's statement of changes in equity in the financial statements prepared in accordance with IFRS included in this annual report.

MAJOR CUSTOMERS AND SUPPLIERS

During the financial year of 2004, details regarding the percentages of the Group's sales and purchases attributable to its major customers and major suppliers, respectively, are as follows:

	Approximate Percentage of the Group's Sales	Approximate Percentage of the Group's Purchases
The largest customer	88.66%	
The five largest customers combined	99.59%	
The largest supplier		24.50%
The five largest suppliers combined		44.44%

All electricity generated by the Group was sold to Shandong Electric Power (Group) Corporation and Sichuan Province Power Company. 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 the five largest suppliers and customers of the Group at any time during the year.

SUBSTANTIAL SHAREHOLDERS

So far as the Directors are aware, each of the following persons, not being a Director, Supervisor, chief executive or member of the Company's senior management, had an interest or short position in the Company's shares or underlying shares (as the case may be) as at 31 December 2004 which would fall to be disclosed to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") under the provisions of Divisions 2 and 3 of Part XV of the Securities and Futures Ordinance (the "SFO"), or was otherwise, as at 31 December 2004, interested in 5% or more of any class of the then issued share capital of the Company, or was, as at 31 December 2004, a substantial shareholder (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules")) of the Company:

Name of shareholder	Type of shares	Number of shares held	Interest			Short position
			Approximate percentage of shareholding in the Company's total issued share capital as at 31 December 2004	Approximate percentage of shareholding in the Company's total issued domestic shares as at 31 December 2004	Approximate percentage of shareholding in the Company's total issued H shares as at 31 December 2004	
China Huadian Corporation	Domestic shares	2,815,075,430	53.56%	73.60%	—	—
Shandong International Trust and Investment Corporation	Domestic shares	903,443,970	17.19%	23.62%	—	—
HKSCC Nominees Limited (Notes)	H shares	1,420,471,900	27.02%	—	99.26%	See Note 5

REPORT OF THE DIRECTORS *(continued)*

Notes:

Based on the information available to and obtained by the Directors as at 31 December 2004, the information available on the website of the Stock Exchange and so far as the Directors are aware and understand, as at 31 December 2004 (in the order appearing on the Stock Exchange's website):

1. Among the 1,420,471,900 H shares held by HKSCC Nominees Limited, UBS AG had an interest in an aggregate of 143,395,900 H shares of the Company (representing approximately 10.02% of the then total issued H shares), out of which 143,395,900 H shares, 14,118,000 H shares (representing approximately 0.99% of the then total issued H shares) being held in the capacity as beneficial owner, with the remaining 129,277,900 H shares (representing approximately 9.03% of the then total issued H shares) being held in the capacity as investment manager. According to the information as disclosed in the website of the Stock Exchange and so far as the Directors understand, UBS AG held its indirect interests in the Company in the manner as follows:
 - (a) 8,204,000 H shares (representing approximately 0.57% of the Company's then total issued H shares) were held by UBS Global Asset Management (Americas) Inc, which in turn was 100% held by UBS AG;
 - (b) 35,070,000 H shares (representing approximately 2.45% of the Company's then total issued H shares) were held by UBS Global Asset Management (UK) Inc, which in turn was 100% held by UBS AG;
 - (c) 9,889,000 H shares (representing approximately 0.69% of the Company's then total issued H shares) were held by UBS Fund Services (Luxembourg) SA, which in turn was 100% held by UBS AG;
 - (d) 39,387,000 H shares (representing approximately 2.75% of the Company's then total issued H shares) were held by UBS Global Asset Management (Singapore) Limited, which in turn was 100% held by UBS AG;
 - (e) 1,040,000 H shares (representing approximately 0.07% of the Company's then total issued H shares) were held by UBS Global Asset Management (Hong Kong) Limited, which in turn was 100% held by UBS AG;
 - (f) 10,482,000 H shares (representing approximately 0.73% of the Company's then total issued H shares) were held by UBS Global Asset Management (Japan) Ltd, which in turn was 100% held by UBS AG.
2. Among the 1,420,471,900 H shares held by HKSCC Nominees Limited, Alliance Capital Management L.P. had, through controlled corporations, an interest in an aggregate of 129,812,000 H shares of the Company (representing approximately 9.07% of the then total issued H shares). According to the information as disclosed in the website of the Stock Exchange and so far as the Directors understand, 450,000 H shares (representing approximately 0.03% of the Company's then total issued H shares) were held by Alliance Capital Ltd, and Alliance Capital Ltd was 100% held by Alliance Capital Management Corporation of Delaware, which in turn was 100% held by Alliance Capital Management L.P.
3. Among the 1,420,471,900 H shares held by HKSCC Nominees Limited, Templeton Asset Management Limited had a direct interest in the capacity of investment manager in an aggregate of 124,576,000 H shares of the Company (representing approximately 8.71% of the then total issued H shares).
4. Among the 1,420,471,900 H shares held by HKSCC Nominees Limited, J.P. Morgan Chase & Co. had an interest in an aggregate of 115,575,400 H shares of the Company (representing approximately 8.08% of the then total issued H shares). Out of such 115,575,400 H shares, J.P. Morgan Chase & Co. had an interest in a lending pool comprising 111,669,400 H shares (representing approximately 7.80% of the then total issued H shares). According to the information as disclosed in the website of the Stock Exchange and so far as the Directors understand, J.P. Morgan Chase & Co. was, as at 31 December 2004, interested in the aforesaid 115,575,400 H shares of the Company in the manner as follows:

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- (a) 111,669,400 H shares (representing approximately 7.803% of the Company's then total issued H shares) were held in the capacity as custodian corporation/approved lending agent (in the lending pool) by JPMorgan Chase Bank, N.A., which in turn was apparently 100% held by J.P. Morgan Chase & Co.;
 - (b) 1,242,000 H shares (representing approximately 0.087% of the Company's then total issued H shares) were held in the capacity as beneficial owner by J.P. Morgan Whitefriars Inc., which in turn was apparently ultimately 100% held by J.P. Morgan Chase & Co.;
 - (c) 2,664,000 H shares (representing approximately 0.186% of the Company's then total issued H shares) were held in the capacity as investment manager by JF Asset Management Limited. JF Asset Management Limited was approximately 99.99% held by J.P. Morgan Fleming Asset Management (Asia) Inc., which in turn was apparently ultimately 100% held by J.P. Morgan Chase & Co.
5. Among the 1,420,471,900 H shares held by HKSCC Nominees Limited, Morgan Stanley had, through controlled corporations, an interest in an aggregate of 102,699,931 H shares of the Company (representing approximately 7.18% of its then total issued H shares). According to the information as disclosed in the website of the Stock Exchange and so far as the Directors understand, Morgan Stanley was, as at 31 December 2004, interested in the aforesaid 102,699,931 H shares of the Company in the manner as follows:
- (a) 75,452,000 H shares (representing approximately 5.273% of the Company's then total issued H shares) were held by Morgan Stanley Investment Management Company. Morgan Stanley Investment Management Company was ultimately 100% held by Morgan Stanley Asia Pacific (Holdings) Limited, which in turn was 90% held by Morgan Stanley International Incorporated, and Morgan Stanley International Incorporated was 90% held by Morgan Stanley;
 - (b) 306,000 H shares (representing approximately 0.021% of the Company's then total issued H shares) were held by Morgan Stanley Asset & Investment Trust Management Co., Limited, which was 100% held by Morgan Stanley International Incorporated, and Morgan Stanley International Incorporated was 90% held by Morgan Stanley;
 - (c) 17,498,000 H shares (representing approximately 1.223% of the Company's then total issued H shares) were held by Morgan Stanley & Co International Limited. Morgan Stanley & Co International Limited was ultimately 100% held by Morgan Stanley Group (Europe). Morgan Stanley Group (Europe) was approximately 98.30% held by Morgan Stanley International Limited, which in turn was 100% held by Morgan Stanley International Incorporated, and Morgan Stanley International Incorporated was 90% held by Morgan Stanley;
 - (d) 773,908 H shares (representing approximately 0.054% of the Company's then total issued H shares) were held by Morgan Stanley Capital Services, which in turn was 100% held by Morgan Stanley;
 - (e) 5,044,023 H shares (representing approximately 0.352% of the Company's then total issued H shares) were held by Morgan Stanley & Co. Incorporated, which in turn was 100% held by Morgan Stanley;
 - (f) 3,626,000 H shares (representing approximately 0.253% of the Company's then total issued H shares) were held by MSDW Equity Finance Services I (Cayman) Limited, which was in turn ultimately 100% held by Morgan Stanley.

According to the information as disclosed in the website of the Stock Exchange and so far as the Directors are aware and understand, as at 31 December 2004, Morgan Stanley also had a short position in 27,453,748 H shares of the Company (representing approximately 1.92% of its then total issued H shares), which was held as to 17,269,748 H shares by Morgan Stanley & Co International Limited, 6,558,000 H shares by Morgan Stanley & Co. Incorporated and 3,626,000 H shares by MSDW Equity Finance Services I (Cayman) Limited.

REPORT OF THE DIRECTORS (*continued*)

6. Among the 1,420,471,900 H shares held by HKSCC Nominees Limited, Allianz Aktiengesellschaft had an indirect interest in the capacity of investment manager in an aggregate of 73,728,000 H shares of the Company (representing approximately 5.15% of the then total issued H shares). According to the information as disclosed in the website of the Stock Exchange and so far as the Directors understand, such 73,728,000 H shares were held indirectly by Allianz Dresdner Asset Management Hong Kong Limited, and Allianz Dresdner Asset Management Hong Kong Limited was ultimately 100% held by Dresdner Bank Aktiengesellschaft, which in turn was, through Allianz Finanzbeteiligungs GmbH, approximately 80.62% held by Allianz Aktiengesellschaft.

Save as disclosed above, according to the records of HKSCC Nominees Limited and other information available to the Directors as at 31 December 2004, the other H shares held by HKSCC Nominees Limited were held by it on behalf of a number of other persons, and to the knowledge of the Directors, none of such persons individually was interested in 5% or more of the then total issued H shares of the Company as at 31 December 2004.

Save as disclosed above and so far as the Directors are aware, as at 31 December 2004, no other person (other than the Directors, Supervisors, chief executives or members of senior management of the Company) had an interest or short position in the Company's shares or underlying shares (as the case may be) which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO and as recorded in the register required to be kept under section 336 of the SFO, or was otherwise a substantial shareholder (as defined in the Listing Rules) of the Company.

SUFFICIENCY OF PUBLIC FLOAT

Based on information that is publicly available to the Company and within the knowledge of the Directors as at the latest practicable date prior to the issue of this annual report, the Directors believe that the Company has at all times during the year ended 31 December 2004 maintained the relevant applicable minimum percentage of listed securities as prescribed by Rule 8.08 of the Listing Rules.

DIRECTORS, SUPERVISORS, CHIEF EXECUTIVES AND SENIOR MANAGEMENT

The following table sets forth certain information concerning the Directors, Supervisors and senior management of the Company during the financial year of 2004. All Directors and Supervisors are currently serving a term of three years, renewable upon re-election and reappointment every three years.

Name	Position in the Company	Changes
He Gong	Chairman of the Board of Directors	
Da Hongxing	Vice Chairman of the Board of Directors	
Zhu Chongli	Vice Chairman of the Board of Directors	
Chen Jianhua	Director, General Manager	
Tian Peiting	Director	
Peng Xingyu	Director	
Zhang Bingju	Director	
Wang Yingli	Director	
Ding Huiping	Independent non-executive Director	
Zhao Jinghua	Independent non-executive Director	
Hu Yuanmu	Independent non-executive Director	
Wang Chuanshun	Independent non-executive Director	
Feng Lanshui	Chairman of the Supervisory Committee	
Li Changxu	Supervisor	
Zheng Feixue	Supervisor	
Zhou Lianqing	Company Secretary	
Zhong Tonglin	Deputy General Manager	
Sun Qingsong	Deputy General Manager	Appointed on 5 January 2004
Wang Wenqi	Deputy General Manager	
Zhu Fangxin	Chief Accountant and Chief Supervisor of Financial Affairs	

REPORT OF THE DIRECTORS (*continued*)

The Directors' and Supervisors' remuneration for the year ended 31 December 2004 are set out in note 9 of the financial statements prepared in accordance with IFRS included in this annual report.

As at 31 December 2004, none of the Directors, Supervisors, chief executives or members of senior management of the Company and their respective associates had any interest or short position in the shares, underlying shares and/or debentures (as the case may be) of the Company and/or any of its associated corporations (within the meaning of Part XV of the SFO) which was required to be notified to the Company and the Stock Exchange pursuant to the provisions of Divisions 7 and 8 of Part XV of the SFO (including interest and short position which any such Director, Supervisor, chief executive or member of senior management was taken or deemed to have under such provisions of the SFO) and was required to be entered in the register of interests required to be kept by the Company pursuant to section 352 of the SFO, or which was otherwise required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies as set out in Appendix 10 to the Listing Rules (which for this purpose shall be deemed to apply to the Supervisors to the same extent as it applies to the Directors).

During the year of 2004 and as at 31 December 2004, none of the Directors, Supervisors, chief executives or members of 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 (or its subsidiaries, holding company or subsidiaries of its holding company) had not made and was not a party to any arrangement enabling any of them, to subscribe for any share capital or debt securities of the Company or any other body corporate.

The biographical details in respect of the existing Directors, Supervisors and members of senior management of the Company, including essentially the particulars required under paragraph 12 of Appendix 16 to the Listing Rules (if and as applicable and appropriate), are set out on pages 32 to 35.

Each of the independent non-executive Directors has issued a confirmation in respect of the factors set out in Rule 3.13 of the Listing Rules concerning his independence pursuant to Rule 3.15 of the Listing Rules. The Company considers all of the independent non-executive Directors to be independent.

DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

No contract of significance or proposed contract of significance, to which the Company or any of its subsidiaries, holding company 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.

SERVICE CONTRACTS OF THE DIRECTORS AND SUPERVISORS

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

CONTINUING CONNECTED TRANSACTIONS

As disclosed in the Company's announcement dated 8 April 2003 and the Company's 2003 annual report, pursuant to the State's policy regarding restructuring of State-owned power assets, the then entire shareholding interest in the Company originally held by Shandong Electric Power (Group) Corporation ("SEPCO"), was transferred by way of administrative allocation on 1 April 2003 to China Huadian Corporation, and SEPCO is therefore 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 its subsidiaries, associated companies, and agencies and departments under its control cease to constitute connected transactions or continuing connected transactions of the Company. All transactions that have since then been, and may in future be, entered into between the Group and SEPCO and/or its group members are not, and will not constitute, connected transactions or continuing connected transactions of the Company.

REPORT OF THE DIRECTORS (*continued*)

The Company has not entered into any continuing connected transaction (within the meaning as provided for under Rule 14A.14 of the Listing Rules) during the year ended 31 December 2004. Any connected transaction of the Company involving financial assistance that took place in 2004 was in relation to financial assistance provided by connected person(s) for the benefit of the Group on normal commercial terms (or better to the Group) where no security over the assets of the Group was granted in respect of such financial assistance, and was, by virtue of Rule 14A.65(4) of the Listing Rules, exempt from the reporting, announcement and independent shareholders' approval requirements of Chapter 14A of the Listing Rules.

SIGNIFICANT EVENTS

1. Acquisition of 40% equity interest in Chizhou Company - connected transaction

On 29 June 2004, the Company entered into a share transfer agreement with China Huadian Corporation (the controlling shareholder of the Company), pursuant to which the Company has agreed to acquire from China Huadian Corporation its 40% equity interest in Chizhou Company for a consideration of RMB79,740,000 (approximately HK\$75,230,000). All of the conditions precedent set out in the share transfer agreement have been fulfilled. In accordance with the terms of the share transfer agreement approved by the relevant PRC authorities, the Company has fully paid the consideration for the acquisition to China Huadian Corporation.

Chizhou Company was established in the PRC in July 2003. As at 29 June 2004, Chizhou Company had a paid-up registered capital amounting to RMB192,000,000 (approximately HK\$181,100,000). It is owned as to 35%, 20% and 5%, respectively, by three other shareholders, namely, 安徽省能源集團公司 (Anhui Provincial Power Group Company), 申能(集團)公司 (Shenneng (Group) Company) and 安徽康源電熱有限公司 (Anhui Kangyuan Electricity and Heat Co-generation Company Limited), all of which are third parties independent of the Group.

Chizhou Company is located in the Anhui Province of the PRC, and is principally engaged in the electricity-generating business in the Anhui Province. The acquisition signifies that the Company continues to expand its business into other PRC provinces outside the Shandong Province, and reflects the support that China Huadian Corporation (as the Company's controlling shareholder) has been demonstrating in favour of the Company's developments.

As China Huadian Corporation is the controlling shareholder of the Company, the entering into by the Company of the share transfer agreement and the transactions thereunder constitutes a connected transaction of the Company for the purpose of the Listing Rules. The transaction falls within the provision under Rule 14A.32(1) of the Listing Rules, and is exempt from the independent shareholders' approval requirements under the Listing Rules.

Details of the acquisition are set out in the Company's announcement dated 30 June 2004.

2. Transactions entered into in 2003 and performed in 2004

As disclosed in the Company's announcement dated 9 May 2003, shareholders' circular dated 30 May 2003 and 2003 annual report, the Company entered into an acquisition agreement with China Huadian Corporation on 9 May 2003 for the acquisition of 80% equity interest in Guangan Company from China Huadian Corporation for a consideration of RMB475.50 million, which was determined by reference to the valuation of the net assets of Guangan Company as at 31 December 2002 and, under the acquisition agreement, shall be adjusted with reference to 80% of the difference between Guangan Company's audited net asset value as at 31 December 2002 and that as at the date of completion determined in accordance with the PRC Accounting Standards and Regulations. The terms of the acquisition agreement, together with all transactions thereunder, were approved by independent shareholders of the Company at its 2002 annual general meeting held on 24 June 2003. The adjusted consideration is RMB580.81 million, which has been fully paid by the Company in accordance with the acquisition agreement. The Company started to exercise effective control of Guangan Company from 1 January 2004, and Guangan Company has become a subsidiary of the Company since 1 January 2004.

As also mentioned in the Company's 2003 annual report, in December 2003, Qingdao Company (55% owned by the Company) entered into an agreement regarding the construction of Qingdao sea water desulphurisation project with China Huadian Engineering (Group) Corporation ("Huadian Engineering") and ALSTOM Power Norway AS for a total consideration of US\$5,790,000 (approximately RMB47,922,000), with the Group's share being in the amount of US\$3,184,500 (approximately RMB26,357,100.). In 2004, pursuant to the payment terms of the agreement, Qingdao Company paid an aggregate amount of RMB19,797,000 to Huadian Engineering.

Further details of these transactions are disclosed in the Company's 2003 annual report.

3. Establishment of a joint venture in Sichuan

On 20 December 2004, the Company entered into an agreement regarding the proposed establishment of a joint venture company, 四川瀘州川南發電有限責任公司 Sichuan Luzhou Chuannan Power Generating Company Limited, in Sichuan Province with certain independent third parties.

The joint venture will principally be engaged in the development and operation of an electricity plant, and the production and supply of electricity, in Sichuan Province. The electricity plant to be developed by the joint venture is expected to comprise two 600MW generating units in its first phase, with a total planned capacity of four 600MW generating units. The initial term of the joint venture is 25 years commencing from the date of issue of its business licence. The Company is expected to have a 40% equity interest in the joint venture. Under the agreement, the Company is required to contribute capital amounting to a total of RMB400 million towards the joint venture by way of instalments. The Company may make its capital contributions by cash or by injecting net assets into the joint venture. The joint venture is expected to arrange for banking facilities with financial institutions to satisfy its future development and other capital requirements.

The establishment of the joint venture is expected to strengthen and enhance the development of the Company's electricity-generating business in Sichuan Province. The agreement does not constitute a notifiable transaction of the Company under the Listing Rules.

Details of the agreement are set out in the Company's announcement dated 20 December 2004.

4. Adjustments to electricity tariff

Effective from 15 June 2004, the on-grid electricity tariff for power plants in Shandong Province where the Company operates has been increased by RMB1.5 per MWh (tax inclusive hereinafter), with utilisation hours of power generation being 5,500 hours under the authorised tariff. In addition, an extraordinary tariff amounting to RMB260 per MWh was adopted for electricity generated in excess of the utilisation hours of power generation under the authorised tariff.

Effective from 1 July 2004, the on-grid electricity tariff for the 2 x 300MW generating units of Guangan Company Phase I has been increased from RMB331.4 per MWh to RMB316.4 per MWh, and the utilisation hours of power generation under the authorised tariff were adjusted from 3,060 hours to 4,500 hours. Furthermore, under an approval granted to Guangan Company, the on-grid electricity tariff for its Phase II project was determined at RMB310 per MWh (including desulphurisation), with utilisation hours of power generation being 4,500 hours under the authorised tariff. In addition, an extraordinary tariff of RMB240 per MWh was adopted for electricity generated in excess of the utilisation hours of power generation under the authorised tariff.

REPORT OF THE DIRECTORS *(continued)*

Details of the adjustments are set out in the following table:

Electricity tariff unit: RMB/MWh

Power plants (generating units)	Approved adjustment to electricity tariff
Zouxian Plant, Shiliquan Plant and Laicheng Plant generating unit No. 1	From 336.40 to 337.90
Laicheng Plant generating units No. 2, 3 & 4	From 320.00 to 321.50
Zibo Company generating units No. 1 & 2	From 418.48 to 419.98
Zibo Company generating units No. 3 & 4	From 320.00 to 321.50
Tengzhou Company generating unit No. 1	From 373.13 to 374.63
Tengzhou Company generating units No. 2 & 3	From 320.00 to 321.50
Zhangqiu Company	From 320.00 to 321.50
Qingdao Company generating units No. 1 & 2	From 437.86 to 439.36
Weifang Plant	From 358.18 to 359.68
Guangan Company Phase I	From 331.40 to 316.40
Guangan Company Phase II (including desulphurisation)	At 310.00

5. Preferential income tax policies for Western Development Policy applicable to Guangan Company

According to the notice received by the Company from the relevant regulatory authorities in August 2004, Guangan Company (which is 80% owned by the Company) was, in accordance with the PRC Western Development Policy, was granted a tax concession to pay PRC income tax at a preferential rate of 15% with effect from year 2004.

6. Approval on project proposal for the two 300MW generating units of Qingdao Company Phase II Project by SDRC

The report on feasibility study of the expansion project in respect of the two 300MW heat and electricity co-generation coal-fired power generating units of Phase II of Qingdao Company (which is 55% owned by the Company) was approved by SDRC in March 2005.

7. Approval on project proposal of the two 600MW generating units of Guangan Company Phase III project

According to the SDRC approval in the respect of the project proposal for Guangan Company's Phase III project (which is 80% owned by the Company) received on 7 September 2004, Guangan Company has been approved to proceed to the next stage of its Phase III project.

According to the project schedule, two domestically produced subcritical coal-fired power generating units will be constructed in conjunction with installation of flue gas desulphurisation equipment.

8. Issue of A shares

The Company's A shares were listed on the Shanghai Stock Exchange on 3 February 2005. Pursuant to its A share issue, the Company issued 765,000,000 shares in January 2005 at an issue price of RMB2.52 per share. Out of such 765,000,000 shares, 196,000,000 shares were allocated and issued to China Huadian Corporation, which were in the form of unlisted State-owned shares and will not be listed until such time when the PRC government releases any new policy regulating the exchange trading of State-owned shares and legal-person shares. The remaining 569,000,000 shares issued under the Company's A share issue are listed A shares, representing approximately 9.45% of the Company's total enlarged issued share capital comprising 6,021,084,200 shares. Total proceeds raised from the A share issue amounted to RMB1,927,800,000.

REPORT OF THE DIRECTORS (continued)

As China Huadian Corporation is the controlling shareholder of the Company, the issue of 196,000,000 State-owned shares pursuant to the Company's A share issue to China Huadian Corporation constituted a connected transaction of the Company under the Listing Rules, which was duly approved by independent shareholders of the Company at its 2002 annual general meeting held on 24 June 2003 and 2003 annual general meeting held on 29 June 2004.

The shareholding structure of the Company immediately before and immediately upon the completion of its A share issue is set out as follows:

Type of shares	Immediately before completion of the A share issue	Approximate shareholding percentage (%)	Immediately upon completion of the A share issue	Approximate shareholding percentage (%)
1. Unlisted domestic shares				
Holder of State-owned shares —				
China Huadian Corporation	2,815,075,430	53.56	3,011,075,430	50.01
Other holders of unlisted domestic shares	1,009,980,770	19.21	1,009,980,770	16.77
Sub-total:	3,825,056,200	72.77	4,021,056,200	66.78
2. Listed shares				
A share shareholders	—	—	569,000,000	9.45
H share shareholders	1,431,028,000	27.23	1,431,028,000	23.77
Sub-total:	1,431,028,000	27.23	2,000,028,000	33.22
3. Total	5,256,084,200	100.00	6,021,084,200	100.00

Further details are set out in the Company's announcements dated 14 May 2004, 25 June 2004, 29 June 2004, 14 January 2005, 19 January 2005, 21 January 2005 and 28 January 2005 and its shareholders' circular dated 14 May 2004.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

During the financial year of 2004, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of its listed securities.

FINANCIAL SUMMARIES

Summaries of the results and the assets and liabilities of the Group for each of the five years ended 31 December 2004 prepared in accordance with IFRS are set out on page 88.

The Company is not aware of any matter taking place in the year ended 31 December 2004 that would be required to be disclosed under Rules 13.13 to 13.19 of the Listing Rules.

COMPLIANCE WITH THE CODE OF BEST PRACTICE

The Group has throughout the year of 2004 complied with the then applicable Code of Best Practice as set out in Appendix 14 to the pre-existing Listing Rules.

REPORT OF THE DIRECTORS (*continued*)

MATERIAL LITIGATION

The Group was not involved in any material litigation or arbitration during the financial year of 2004. As at 31 December 2004, no litigation or claim of material importance is known to the Directors to be pending or threatened by or against the Group.

DESIGNATED DEPOSITS AND OVERDUE MATERIAL DEPOSITS

As at 31 December 2004, none of the Group's deposits placed with financial institutions or other parties were designated or trust deposits or material deposits which could not be collected by the Group upon maturity.

AUDIT COMMITTEE

The audit committee of the Company has reviewed the financial statements for the year ended 31 December 2004 prepared under IFRS.

AUDITORS

The Company has not changed its auditors in any of the preceding three years. A resolution for the re-appointments of KPMG Huazhen and KPMG as statutory domestic auditors and international auditors of the Company, respectively, for the financial year of 2005 will be proposed at the 2004 Annual General Meeting.

On behalf of the Board

He Gong

Chairman

Jinan, Shandong Province, The People's Republic of China
22 March 2005