

Directors' Report

The board of directors of the Company (the "Board") is pleased to present the report of the Board of Directors, together with the audited financial statements of the Group for the year ended 31 December 2006.

Principal Activities

The principal activities of the Group include production, transportation and sales of coal as well as power generation in the PRC. The coal business involves developing and operating coal mines, producing and processing coal, and transportation and sale of coal products. The power generation business involves the use of coal sourced internally as well as from external suppliers to generate power for sale primarily to power grid companies.

Structure of Share Capital

The table below sets out the structure of the share capital of the Company as at 31 December 2006:

Types of shares	Number of shares	Proportion (%)
Domestics shares	14,691,037,955	81.21
H shares	3,398,582,500	18.79
Total	18,089,620,455	100.00

Results of Operation

The financial results of the Group for 2006 are set out in the section "Financial Statements" of this report.

Dividends

On 23 March 2007, the Board proposed to distribute dividends of RMB0.34 per share in respect of the period between 1 January 2006 and 31 December 2006 to all equity shareholders of the Company. The proposed distribution of dividends will be considered and approved at the shareholders' annual general meeting to be held on 15 May 2007. The dividends will be paid to shareholders whose names appear on the register of members at the close of business on 14 April 2007. The register of members will be closed from 14 April 2007 to 14 May 2007 (inclusive), during which period no transfer of shares will be registered. In order to qualify for the dividends, all transfer documents must be lodged together with the relevant share certificates, at Computershare Hong Kong Investor Services Limited (address: Rooms 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong) no later than 4:30 p.m. on 13 April 2007.

Pursuant to Articles 168 and 169 of the Articles of Association of the Company, the Company shall declare dividends in Renminbi. Dividends of domestic shares shall be paid in Renminbi while dividends of H Shares shall be paid in Hong Kong Dollars. The value of Hong Kong Dollars shall be calculated on the basis of the average exchange rate of Renminbi and Hong Kong Dollars announced by the Bank of China five working days before the date of declaration of dividends by the shareholders' annual general meeting on 15 May 2007. The final dividends for 2006 will be paid on or about 20 June 2007.

Major Customers and Suppliers

The largest external customer and the five largest external customers of the Company accounted for approximately 8.3% and 24.3% respectively of the Company's revenues for the year ended 31 December 2006.

For the year ended 31 December 2006, the total amount of purchases made by the Company from its five largest suppliers amounted to RMB7,721 million, and accounted for 26.0% of the total purchases for the year. The amount of purchases from the largest supplier amounted to RMB3,502 million, and accounted for 11.8% of the total purchases for the year. As far as the Company is aware, none of the directors, their associates and shareholders who are interested in more than 5% of the share capital of the Company has any interest in the five largest suppliers and external customers.

Purchase, Sale or Repurchase of Shares of the Company

For the year ended 31 December 2006, none of the Company and any of its subsidiaries had purchased, sold or repurchased any securities (as defined in the Listing Rules) of the Company.

Minimum Public Float

The public float of the Company satisfies the requirement in Rule 8.08 of the Listing Rules.

Property, Plant and Equipment

Additions to the property, plant and equipment of the Group for the year ended 31 December 2006 totalled RMB32,290 million. Details of movements are shown under note 15 of the section "Financial Statements" of this report.

Distributable Reserves

As at 31 December 2006, the aggregate amount of reserves which is available for distribution to the equity shareholders of the Company was RMB14,975 million.

Shareholding of Substantial Shareholders

Details are set out in the section "Corporate Governance Report" of this report.

Directors and Supervisors' Interests in the Share Capital of the Company

Details are set out in the section "Corporate Governance Report" of this report.

Staff Retirement Plan

In accordance with applicable laws and regulations, the Company participated in various retirement plans organised by municipal and provincial governments for employees. Details are set out in note 36 of the section "Financial Statements" of this report.

Remuneration

In compliance with the Code on Corporate Governance Practices as set out in Appendix 14 to the Listing Rules, the Company has established a Remuneration Committee to formulate remuneration policies and determine and manage the remuneration of the Company's senior management.

Service Contracts

The Company has entered into service contracts with all its directors and supervisors for a period of three years. None of the directors or supervisors has entered into any service contract with the Company which is not determinable within one year without any compensation (other than the statutory compensation).

The directors, supervisors and senior management of the Company receive remuneration in the form of salaries, bonuses, housing allowances and other benefits-in-kind, including contributions to pension plans.

Remuneration of the Directors and Supervisors

Details of the remuneration of the Company's directors and supervisors are set out in note 10 of the section "Financial Statements" of this report.

Share Appreciation Rights Scheme

In 2006, the Company granted share appreciation rights to its senior management and staff holding key positions in accordance with its Share Appreciation Rights Scheme. 3.235 million shares were granted to 50 members of the senior management and staff holding key positions, representing 0.1% of the total 3.399 billion shares issued overseas as foreign-invested shares (H shares). The grant was approved by the shareholders at the shareholders' annual general meeting for 2005.

Management Contracts

Other than the service contracts of the management officers of the Company, the Company has not entered into any contract with any individual, firm or body corporate to manage or administer the whole or any substantial part of any business of the Company.

Donations

The Group contributed a total of RMB94 million as charitable and other donations for the year ended 31 December 2006.

Subsidiaries

Details of the principal subsidiaries of the Company are contained in note 18 of the section "Financial Statements" of this report.

Connected Transactions

The following are the key connected transactions of the Group in 2006:

Exempted Connected Transactions

Non-competition Agreement

The Company entered into a Non-competition Agreement with Shenhua Group on 24 May 2005. Pursuant to this agreement, Shenhua Group agreed not to compete with us in our core business and granted us options and pre-emptive rights to acquire the business retained by Shenhua Group and certain future businesses from Shenhua Group.

For the year ended 31 December 2006, except for the matters disclosed in the announcement of the Company dated 10 March 2006, the directors including independent non-executive directors has not made any decisions as to whether to exercise the options.

Non-exempted Continuing Connected Transactions

The following table sets out details of annual caps and actual transaction amounts during 2006, in respect of the continuing connected transactions of the Group which were subject to independent shareholders' approval, reporting and announcement requirement:

Connected transactions and parties	Expenses		Revenues	
	Amount incurred RMB million	Cap RMB million	Amount incurred RMB million	Cap RMB million
Export Agency Agreement with Shenhua Group (three years from 1 January 2005)	67.04	94.40	–	–
Agency Sales Agreement for the Xisanju Companies with Shenhua Group (three years from 1 January 2005)	–	–	11.86	14.90
Mutual Provision of Production Supplies and Ancillary Services Agreement with Shenhua Group (three years from 1 January 2005)	939.54	992.70	146.19	153.00
Mutual Supply of Coal Agreement with Shenhua Group (three years from 1 January 2005)	1,420.78	1,869.10	991.85	1,734.50
Zhonglian Supply Agreement with Zhonglian Energy (three years from 1 January 2005)	242.31	700.00	1.20	38.90
Dingzhou Coal Supply Agreement with Hebei Province Development and Investment Company (three years from 1 January 2005)	–	–	738.41	899.80
Power Supply Agreement with North China Power Grid, the State Power Grid Corporation and their several non-wholly owned subsidiaries (see "Power Purchase Arrangement")	–	–	11,313.41	19,100.00
Properties Leasing Agreement with Shenhua Group (three years from 1 January 2005)	40.83	51.00	–	0.80
Financial Services Agreement with Shenhua Finance Company Limited (from 21 July 2006 to 31 December 2007)	–	–	2,973.82 ¹	3,400.00 ²

Notes:

1. Actual maximum daily balance in 2006.
2. The cap represents the deposit with Shenhua Finance which is the average maximum daily balance.

(1) Export Agency Agreement

In respect of the export sales of our coal products by Shenhua Trading, we entered into an export agency agreement dated 24 May 2005 ("Export Agency Agreement") with Shenhua Group for the export by Shenhua Trading of our coal products for a period of three years from 1 January 2005. Pursuant to the Export Agency Agreement, we appointed Shenhua Trading as our non-exclusive agent for the export of our coal products.

For the year ended 31 December 2006, the annual cap was RMB94.40 million, and the Group paid a total of RMB67.04 million as agency fees to Shenhua Group.

(2) Agency Sales Agreement for the Xisanju Companies

Shenhua Group entered into an agency sales agreement dated 24 May 2005 (the "Agency Sales Agreement") with us and our subsidiary, Shenhua Inner Mongolia Coal Transportation and Sales Co., Ltd. The term of the Agency Sales Agreement is three years commencing from 1 January 2005 and is renewable on our request. Pursuant to the Agency Sales Agreement, we were appointed as the exclusive agent in the PRC for the sale of all the thermal coal produced by Shenhua Wuda Mining Company Limited, Shenhua Haibowan Mining Company Limited and Shenhua Baotou Mining Company Limited (each a subsidiary of Shenhua Group and collectively referred to as "Xisanju Companies") and the non-exclusive agent for the sale of the coking coal produced by the Xisanju Companies.

For the year ended 31 December 2006, the annual cap was RMB14.90 million, and the agency sales fee of coal received by the Group from Xisanju Companies was RMB11.86 million.

(3) Mutual Provision of Production Supplies and Ancillary Services Agreement

Shenhua Group entered into an agreement on 24 May 2005 with us for the mutual provision of production supplies and ancillary services. This mutual supply agreement is for a term of three years commencing from 1 January 2005 and may be renewed upon mutual agreement by both parties.

For the year ended 31 December 2006, (1) the annual cap was RMB992.70 million, and the Group paid a total of RMB939.54 million as agency fees to Shenhua Group for its provision of production supplies and ancillary service; and (2) the annual cap was RMB153.00 million, and the Group received RMB146.19 million for provision of products and services to Shenhua Group.

(4) Mutual Supply of Coal Agreement

Shenhua Group entered into an agreement on 24 May 2005 with us for the mutual provision of coal ("Mutual Supply of Coal Agreement"). The term of this agreement is for three years commencing from 1 January 2005 and may be renewed upon agreement by both parties.

For the year ended 31 December 2006, (1) the annual cap was RMB1,869.10 million, and the Group paid a total of RMB1,420.78 million in respect of Shenhua Group's provision of coal to the Group; and (2) the annual cap was RMB1,734.50 million, and the Group received RMB991.85 million for its provision of coal to Shenhua Group.

(5) Zhonglian Supply Agreement

We entered into an agreement with Shenhua Zhonglian Energy Holdings Co., Ltd., (“Zhonglian Energy”) dated 24 May 2005. Zhonglian Energy holds a 25% equity interest in our non-wholly owned subsidiary, Shuozhou Shenhua Tengda Coal Cleaning and Selection Co., Ltd. (“Shenhua Tengda”). Zhonglian Energy also holds a 70% equity interest in Shenhua Zhonglian Shuozhou Coal Company (“Zhonglian Shuozhou”). According to the Listing Rules, Zhonglian Energy is our connected person as it is a substantial shareholder of one of our subsidiaries and Zhonglian Shuozhou is also our connected person by reason of it being an associate (as defined in the Listing Rules) of Zhonglian Energy. Zhonglian Shuozhou supplies coal to one of our subsidiaries, Shenhua Changyun High Technology Coal Blending Co., Ltd. (“Changyun Coal Blending”). Shenhua Tengda supplies coal preparation services to Zhonglian Shuozhou. The term of the Zhonglian Supply Agreement is for three years commencing from 1 January 2005.

For the year ended 31 December 2006, (1) the annual cap was RMB700.00 million, and the Group paid RMB242.31 million to Shenhua Group for provision of coal by the subsidiaries of Zhonglian Energy; and (2) the annual cap was RMB38.90 million, and the Group received RMB1.20 million for provision of coal preparation services to the subsidiaries of Zhonglian Energy.

(6) Dingzhou Coal Supply Agreement

We hold a 51% equity interest in Hebei Guohua Cangdong Power Co., Ltd., one of the equity holders of which is Hebei Province Development and Investment Company, which also holds a 40.5% interest in Hebei Guohua Dingzhou Power Co., Ltd. (“Dingzhou Power Company”). One of our subsidiaries, Beijing Guohua Logistics Company Limited supplied coal to Dingzhou Power Company. According to the Listing Rules, Hebei Province Development and Investment Company is our connected person and Dingzhou Power Company is also our connected person by reason of it being an associate (as defined in the Listing Rules) of Hebei Province Development and Investment Company. We entered into a coal supply agreement on 24 May 2005 for supply of coal to Dingzhou Power Company. The term of the agreement is for three years commencing from 1 January 2005.

For the year ended 31 December 2006, the annual cap was RMB899.80 million, and the Group received RMB738.41 million for provision of coal to Dingzhou Power Company.

(7) Supply of Power by Our Power Plants to Substantial Shareholders of Some of Our Non-wholly Owned Subsidiaries

One of our indirect subsidiaries, Tianjin Guohua Panshan Power Generation Company, operates the Panshan Power which supplies power generated by it to one of its own substantial equity holders, the North China Power Grid. Pursuant to the Listing Rules, North China Power Grid is a connected person as it is a substantial shareholder (as defined in the Listing Rules) of our subsidiary. Any transactions between it, its associates (including its holding company, subsidiaries or fellow subsidiaries) and us are connected transactions. Several of our power plants also sell the power generated by them through the power grid companies where they are located. As these power purchasers are all owned or controlled by the same parent company, the State Grid Corporation of China, they are all fellow subsidiaries of a connected person and therefore, the supply of power to these power grid companies are all connected transactions within the Listing Rules. Each of our power plants agreed power purchase arrangements (“Power Purchase Arrangements”) with its corresponding power purchasers to supply them power until 31 December 2006.

For the year ended 31 December 2006, the annual cap was RMB19,100.00 million, and the Group received RMB11,313.41 million for its power supply to North China Power Grid Corporation, the State Power Grid Corporation as well as its subsidiaries.

(8) Properties Leasing Agreement

We have entered into a properties leasing agreement on 24 May 2005 with Shenhua Group (the “Properties Leasing Agreement”) regarding the terms and conditions for the lease of certain buildings. The lease is for a period of ten years commencing from 1 January 2005, and may be renewed upon agreement.

In respect of the properties leasing agreement, the annual cap for rental payable in 2006 was RMB51.00 million and rental receivable in 2006 was RMB0.8 million. For the year ended 31 December 2006, the Group (1) paid a rental payment of RMB40.83 million to Shenhua Group; and (2) had no rental income since rental service to be provided to Shenhua had not commenced.

(9) Financial Services Agreement

On 21 July 2006, the Company and Shenhua Finance, a non-wholly owned subsidiary of Shenhua Group, entered into a financial services agreement (the "Financial Services Agreement"), pursuant to which Shenhua Finance provides deposit services, loan services and other financial services to the Group. Shenhua Finance is a non-wholly owned subsidiary of Shenhua Group in which Shenhua Group owns 59.29% equity interests directly and indirectly through its subsidiaries, and is therefore a connected person of the Company. Accordingly, the Financial Services Agreement and the financial services transactions thereunder constitute a continuing connected transaction of the Company under the Listing Rules. The term of the Financial Services Agreement is from 21 July 2006 to 31 December 2007.

For the year ended 31 December 2006, the annual cap for the average daily maximum balance of the Group's deposit with Shenhua Finance was RMB3,400.00 million, and the actual average daily maximum balance is below the cap.

With the continued development of the Group and based on internal estimates of the demand under and the operating conditions of the continuing connected transactions, the Company noted that the existing caps for transactions in 2006 and/or 2007 under the Mutual Supplies and Services Agreement, Mutual Supply of Coal Agreement, Agency Sales Agreement and Zhonglian Supply Agreement pursuant to the existing waiver from the Hong Kong Stock Exchange was insufficient to meet the demand of the Group. Therefore, The Company revised the caps for 2006 and/or 2007 of the four categories of transactions. The revised caps are as follows (1) Mutual Supplies and Services Agreement: in respect of annual cap for production supplies and ancillary services provided by Shenhua Group to the Group for 2006 was revised from the original cap of RMB886.70 million to RMB992.70 million; the annual cap for production supplies and ancillary services provided by the Group to Shenhua Group for 2007 was revised from the original annual cap of RMB202.00 million to RMB300.00 million; (2) Mutual Supply Coal Agreement: the annual caps in relation to the supply of coal by the Group to Shenhua Group for the years 2006 and 2007 were revised from RMB237.40 million and RMB249.30 million to RMB1,734.50 million and RMB2,000.00 million, respectively. The annual caps for the supply of coal by Shenhua Group to the Group for the years 2006 and 2007 were revised from RMB1,114.70 million and RMB1,281.90 million to RMB1,869.10 million and RMB2,500.00 million, respectively; (3) Agency Sales Agreement: the annual cap for the agency sales services to be provided by the Company to Xisanju Companies for the years 2006 and 2007 were revised from RMB6.10 million and RMB7.90 million to RMB14.90 million and RMB18.80 million respectively; (4) Zhonglian Supply Agreement: the annual caps for the supply of coal by Zhonglian Shuozhou to Changyun Coal Bleaching for the years 2006 and 2007 were revised from RMB581.80 million and RMB698.20 million to RMB700.00 million and RMB1,050.00 million, respectively.

The independent non-executive directors of the Company have reviewed the non-exempt continuing connected transactions (1) to (9) set out above and are of the opinion that: (A) these transactions were within the ordinary course of business of the Group; (B) these transactions were conducted on normal commercial terms, or where there was no sufficient comparable transactions to judge whether they were on normal commercial terms, on terms no less favorable to the Group than terms available to or from (as applicable) independent third parties; and (C) these transactions were conducted in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The auditor of the Company has reviewed the transactions and issued a letter to the Board to state that: (1) these transactions received the approval by the Board of the Company; (2) they are not aware of any indication which would make them believe that these transactions were not conducted in compliance with the related terms of agreements for the transactions or their prices were not made in line with the Group's pricing policy; and (3) they are not aware of any other matters which would make them believe that these connected transactions exceeded the existing caps as approved by the Hong Kong Stock Exchange.

Non-exempt Connected Transaction

Acquisition of 70% equity interest in Jinjie Energy

On 10 March 2006, the Company and Beijing Guohua Power Co. Ltd, a wholly-owned subsidiary of Shenhua Group, entered into an acquisition agreement (the "Acquisition Agreement") for the acquisition of 70% equity interest in Jinjie Energy. Jinjie Energy is engaged in coal production and power generation in Shaanxi Province, the PRC. Upon completion of the Acquisition Agreement, the Company and Shangdong Luneng Development Group Company Limited respectively held 70% and 30% of the equity interest in Jinjie Energy. Beijing Guohua Power Co. Ltd is a wholly owned subsidiary of Shenhua Group, and therefore a connected person of the Company. Accordingly, the Acquisition Agreement and the transactions thereunder constituted a connected transaction of the Company under the Listing Rules.

The major terms of the Acquisition Agreement were as follows:

The aggregate consideration for the acquisition was RMB1,161,639,200 (equivalent to approximately HK\$1,116,960,769), subject to an adjustment by an amount equal to the aggregate sum of capital contributions in Jinjie Energy made by Beijing Guohua Power Co., Ltd at any time between 1 January 2006 and the completion date in accordance with the relevant resolutions of the shareholders of Jinjie Energy to increase its registered capital, up to a maximum amount of RMB90 million (equivalent to approximately HK\$86,538,461.54). The total consideration was paid by the Company on 31 August 2006 and was funded out of the Group's working capital.

Waivers

The Company has obtained a waiver from the Hong Kong Stock Exchange prior to the Company's listing in relation to connected transactions (1) to (6), and (8) set out above, from strict compliance with the announcement and/or independent shareholders' approval requirements of the Listing Rules until 31 December 2007.

Pre-emptive rights

There are no provisions regarding pre-emptive rights under the Articles of Association of the Company and the laws of the PRC, which would oblige the Company to issue new shares to its existing shareholders in proportion to their existing shareholdings.

Auditors

The Company has appointed KPMG and KPMG Huazhen as the international and PRC auditors, respectively, of the Company for the year ended 31 December 2006. KPMG has conducted the audit of the financial statements which were prepared in accordance with International Financial Reporting Standards ("IFRSs"). KPMG and KPMG Huazhen have been engaged by the Company since its listing date. Resolutions for reappointments of KPMG and KPMG Huazhen as the international and PRC auditors of the Company for the year ending 31 December 2007 will be proposed at the forthcoming shareholders' annual general meeting on 15 May 2007.

Taxation

For the year ended 31 December 2006, no foreign shareholder who is not resident of the PRC is liable for Individual or Enterprise Income Tax, Capital Gains Tax, Stamp Duty or Estate Duty of the PRC in relation to their holding of shares of the Company. Shareholders are urged to consult their tax advisers regarding the PRC, Hong Kong and other tax consequences of owning and disposing of the Company's H shares.

Material Events

Yuyao gas-fired plant is located in Yuyao City of Zhejiang Province with a planned installed capacity of 780MW. Construction of the plant was commenced on 28 June 2004. In September 2009, the civil engineering, installation and static adjustment and trial runs were been completed and Yuyao Power is ready to be put into operation. In November 2006, natural gas from the East China Sea began to be transmitted to Yuyao Power for trial runs. In December 2006, tests other than the 168 hours full-loaded trial operation have been completed. Over 98% of the investment has been completed.

Based on the IFRS, the Company considered that the gas-fired units of Yuyao Power in 2006 were ready for intended use, and the accounting treatment for the transfer of construction-in-progress into fixed assets has been completed, with the total of assets transferred being RMB2.007 billion. In 2006, a loss of RMB241 million was incurred, which comprised pre-operating expenses, financial expenses for the period and depreciation. The management considers that no provision of impairment is required.

By order of the Board

Chen Biting

Chairman

Beijing, China

23 March 2007

As at the date of the report of directors, the Board comprises Mr. Chen Biting and Dr. Ling Wen, as executive directors, Dr. Zhang Xiwu, Dr. Zhang Yuzhuo and Mr. Han Jianguo, as non-executive directors, and Mr. Huang Yicheng, Mr. Anthony Francis Neoh and Dr. Chen Xiaoyue, as independent nonexecutive directors.