Management Discussion and Analysis of Financial Condition and Results of Operations

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The following discussion and analysis should be read together with the audited financial statements and related notes of the Group set out in this report for this year.

(I) Overview

For the year ended 31 December 2005, the profit before income tax of the Group was RMB22.095 billion, representing an increase of 65.6% as compared to that of 2004. The profit attributable to equity shareholders of the Company was RMB15.632 billion, representing an increase of 75.0% as compared to that of 2004. Basic earnings per share of the Company was RMB0.937. Profits of both our coal and power segments achieved historic highs in 2005. The increase in profit was primarily due to the Group's ability to capitalise in a timely manner on the high demand and prices in the coal market and by expanding our mining activities to raise coal production and the adoption of marketing measures to boost coal sales as well as the increase in power output dispatch, consolidation of corporate management and our devotion to the innovation of technology and management techniques in our power segment.

The comparison between the year ended 31 December 2005 and the year ended 31 December 2004:

(II) Combined Results of Operations

1. Operating Revenues

Operating revenues increased 33.0% from RMB39.267 billion for the year ended 31 December 2004 to RMB52.242 billion for the year ended 31 December 2005. The increase was primarily due to (1) increases in the price as well as the production and sales of coal; and (2) implementation of the policy of indexing power tariff to coal prices, resulting in an increase in the average on-grid tariff.

2. Cost of Revenues

Cost of revenues increased 18.4% from RMB21.222 billion for the year ended 31 December 2004 to RMB25.119 billion for the year ended 31 December 2005. The increase was primarily due to (1) the increase in commercial coal production and sales volume as well as gross power generation/total power output dispatch; (2) increases in expenses in purchasing coal from third parties, personnel expenses, repairs and maintenance; and (3) the corresponding increase in amount of depreciation and amortisation as a result of the increase in average balance of fixed assets.

3. Materials, Fuel and Power

Materials, fuel and power increased 30.8% from RMB4.452 billion for the year ended 31 December 2004 to RMB5.821 billion for the year ended 31 December 2005. The increase was primarily due to (1) the increase in prices of coal purchased from third parties; and (2) the enhanced throughput of our self-owned rail lines and ports resulting in the increased consumption of power.

4. Personnel Expenses

Personnel expenses increased 30.8% from RMB1.564 billion for the year ended 31 December 2004 to RMB2.046 billion for the year ended 31 December 2005. The increase was primarily due to our improved operating results in 2005 and the corresponding increase in personnel wages and benefits as well as adjustments to our employee composition which resulted in an increase in personnel expenses.

1. Mr. Wu Yuan, President
2. Shendong Mines and coal loading station

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increased our bank deposits resulting in an increase in interest income of RMB0.194 billion; (2) the weakening of the exchange rate of Japanese Yen to Renminbi resulted in a foreign exchange gain of RMB0.987 billion. Meanwhile, this caused a loss of RMB0.368 billion in the fair value of our swap contracts; and (3) the weakening of exchange rate of Hong Kong Dollars to Renminbi caused a foreign exchange loss of RMB0.368 billion in the proceeds from our IPO.

5. Depreciation and Amortisation

Depreciation and amortisation increased 8.1% from RMB4.795 billion for the year ended 31 December 2004 to RMB5.182 billion for the year ended 31 December 2005. The increase was primarily due to increases in investments in fixed assets and average balance of fixed assets which resulted in an increase in provisions for depreciation and amortisation.

6. Repairs and Maintenance

Repairs and maintenance increased 24.0% from RMB2.146 billion for the year ended 31 December 2004 to RMB2.660 billion for the year ended 31 December 2005. The increase was primarily due to the conduct of overhaul of coal mining equipment and change of rail tracks.

7. Transportation Charges

Transportation charges increased 11.8% from RMB5.557 billion for the year ended 31 December 2004 to RMB6.215 billion for the year ended 31 December 2005. The increase was primarily due to the increase of contributions to port construction fund as well as higher national rail freight rates which resulted in an increase in transportation charges of coal.

8. Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 32.0% from RMB2.492 billion for the year ended 31 December 2004 to RMB3.289 billion for the year ended 31 December 2005. The increase was primarily due to the increase in selling, general and administrative personal expenses and taxes such as business tax.

9. Profit from Operations

Profit from operations increased 52.8% from RMB15.499 billion for the year ended 31 December 2004 to RMB23.684 billion for the year ended 31 December 2005.

10. Net Financing Costs

Net financing costs decreased 12.6% from RMB2.358 billion for the year ended 31 December 2004 to RMB2.060 billion for the year ended 31 December 2005. The decrease in financing costs was primarily due to (1) the proceeds from our IPO which

11. Profit before Income Tax

Profit before income tax increased 65.6% from RMB13.339 billion for the year ended 31 December 2004 to RMB22.095 billion for the year ended 31 December 2005.

12. Income Tax

Income tax increased 47.2% from RMB2.773 billion for the year ended 31 December 2004 to RMB4.083 billion for the year ended 31 December 2005. The increase was primarily due to an increase in taxable income.

13. Profit attributable to equity shareholders of the Company

Profit attributable to equity shareholders of the Company increased 75.0% from RMB8.935 billion for the year ended 31 December 2004 to RMB15.632 billion for the year ended 31 December 2005.

The Group conducts the production, sales and transportation of coal as well as power generation and related activities through two main business segments: coal segment and power segment.

(III) Coal Segment

1. Operating Revenues

Operating revenues increased 40.6% from RMB32.371 billion for the year ended 31 December 2004 to RMB45.500 billion for the year ended 31 December 2005. The increase was primarily due to the increases in coal prices, the volume of production and sales of coal. The average coal price of the Group in 2005 was RMB305 per tonne, marking an increase of RMB60 per tonne, or 24.5% as compared to RMB245 per tonne in the previous year.

Revenues from sales to external customers increased 40.8% from RMB29.369 billion for the year ended 31 December 2004 to RMB41.344 billion for the year ended 31 December 2005. The increase was primarily due to the increases in coal prices and the sales volume of coal.

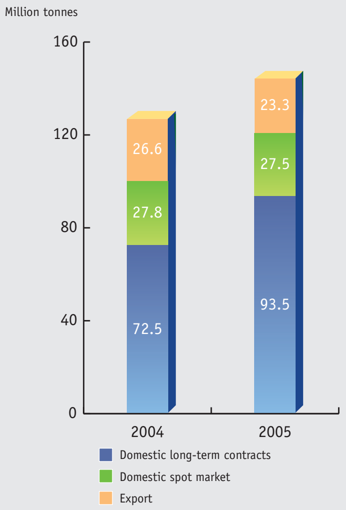
Revenues from sales by our coal segment to our power segment increased 38.4% from RMB3.002 billion for the year ended 31 December 2004 to RMB4.156 billion for the year ended 31 December 2005. The increase was primarily due to the increases in coal prices and the sales volume of coal.

The following table shows the sales volume of coal in 2005:

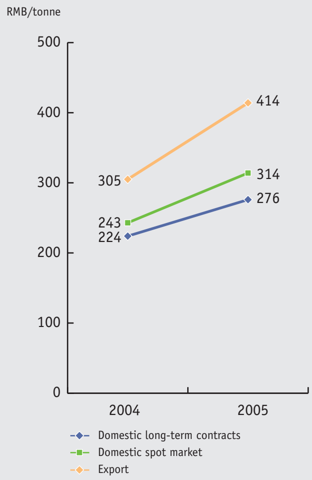
Coal sales by market in 2005	Sales volume *Million tonnes*	Percentage of sales volume %	Sales price *RMB/tonne*
Total domestic sale/weighted average price	121.1	83.9	285
Long-term contract sales volume/weighted average price	93.5	77.3	276
Mine mouth	2.1	2.2	132
Direct arrival (along rail lines)	32.4	34.7	208
Seaborne (FOB)	59.0	63.1	318
Spot market sales volume/weighted average price	27.5	22.7	314
Mine mouth	3.8	13.8	93
Direct arrival (along rail lines)	5.8	21.1	298
Seaborne (FOB)	17.9	65.1	367
Export sales/price	23.3	16.1	414
Total coal sales/weighted average price	**144.4**	**100.0**	**305**

1. Loading station
2. Kangjiatan Mine in Shendong Mines

Coal Sales

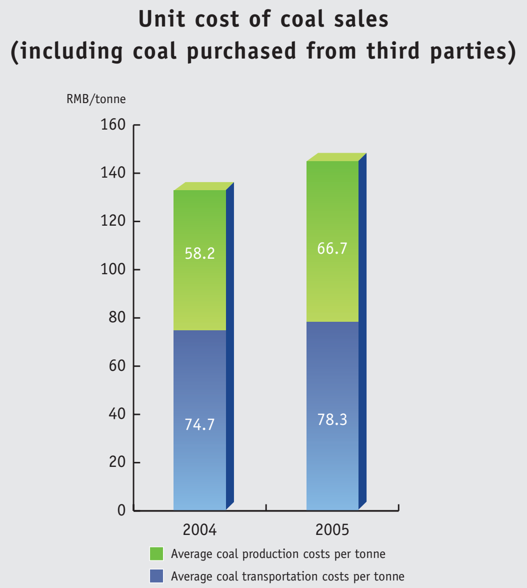


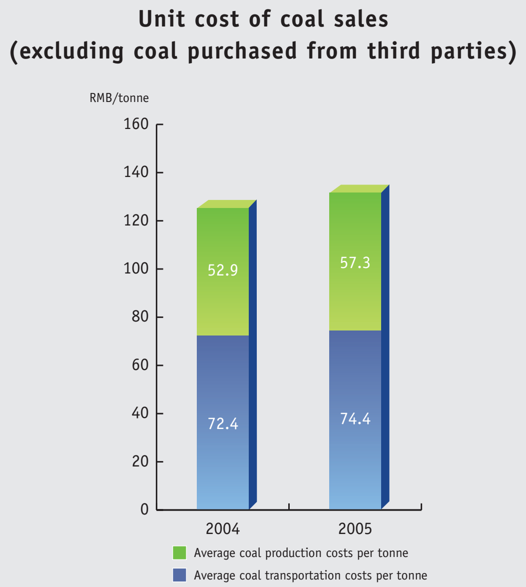
Coal Prices



The total sales volume increased from 126.9 million tonnes in 2004 to 144.4 million tonnes in 2005, of which domestic sales increased by 20.8 million tonnes, from 100.3 million tonnes in 2004 to 121.1 million tonnes in 2005. Export sales decreased by 3.3 million tonnes from 26.6 million tonnes in 2004 to 23.3 million tonnes in 2005. The weighted average price of coal increased from RMB245 per tonne in 2004 to RMB305 per tonne in 2005. The increase was primarily due to the increase of the weighted average prices for domestic and export sales from RMB229 per tonne and RMB305 per tonne in 2004 to RMB285 per tonne and RMB414 per tonne in 2005 respectively.

For the domestic sales, sales volume from long-term contracts increased from 72.5 million tonnes in 2004 to 93.5 million tonnes in 2005. Spot market sales volume decreased from 27.8 million tonnes in 2004 to 27.5 million tonnes in 2005. The weighted average prices of long-term contracts and spot market sales increased from RMB224 per tonne and RMB243 per tonne in 2004 to RMB276 per tonne and RMB314 per tonne in 2005 respectively.





	2005			2004		
	Sales volume	Percentage of sales volume	Sales price	Sales volume	Percentage of sales volume	Sales price
Coal sales by customer	*Million tonnes*	*%*	*RMB/ tonne*	*Million tonnes*	*%*	*RMB/ tonne*
Sales to external customers	**128.0**	**88.6**	**312**	111.7	88.0	251
Domestic sales to external customers	**104.6**	**81.8**	**290**	85.1	76.2	235
Export sales	**23.3**	**18.2**	**414**	26.6	23.8	305
Domestic sales to our power operations	**16.4**	**11.4**	**253**	15.2	12.0	198
Total coal sales/weighted average price	**144.4**	**100.0**	**305**	126.9	100.0	245

1. Overburden removing equipment at Zhunge'er mines

2. Cost of Revenues

Cost of revenues increased 22.3% from RMB17.810 billion for the year ended 31 December 2004 to RMB21.777 billion for the year ended 31 December 2005. The increase was primarily due to (1) increase in coal prices which resulted in a rise in the amount expended in purchasing coal from third parties; and (2) increases in fees for coal preparing for better environmental protection as well as the increase in payments for surface restoration.

The table below sets out the unit cost of coal sales per tonne:

	2005		2004	
Unit cost of coal sales	Including coal purchased from third parties *RMB/tonne*	Excluding coal purchased from third parties *RMB/tonne*	Including coal purchased from third parties *RMB/tonne*	Excluding coal purchased from third parties *RMB/tonne*
Average cost of coal sales per tonne	**145.0**	**131.7**	132.9	125.3
Average coal production costs per tonne	**66.7**	**57.3**	58.2	52.9
Average coal transportation costs per tonne	**78.3**	**74.4**	74.7	72.4

Average cost of coal sales per tonne in 2005 (excluding coal purchased from third parties) increased from that of 2004 by only RMB6.4. Such cost can generally be controlled. Average cost of coal sales per tonne in 2005 (including coal purchased from third parties) increased from that of 2004 by RMB12.1. This was mainly caused by the increase in prices of coal purchased from third parties.

3. Profit from Operations

Profit from operations increased 67.8% from RMB12.695 billion for the year ended 31 December 2004 to RMB21.301 billion for the year ended 31 December 2005.

(IV) Power Segment

1. Operating Revenues

The operating revenues increased 10.2% from RMB9.938 billion for the year ended 31 December 2004 to RMB10.951 billion for the year ended 31 December 2005. The increase was primarily due to the increase in total power output dispatch of the Group and the weighted average tariff. The weighted average tariff of RMB274.4 per MWh for the year ended 31 December 2004 increased 7.3% to RMB294.4 per MWh for the year ended 31 December 2005.

The table below sets out the status of power segment in 2005 and 2004:

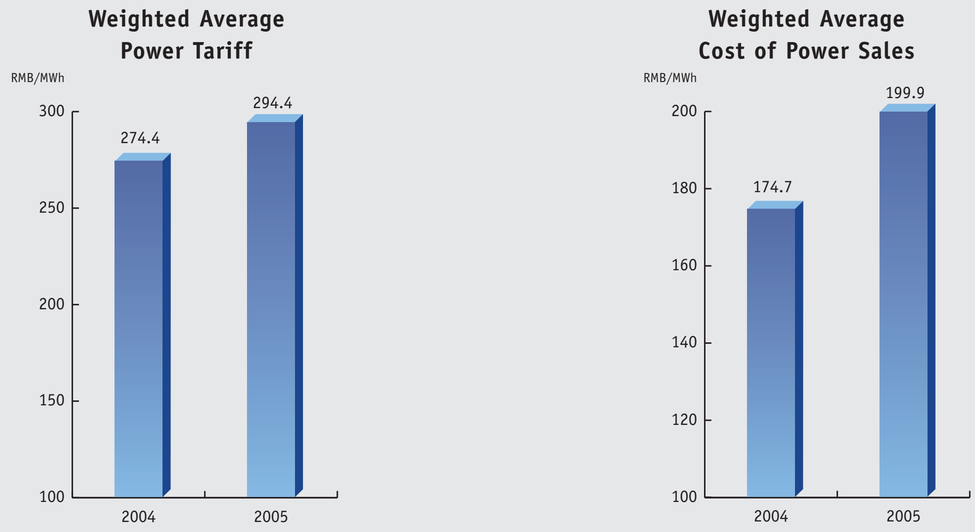
2005

Operating power plants	Power tariff *RMB/MWh*	Cost of power sales *RMB/MWh*	Fuel cost *RMB/MWh*	Standard coal price *RMB/tonne*
Beijing Thermal	**357**	**198.6**	**99**	**317.2**
Panshan Power	**325**	**210.9**	**117**	**353.9**
Sanhe Power	**297**	**194.7**	**112**	**344.6**
Taishan Power	**359**	**231.0**	**145**	**453.6**
Suizhong Power	**273**	**215.0**	**135**	**406.2**
Guohua Zhunge'er	**202**	**135.9**	**62**	**192.6**
Ninghai Power*	**309**	**N/A**	**134**	**446.7**
Zhunge'er Power	**170**	**135.9**	**58**	**128.4**
Shenmu Power	**223**	**152.5**	**64**	**161.3**
Weighted average	**294.4**	**199.9**	**118.3**	**358**

* In December 2005, Phase I of Ninghai Power, a 600MW unit, commenced commercial operation.

2004

Operating power plants	Power tariff *RMB/MWh*	Cost of power sales *RMB/MWh*	Fuel cost *RMB/MWh*	Standard coal price *RMB/tonne*
Beijing Thermal	334	178.32	82	265.4
Panshan Power	298	104.10	95	277.2
Sanhe Power	275	177.41	90	270.8
Taishan Power	340	191.92	126	380.5
Suizhong Power	264	193.02	109	327.8
Guohua Zhunge'er	186	104.10	48	125.4
Zhunge'er Power	162	131.60	53	116.0
Shenmu Power	217	106.99	26	61.7
Weighted average	274.4	174.70	94.7	268



2. Cost of Revenues

Cost of revenues increased 16.8% from RMB6.446 billion for the year ended 31 December 2004 to RMB7.531 billion for the year ended 31 December 2005. The increase was primarily due to the increase in coal prices resulting in an increase in fuel costs.

3. Profit from Operations

Profit from operations decreased 10.0% from RMB2.912 billion for the year ended 31 December 2004 to RMB2.622 billion for the year ended 31 December 2005.

(V) Liquidity and Financial Resources

For the year ended 31 December 2005, the principal financial resources of the Group were cash from operating activities, short-term and long-term borrowings and the proceeds from IPO. The funds of the Group were mainly used in operating activities, capital expenditure, repayments of short-term and long-term borrowings and dividends distribution to Shenhua Group.

(VI) Cash Flow from Operating Activities

For the year ended 31 December 2005, net cash from operating activities of the Group increased 27.2% from RMB18.934 billion for the year ended 31 December 2004 to RMB24.088 billion for the year ended 31 December 2005. This was primarily due to an increase in sales revenues.

(VII) Cash Flow Used in Financing Activities

The table below sets out the net borrowings of the Group as at 31 December 2005 and 31 December 2004:

	As at 31 December	
	2005	2004
	RMB million	*RMB million*
Short-term borrowings and current portion of long-term borrowings	**9,443**	13,857
Long-term borrowings, less current portion	**39,933**	46,332
Total borrowings	**49,376**	60,189
Less:		
Cash and cash equivalents	**19,825**	7,138
Time deposits with original maturity over three months	**66**	55
Net borrowings	**29,485**	52,996

The long-term borrowings were repayable as follows:

	As at 31 December	
	2005	2004
	RMB million	*RMB million*
Within one year or on demand	**3,692**	5,616
After one year but within two years	**6,154**	4,950
After two years but within five years	**14,739**	21,869
After five years	**19,040**	19,513
Total	**43,625**	51,948

As at 31 December 2005, 87% of the total amount of outstanding borrowings of the Group was in Renminbi, 12% of its borrowings in Japanese Yen and 1% of its borrowings in US Dollars.

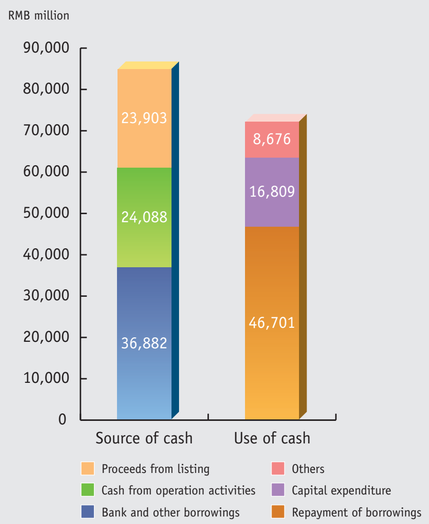
As compared with the year ended 31 December 2004, the Group had an increase of 203.2% in net cash from financing activities for the year ended 31 December 2005. This was primarily due to the net proceeds of RMB23.903 billion from the IPO of the Company and an increase in the net repayment amount from the previous year.

As at 31 December 2005, none of the Group's borrowings were secured.

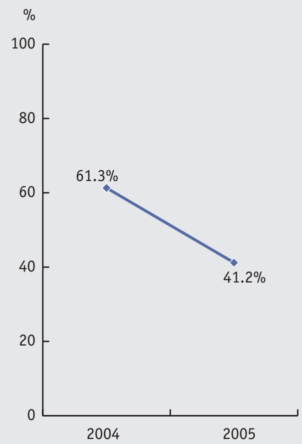
(VIII) Total Debt Capitalisation Ratio

As at 31 December 2005, the total debt capitalisation ratio of the Company decreased 20 percentage points from 61.3% as at 31 December 2004 to 41.2% as at 31 December 2005. The total debt capitalisation ratio = [long-term interest-bearing debt + short-term interest-bearing debt (including bills payable)]/(total debt + total equity).

2005 Cash Utilisation



Total Debt Capitalisation Ratio



(IX) Significant Investments

For the year ended 31 December 2005, the Group had no new significant external investments.

(X) Significant Acquisitions and Disposals

For the year ended 31 December 2005, the Group had no significant acquisitions and disposals.

(XI) Exchange Rate Risk

Since 21 July 2005, China has adopted a managed floating exchange rate regime based on market demand and supply with reference to a basket of currencies. The People's Bank of China administers and regulates the exchange rate of Renminbi taking into account domestic and foreign economic and financial conditions.

The Company and most entities whose accounts are consolidated in the financial statements use Renminbi as their reporting currency. The fluctuation of Renminbi has advantages and disadvantages to the Company. The appreciation of Renminbi against the US Dollars reduced the cost of imported equipment and accessories, and decreased the cost of repayment of debts in foreign currencies. On the other hand, it brought down the turnover of our exported coal. The overall effect was positive.

(XII) Commodity Value Risk

The Group engages in coal production and sales and power generation business. The worldwide coal market is affected by various factors such as international politics, economy, military affairs and supply and demand. The Chinese coal market is affected by supply and demand, transportation capacity and safety conditions. Reduction in domestic and international coal prices will adversely affect the Group's financial performance.

(XIII) Industry Risk

Consistent with the operational activities of other Chinese coal companies and power generation companies, the Company's operations are under the supervision of the PRC government in respect of industry policy, project approval, issue of licences, industry special tax, environmental protection and safety standards, etc. Therefore, the Company may be restricted in its business development or profit enhancement. Certain future policies regarding coal and power industry made by the PRC government may also affect the operations of the Company.

(XIV) Contingent Liabilities

As at 31 December 2005, the status of the Group's contingent liabilities was as follows:

1. Bank Guarantees

As at 31 December 2005, the Group had the following guarantees for bank loans, which are not expected to result in significant liability.

Bank guarantees	As at 31 December 2005 *RMB million*	2004 *RMB million*
Associates	**310**	130
Third parties	**–**	109
Total	**310**	239

As at 31 December 2005, no asset of the Group was encumbered.

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2. Environmental Protection Responsibility

The Group has been operating in China for many years. China has implemented comprehensive environmental protection regulations which affect our coal and power generation business. It is not clear what future environmental protection legislation will be enacted but legislation in future may have a material impact on us. However, the management of the Group believes that, other than that accounted for in the financial statements, no environmental protection liability that may adversely affect the Group's financial condition currently exists.

3. Contingent Legal Liabilities

As at 31 December 2005, the Group was not involved in any material litigation or arbitration. To the best knowledge of the Company, the Group had no material litigation or claim which was pending, or threatened against the Company. As at 31 December 2005, the Group was the defendant of certain non-material litigation as well as the plaintiff of some other litigation arising from the ordinary course of its business. The likely outcome of these contingent liabilities, litigation and other legal proceedings is not certain. However, the management of the Group believes any possible legal liability which may be incurred will not have a material adverse effect on the Group's financial condition.

4. Group's Insurance

Consistent with what we believe is the customary practice for PRC coal mining entities, for the year ended 31 December 2005, the Group had not maintained fire, liability or other property insurance covering our property, equipment or inventory in our coal operations. We maintain business interruption insurance or third-party liability insurance for personal injuries or environmental damages arising from accidents on our property or relating to our operations for certain of our power plants and for our vehicles. In relation to our transportation operations, we carry property insurance for our freight rail cars, and we carry vehicle insurance at our Huanghua Port. Besides, in accordance with requirement of relevant regulations, the Group maintained insurance for its employees against occupational injury, medical treatment, third party liability and unemployment.

The Group insured all of its operating power plants against property losses, lost profits, damages in plant and equipment, employee injuries and third party liability. Consistent with our understanding of China's industry practices, the Group did not carry insurance for risks relating to our power plants that are under construction.

The Group will continue to review and assess its risk portfolio and make necessary and appropriate adjustments to our insurance cover based on its needs and industry practice with respect to insurance in China.

1. Greening and reclamation of mines