

Management Discussion and Analysis

PERFORMANCE REVIEW

The Group's total turnover grew by 3.4% to HK\$740.7 million (2003: HK\$716.5 million) which included additional fuel cost surcharge of HK\$12.3 million (2003: HK\$42.6 million). However, the total cost of sales grew more markedly by 17.0% to HK\$747.8 million (2003: HK\$639.3 million). As the relevant PRC parties of the Guangdong Provincial Government and the customer have not yet agreed and hence the Group has not yet recognized and received the amount of additional fuel cost surcharge for the year ended 31 December 2004, the Group suffered gross loss of HK\$7.0 million (2003: profit of HK\$77 million). Although administrative expense was contained at HK\$22.5 million (2003: HK\$22.5 million), loss from operations amounted to HK\$47.0 million (2003: profit of HK\$19.1 million). Finance cost continued to decline from the previous HK\$26.4 million to HK\$20.9 million. Loss from operating activities before taxation widened to HK\$67.9 million (2003: HK\$7.3 million) and loss per share further widened from the previous 2.1 Hong Kong cents to 6.7 Hong Kong cents.

OPERATIONAL REVIEW

Market Development

During the year, Foshan Municipality experienced sustained electricity demand growth as a result of the sustained strong growth of economic activities of Guangdong Province, PRC. Despite the increased power supplies from the provincial grid, electricity supply shortage persisted. Shakou Power Plant and other local power plants in Foshan Municipality had to operate at maximum capacity during peak load demand periods. However, operating environment remained extremely difficult as fuel oil price surged to new high levels during the year as a result of the movements in international oil price. On-grid tariff adjustment remained inflexible under the strict control of the relevant authorities of the Guangdong Provincial Government. During the year, a number of newly built power plants in the Province commenced operation. In particular, a new thermal power plant named Funeng Power Plant, operated by Funeng Power Supply Co., Ltd. ("Funeng JV"), was built in Foshan Municipality in close proximity to the Group's existing power generating facilities. Funeng JV, a Sino-foreign equity joint-venture established in the PRC, is controlled by the Group's PRC joint-venture partner. Funeng Power Plant has a total installed capacity of approximately 360 megawatts; the first phase of 180 megawatts had already commenced production in late 2004 while the second phase of 180 megawatts is expected to commence production in mid-2005. Due to the expected strong growth of electricity demand of Foshan Municipality in the coming years, the Group considered that Funeng Power Plant would not be in immediate and direct competition with the Groups' existing business. The Group believed that by adopting a cooperative business strategy towards Funeng Power Plant, the Group could foster further opportunities for future cooperation.

Electricity Sales

The Group increased its electricity sales volume by 7.7% to approximately 1.54 billion (2003: 1.43 billion) kilowatt-hours. All the electricity produced was primarily sold to the Group's sole customer, 廣東省廣電集團有限公司佛山供電分公司 (Guangdong Guan-dian Power Grid Group Co. Ltd., Foshan Branch), for onward sales and transmissions to end-users in Foshan Municipality, Guangdong Province, the PRC. The Group's on-grid tariff remained unchanged throughout the year. The average plant utilization rate for the year improved to 59% (2003: 54%). No major incident of mechanical breakdown or operational failure was recorded.

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Fuel Oil Price

During the year, international oil price continued to hike and fuel oil prices hovered at new high levels. With the support of its fuel oil suppliers, the Group continued its strategic bulk-purchasing policy and was able to sustain a less marked increase as compared with market magnitude in fuel oil cost. The weighted average cost of heavy oil consumed by Shakou JV for the year therefore increased by 8.2% from the previous Renminbi 1,798 to Renminbi 1,946 per tonne.

Additional Fuel Cost Surcharge

The Group continued its strategy to reduce the full impact of increased fuel oil cost on its performance by negotiating with the relevant PRC parties of the Province and the customer for additional fuel cost surcharge. During the year, the Group received additional fuel cost surcharge for the fourth quarter of 2003 of an aggregate amount of HK\$12.3 million. As such additional fuel cost surcharge was confirmed and received after the approval date of the Group's accounts for 2003, the amount had been accounted for in the Group's accounts for this year. The total amount of additional fuel cost surcharge for the year 2003 was therefore HK\$54.9 million. However, as up to the date of this report, the relevant PRC parties of the Guangdong Provincial Government and the customer have not yet agreed and hence the Group has not yet recognized and received the amount of additional fuel cost surcharge for the year ended 31 December 2004. Barring unforeseen circumstances, the Group believed that such additional fuel cost surcharge would be finalized and received in 2005.

Facility Lease Agreement

On 30 July 2004, Shakou JV and Funeng JV entered into the Facilities Lease Agreement, pursuant to which Funeng JV agreed to lease from Shakou JV certain assets (including office premises, factory premises, land-use rights and auxiliary power generation facilities) for two years commencing from 30 July 2004, the date of the Facilities Lease Agreement. The consideration is to be satisfied in cash by two annual payments of RMB4.8 million (equivalent to approximately HK\$4.5 million) each. Details of the transaction have already been disclosed in the Company announcement dated 2 August 2004.

FINANCIAL REVIEW

Liquidity and Financial Resources

The Group funded its operation largely by internal cash inflow generated from its operating activities. However, net cash outflow from operating activities amounted to HK\$46.5 million (2003: inflow of HK\$177.2 million) mainly due to the increased net loss and the increased trade receivables. Net cash generated from investing activities amounted to HK\$0.9 million (2003: HK\$1.0 million). During the year, the Group repaid other loans of an aggregate amount of HK\$87.8 million (2003: HK\$71.4 million) and bank loans of HK\$50.5 million (2003: HK\$168.4 million), partly re-financed by proceed from new bank borrowings of HK\$97.3 million (2003: HK\$162.8 million). As a result, net cash used in financing activities amounted to HK\$76.4 million (2003: HK\$125.9 million). Total cash and cash equivalents as at balance sheet date therefore decreased significantly from HK\$220.3 million to HK\$98.3 million.

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As at balance sheet date, the Group's total current assets amounted to HK\$296.2 million (2003: HK\$295.6 million), which mainly comprised of cash and cash equivalents of HK\$98.3 million (2003: HK\$220.3 million); and trade and other receivables of HK\$179.8 million (2003: 56.8 million). Total current liabilities amounted to HK\$180.1 million (2003: HK\$251.2 million), which mainly comprised of trade and other payables of HK\$132.1 million (2003: HK\$123.0 million); current portion of long-term loans of HK\$ nil (2003: HK\$65.3 million); and a short-term bank loan of HK\$46.8 million (2003: HK\$50.5 million). Net working capital surplus amounted to HK\$116.1 million (2003: HK\$44.4 million). Current ratio moderately increased from the previous 1.18 to 1.64. Net debts (total interest-bearing short-term debts and long-term debts less cash) grew 34.4% to HK\$316.2 million (2003: HK\$235.2 million).

Committed Banking Facilities

As at 31 December 2004, the Group had available committed banking facilities from three PRC banks for an aggregate amount of HK\$196.5 million (2003: HK\$196.5 million). At 31 December 2004, the outstanding balance of a short-term Renminbi bank loan was HK\$46.8 million (2003: HK\$50.5 million) and the bank loan bears interest at an annual rate of 4.779% (2003: 4.536%). The Group also had three three-year term bank loans the aggregate outstanding balance of which amounted to HK\$78.6 million (2003: HK\$28.1 million) and the loans all bear interest at annual rate of 4.941% (2003: 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 2004, the Group's power generating facilities of an aggregate amount of HK\$1.1 billion (2003: HK\$1.2 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 2004, the Group had contingent liabilities of approximately HK\$43 million (2003: 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 continued to finance 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 9.2% to HK\$367.6 million (2003: HK\$404.9 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\$289.0 million (2003: HK\$376.8 million); and (2) three three-year Renminbi term loans due to three PRC banks of aggregate amount of HK\$78.6 million (2003: HK\$28.1 million). 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% (2003: 5.76%) per annum. During the year, the Group made partial payment of HK\$87.8 million (2003: HK\$71.4 million).

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Furthermore, Shakou JV negotiated with its PRC joint-venture partner and its associate to reschedule current portions of the long-term loans due for repayments in 2005 of an aggregate amount of HK\$93.7 million (2003: 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 31.2% to 29.8%.

Net Assets

The Group's net assets amounted to HK\$1.39 billion (2003: HK\$1.46 billion). The net book value of goodwill arising from acquisition of subsidiaries was HK\$578.3 million (2003: HK\$609.9 million). Net assets per share decreased from the previous HK\$1.76 to HK\$1.68 while net tangible assets per share decreased slightly from the previous level of approximately HK\$1.03 to HK\$0.98.

Exchange Risk

During the year, 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.

Employees and Remuneration Policies

As at year end, the Group employed a total of approximately 198 (2003: 198) staff excluding executive directors. Remuneration packages principally comprised salary and performance bonuses based on individual merits. The Group's total employee remuneration for the year was approximately HK\$21.4 million (2003: HK\$21.4 million).

SITU Min
Chief Financial Officer

HE Haochang
Chairman and Managing Director

Hong Kong, 14 April 2005