Discussion and Analysis of the Group's Performance

OVERVIEW ON ELECTRICITY GENERATION BUSINESS

During the year ended 31 December 2005, the Group's on-grid electricity amounted to 2,233 million kwh of electricity, representing an increase of 52% as compared to 1,473 million kwh over last year. As a result, the turnover of on-grid electricity increased by 53% to HK$1,292 million. This increase was mainly due to (i) the increase in power generation capacity: completion of third and fourth combined cycle generating units which commenced commercial production in September 2004 and May 2005 respectively and (ii) continuation of the increased demand for electricity in the Guangdong Province during the year. In December 2005, the Group was equipped with a total installed capacity of 665,000 kilowatts, an increase of 1.4 times over the installed capacity of last year.

The direct operating expenses attributable to electricity supplies increased by 71% to HK$1,141 million due to the increase in electricity generation and escalating fuel cost, which was primary direct operating expense. During the year, the Group incurred a total fuel cost of HK$1,072 million.

The staggering high world crude oil price had significantly affected the price of the heavy oil during the second half of the year so as to put the Group's power generation business under enormous pressure. Despite the fact that the management had contributed a lot of efforts towards improving productivity and continued to strengthening of fuel procurement and inventory control in order to minimize the impact of higher fuel cost to the Group, the gross profit margin of power generation for the year was decreased by 15.9% as compared to last year.

The Group had receive a compensation of high fuel cost from Shenzhen Power Supply Bureau in an amount of HK$9 million and HK$51 million for the power generation during the period from January 2005 to April 2005 and from May 2005 to August 2005 respectively, and the Group is still in discussion with Shenzhen Power Supply Bureau regarding the compensation amount for the period from September 2005 to December 2005.

The management of the Group expects the current price level of heavy oil will sustain for a period of time. Therefore the power plant is undergoing conversion which allows natural gas, which is expected to be a significantly cheaper source of fuel with substantial less pollution, to be used as an alternative. The management of the Group expects in 2006 two 180 MW power generator units will be modified to burn natural gas as an additional energy source, making these two units unique with dual-fuel firing capability. In addition, it will provide greater flexibility to the power plant to select a cheaper source of fuel in the future. In view of the location of the Group's power plant is in close proximity to the Guangdong Liquefied Natural Gas Terminal, which is expecting to be completed in 2006, the Group's power plant is in an advantageous position to change from heavy oil to natural gas.

Discussion and Analysis of the Group's Performance

OVERVIEW ON GAS BUSINESS

On 2 June 2005, the Group completed the acquisition of 58.45% shareholding interests in Panva Gas for a consideration of HK$1,753 million payable by issuing new Enerchina shares at HK$0.69 per share. Panva Gas is a listed company on the main board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") and it is principally engaged in the sale and distribution of LP Gas and natural gas (together "Gas Fuel") in the PRC including the sale of LP Gas in bulk and in cylinders, the provision of piped LP Gas and natural gas, construction of gas pipelines, the operation of city gas pipeline network, the operation of Gas Fuel automobile refilling stations, and the sale of LP Gas and natural gas household appliances. Subsequent to the acquisition, the Group had through various on market purchased an aggregate of 19,935,000 shares of Panva Gas for a total consideration of HK$62.3 million, equivalent to an average of HK$3.124 per share, representing approximately 2.1% of the issued share capital of Panva Gas. As the results of the acquisition and various on market purchases, the Group is currently holding approximately 60.42% shareholding interests in Panva Gas.

As the acquisition was completed on 2 June 2005, these financial statements had consolidated the results of Panva Gas from 2 June 2005 up to 31 December 2005.

For the period from the date of acquisition to 31 December 2005, Panva Gas recorded a turnover of HK$1,529 million and an attributable profit to shareholders of HK$65 million. In 2005, Panva Gas achieved to acquire new projects and further strengthened its piped gas business in Sichuan and the northeastern PRC region while increased its market penetration in the Guangdong province. A total of seven projects were secured during the year comprising piped gas distribution and gas pipeline construction in cities which including Jianyang in the Sichuan province, Tieling, Chaoyang and Benxi in the Liaoning province, and Shaoguan and Qingyuan in the Guangdong province.

EXCEPTIONAL GAIN

In the first half of 2005, the Group had completed a disposal of its 41% equity interests in Xin Hua Control for a consideration of US$24 million, which was equivalent to approximately HK$183 million. The Group recorded a gain of HK$96 million from the disposal. Xin Hua Control is principally engaged in the business of manufacture and sale of control systems for power plants and large scale manufacturing plants. The Directors are of the view that the disposal is the sale of non-core business and it is in the interest of the Group.

FINANCIAL POSITION

The Group's total borrowings increased from HK$1,306 million as at 31 December 2004 to HK$3,285 million as at 31 December 2005. The increase of the total borrowings was mainly due to the consolidation of the total borrowings of Panva Gas after the acquisition.

The total borrowings were mainly comprised of bank and other loans amounted to HK$1,248 million, and convertible bonds and notes amounted to HK$2,036 million. The bank borrowings are mainly used to finance the expansion of the power plant in Shenzhen and the convertible bonds and notes are used for the expansion of piped gas business in the PRC. The Group's gearing ratio, measured by net borrowings (after deducting cash and bank balances of HK$1,580 million) over shareholders' funds increased from 19% to 46%.

Discussion and Analysis of the Group's Performance

Total assets pledged in securing these loans had a net book value of HK$852.3 million as at 31 December 2005. All the bank borrowings of the Group are at floating rates and denominated in both Renminbi and United States dollars. The Group operation is mainly carried out in the PRC, substantial receipts and payments in relation to the operations are denominated in Renminbi. No financial instruments were used for hedging purpose other than the interest rate swaps entered into by Panva Gas. However, the Board will continue to evaluate and monitor the potential impact of the appreciation of Renminbi to the Group and manage the risks of using different financial instruments.

The Group's cash and cash equivalents amounted to HK$1,580 million, which including pledged deposits of HK$243 million, as at 31 December 2005 and mostly denominated in Renminbi, Hong Kong dollars and United States dollars.

OUTLOOK

As the Group's fourth generator with an installed capacity of 180,000 kilowatts was completed and commenced in May 2005, which has brought the Group's total installed capacity to 665,000 kilowatts. The Group expects with the increased in installed capacity and together with the growth in power consumption in the Guangdong province, the power plant will further increase the power output in 2006. However, the Group sees the power sector in the PRC still a challenge in 2006 as the heavy oil price is still a major determinant of the Group's power sector profitability and the Group considers that the heavy oil price may not come down significantly in the near future. In addition, under the current electricity supply regime of the PRC, the Group cannot transfer the additional fuel cost to its customer and we can only receive partial compensation from the PRC government for the additional fuel cost. In view of this situation, we will continue to undergo the gas conversion of the power plant which allows natural gas, which is expected to be a significantly cheaper source of fuel with substantial less pollution, to be used as an alternative. The Group will continue to strengthen its remedial policies to mitigate the effect of the rising fuel cost and reduce the operating costs and enhance overall efficiency. The Group also has put a significant expansion plan in place to increase the power generation capacity, which will be mainly powered by natural gas, from the Group's existing total installed capacity of 665,000 kilowatts to 1,450,000 kilowatts.

Panva Gas will continue to expand its piped gas business in the PRC and currently there are seven other major LP Gas projects have reached final stages and are expected to be conducted in 2006. The Board considers that the acquisition of Panva Gas will provide a long term and reliable income base for Enerchina.

The Group will continue to explore the opportunities to expand into the coal gasification business and the clean energy sector of the PRC. With the extensive gas distribution network of Panva Gas in the PRC, the management of the Group strongly believes it will provide synergies and logistic support for the development of Enerchina's possible future coal gasification business in the PRC.

MAJOR EVENT

On 23 June 2005, Goodunited Holdings Limited ("Goodunited"), an indirect wholly owned subsidiary of Enerchina, seized the opportunity to maximize the benefit from the Group's electricity operations by entering into an agreement with Shenzhen Huishen Electric Power Company Limited ("Shenzhen Husihen") to purchase 30% registered capital of Shenzhen Fuhuade Electric Power Co., Limited ("Shenzhen Fuhuade") for a total consideration of Renminbi 250 million, which was equivalent to approximately HK$234 million. The acquisition was completed on 29 July 2005.

Discussion and Analysis of the Group's Performance

CAPITAL COMMITMENTS

As at 31 December 2005, the Group had capital commitments in respect of the acquisition of property, plant and equipment not provided in the financial statements amounted to HK$146 million.

CONTINGENT LIABILITIES

A supplier filed an arbitration in August 2003 against Shenzhen Fuhuade claiming for additional contract price in the amount of HK$28 million. The arbitration is still in progress and the outcome of such cannot be ascertained. No provision for the amount claimed has been made by the Group as at 31 December 2005. Save as the outstanding arbitration, the Group had no material contingent liabilities as at 31 December 2005.

FINAL DIVIDEND

The Board has recommended a final dividend of HK$0.01 (2004: HK$0.035) per Share in respect of the year ended 31 December 2005. Upon approval by the shareholders of the Company at the forthcoming annual general meeting ("AGM"), the final dividend will be paid on or before Tuesday, 6 June 2006 to shareholders whose names appear on the register of members of the Company on Monday, 29 May 2006.

CLOSURE OF REGISTER OR MEMBERS

The register of members will be closed from Thursday, 25 May 2006 to Monday, 29 May 2006, both days inclusive, during which period no transfer of shares will be registered. In order to qualify for the proposed final dividend, all completed transfer forms with share certificates must be lodged with the Company's Hong Kong Registrar and Transfer Office, Computershare Hong Kong Investor Services Limited, Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:00 p.m. on Wednesday, 24 May 2006.

PURCHASE, SALE AND REDEMPTION OF THE COMPANY'S LISTED SECURITIES

There was no purchase, sale or redemption of the listed securities of the Company by the Company or any of its subsidiaries during the year.

AUDIT COMMITTEE

The audit committee of the Company ("Audit Committee") was established in accordance with the requirements of the Listing Rules for the purposes of reviewing and providing supervision over the Group's financial reporting process and internal controls. The Audit Committee comprises three independent non-executive Directors. The members of the Audit Committee are Messrs. Lu Yungang, Davin A. Mackenzie and Xin Luo Lin. The Audit Committee meets regularly with the Company's senior management and the Company's auditors to consider the Company's financial reporting process, the effectiveness of internal controls, the audit process and risk management.

The annual results of the Group for the year ended 31 December 2005 had been audited by the Company's auditors, Deloitte Touche Tohmatsu, and had been reviewed by the Audit Committee.

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APPRECIATION

On behalf of the Board, I would like to take this opportunity to express my appreciation to the staff and management team of the Group for their contribution during the year and also to give my sincere gratitude to all our shareholders for their continual support all these years.

By Order of the Board

OU Yaping
Chairman

Hong Kong, 24 April 2006