

# Chairman's Report

The board of Directors of Shanghai Electric Group Company Limited (the "Company") is pleased to announce the results of the Company and its subsidiaries (the "Group") for the year ended 31 December 2006. The Group's results have been audited by Ernst & Young.

Revenue for 2006 was RMB42,662 million (2005: RMB34,400 million), representing an increase of 24.0% over last year. Profit attributable to equity holders of the parent was RMB2,049 million (2005: RMB1,672 million), representing an increase of 22.5% over last year. Basic earnings per share attributable to ordinary equity holders of the parent was RMB17.23 cents (2005: RMB15.17 cents). Growth rate and growth in dollar terms for above remained at high levels. The Board recommends the payment of a final dividend of RMB6.1 cents per share.

## Business Review

During the year under review, the Group placed much emphasis on research and development and implemented initiatives to upgrade the scale and scope of its operations as well as existing technologies and production capabilities, to reinforce its core competitiveness. These moves are in line with its goal to become a first-tier domestic and world-class equipment manufacturing conglomerate with capabilities for self-mastered innovation and continued development. Financial indicators such as total turnover and profit attributable to equity holders hit records highs this year.

## Sustained Growth and Enhanced Competitiveness

While the Group achieved excellent performance in its operation, it has also enhanced its competitiveness with breakthroughs in a number of market segments. The 1,000MW ultra super-critical power generation equipment for Yuhuan Power Plant in Zhejiang, which was manufactured by the Group and is the first of its kind in China, has commenced operation in 2006. It marks the Group's mastery in the world's most advanced technology for manufacturing of coal-fired power generation equipment. The Group secured a contract for the provision of two sets of 660MW ultra super-critical coal-fired power generation equipment for Wangting Power Plant in Jiangsu. The application of ultra super-critical technology to 600 MW series power generation units for this project will close the technology gap of such class of equipment. In 2006, the Group obtained 6 domestic contracts for supply of 1,000MW coal-fired power generation equipment and coal-fired power plant engineering-procurement-construction ("EPC") projects, total

value RMB11 billion, and secured overseas orders for coal-fired power generation equipment with a total capacity of over 1,800MW, total value RMB2.32 billion. These show the Group's enhanced capabilities in undertaking coal-fired power plant EPC projects and overseas coal-fired power generation equipment orders. Our capability in undertaking power transmission and distribution EPC projects has been further enhanced as and when we successfully secured an EPC contract of RMB415 million for supply of 5 substations of 220kV each to Sudan in 2006. Further development in other business divisions in 2006 was observed. Major orders obtained in such other areas included overseas contracts of USD14.61 million in total for supply of 28 ship-use crankshafts to South Korea; domestic contracts for supply of 88 metropolitan railcars; a coal bed gas power generation EPC project at Jincheng, Shanxi, with an installation capacity of 120MW, being the largest of such projects in the world; and a contract for the world's largest solar power station project in Spain to provide photovoltaic ("PV") modules of not less than 40MW.

## Speeding Up Research and Development and Improving Self-mastered Innovation Capabilities

The Group enhanced its research efforts in all business divisions through acquisition of technology and cooperation with academic and research institutes. The Group obtained wind power equipment contracts with a total installation capacity of 144 MW from Shanxi International Electricity Group and Shandong Luneng Group and established a solid foundation for the development of wind power equipment business. The Group actively participated in the government's introduction of the third generation nuclear power technology and has taken successful steps for establishment of 1,000MW nuclear power generation equipment production capabilities. Through enhanced research and development, the Group substantially accelerated the localization of gas turbines production and materialized the local production of discharge diffusers for gas turbines. In respect of our self-developed projects on the design and manufacturing of medium-to-high-speed elevators, the Group has completed the development and production of the 4 meters per second





medium-speed elevator which has also passed the inspection of the National Elevator Inspection Center and obtained proprietary intellectual property rights.

For the production localization project of ship-use semi-built-up crankshafts, we carried out studies on the design and testing of processing craftsmanship and cutting tools. With fruitful results achieved and requirements for scale production satisfied, 14 ship-use crankshafts were produced in 2006. The Group's production localization project for Type A metropolitan railcar is in good progress with its design having passed experts' examination, this laid the foundation for manufacturing capabilities of modern railcars with proprietary intellectual property rights.

### **Increasing Technological Input and Enhancing Business Potential**

There have been substantial investments in the Group's technological input during the year 2006. The construction of the Lingang Heavy Equipment Manufacturing Base (the "Lingang Base") has been sent into full swing. Major development projects such as the heavy equipment manufacturing plants and ship-use crankshaft (Phase II) were implemented as scheduled.

On top of its efforts to build up the Lingang Base, the Group has increased the technological equipment input for the Lingang Base. We have made impressive progress since the implementation of a wide range of significant technological projects relating to the long-term development of the Group. Inspection for 3 "City Revitalization through Science and Technology" projects, namely the 1,000MW ultra-super-critical coal-fired power generation equipment project, the heavy machinery for coal liquefaction project and the 1,000MW nuclear power generation equipment project, has been completed. Out of these 3 projects, the 1,000MW ultra-super-critical coal-fired power generation equipment project and the 1,000MW nuclear power generation equipment project have applied for 32 and 22 patents, respectively. In addition, Phase I of the production capacity increase program in respect of large-scale casting for the Heavy Machinery Group was basically completed. With the capability of melting 700 tonnes of steel at a time, the Group is able to produce the largest

casting item in China, which also enables China to be self-sufficient in supply of large-scale forging and casting items for heavy industrial use. As such, the Group, and even China, can be well-supported for the further development of their super-large equipment manufacturing industry.

### **Speeding Up Integration of the Group's Internal Resources and Optimizing Asset Structure**

In 2006, the Group put further effort in optimizing asset structure through asset acquisition from the Group's controlling shareholder and integration of its internal resources. Machine Tools Group and Heavy Machinery Group were thus established under our Electromechanical Equipment Division. In 2006, the Group acquired machine tool companies such as Magine Machine Tool Co., Ltd. in China, SMAC Werkzeugamas-chine GmbH and Vahrenwald Werkzeugamaschinen GmbH in Germany and Japan Ikegai Corporation. Resources reallocation was then carried out in those acquired enterprises so as to enhance the Group's overall competitiveness and development potential in machine tools business. Product chain of our machine tools business was also further extended. Various studies were carried out for an improved business model for our heavy machinery business. As a result, a business strategy to speed up the development of heavy machinery and key nuclear island equipment for nuclear power plant was formulated. Through establishment of the Heavy Machinery Group, the businesses of heavy machinery, ship-use crankshaft, key nuclear island equipment for nuclear power plant, heavy duty crane and conveyor systems were centralized, resources and competitive edges could be shared.

### **Actively Promoting Innovative Management with Gradual Improvement in the Overall Management Level of the Group**

The Group has emphasized system innovation and management system improvement during the year. The Group has appointed IBM to provide management consultancy services and has carried out studies and reviews of the Group's organization structure and management models. As a result, IBM developed plans for implementation of a management





information system for the Group with our Power Equipment Division selected for kick-off of the project. The Group has formulated certain regulations such as "Rules governing Reporting of Material Financial Affairs", "Certain Opinions on mobility of senior executives within the Group" and "Operation Guide relating to Intellectual Properties" to strengthen control over financial risk, human resources and technology management amongst others. Moreover, further efforts were put towards brand name development and business promotion. The Group also improved management functions of different business divisions and strengthened management over its subsidiaries in respect of cost and quality controls.

## Future Outlook

According to the "Certain Opinions on Speeding up the Revitalization of the Equipment Manufacturing Industry" (關於加快振興裝備製造業的若干意見) issued by the State Council in the first half of 2006, preferential policies will be introduced to provide greater support to the advanced equipment manufacturing industry. The policies are devised to facilitate the growth of competitive local heavy equipment manufacturers.

The Group will seek to further improve its competitiveness and profitability through speeding up its internationalization process; promoting concepts about international operations, awareness of related legal requirements, and cautiousness to be hard-working and thrifty in daily business operations. The Group will maintain its growth momentum and improve the quality of its financial operation with a view to developing into a highly competitive heavy equipment manufacturing group, providing higher returns to its shareholders and more contributions to the community.

In 2007, the Group will strengthen its operations in the four core business divisions detailed as below.

## Power Equipment Division

Under the directives issued by the National Development and Reform Committee, coal-fired power generation units with small capacity, high energy consumption and high pollution levels are required to close down or undergo overhaul and be replaced by power generation units with bigger capacity and higher performance parameters. Capitalizing on this opportunity, the Group will maximize its market share through continued efforts in improving its research and development and production of coal-fired power generation units with big capacity, high performance parameters and low energy consumption. The Group will expedite the completion of the power plant equipment production facilities at the Lingang Base. Upon completion of the production orders for the MW level wind power equipment, the Group will plan and seek approval for 2MW or above wind power equipment production capability at its Lingang Base. In the course of development of the market and implementation of EPC projects, the Group will place greater emphasis on upgrading its capabilities in design and integration, and make full use of its competitive edges of the synergy effects of its major and ancillary businesses.

## Electromechanical Equipment Division

The Group will fully gear up to complete the new plant for Mitsubishi Electric Shanghai Mechanical & Electrical Elevator Co., Ltd.. We will also accelerate the integration of resources within the Heavy Machinery Group to fully-leverage our overall competitive edges. The Group will enhance the overall manufacturing capabilities for key nuclear island equipment for nuclear power plant. The construction for various heavy machinery projects of the Lingang Base and the remaining forging project under the hot processing technology upgrading master project of the Minhang facilities are to be completed as scheduled. The Group will also complete the installation and test run of the 16,500-tonne hydraulic press.



We will further speed up the integration of internal resources of our Machine Tools Group in order to grasp market opportunities and accelerate market expansion for our new products. With regard to our printing and packaging equipment business, we target to commence commercial production of single-sided printing equipment and small-batch production of double-sided printing equipment in the near future in the course of transfer of leading printing equipment technology from Akiyama International Co., Ltd.

At the same time, the Electromechanical Equipment Division will continue to launch energy-saving products to create value for our users, increase our product competitiveness, and enable the Division to become a leading example in energy-saving amongst different business divisions of the Group.

### Transportation Equipment Division

Through the implementation of the competition by product differentiation strategy for diesel engine business, the Group will deploy the market strategy for our high-end products, expand the product sales channels and strive to increase our market competitiveness.

The Group will ensure the timely completion of the assembly of Type A domestically produced metropolitan railcars, speed up the development of the railcar production base, and speed up the preparation work for the on-rail test-running of railcars. The Group will plan ahead for the establishment of manufacturing base for the localization of railcars in accordance with national development strategy on rail transportation.

### Environmental Systems Division

The Group will also focus on the development of power plant desulphurization and denitration systems and gas purification systems for small-to-medium size power generation units. We strive for an early completion of our solar cells production capacity expansion project and the subsequent successful operation of such facilities to maintain the sustainable development of our photovoltaic cells business. With our experiences in the BOT and BT environmental protection projects, we build our reputation and brand name and expand the scope of our environmental protection systems business. We will also enhance the development potential and technical capabilities of our professional staff in environmental protection business through training.

The Group is fully confident in its future prospects. Through its relentless efforts, the Group will create greater value for its shareholders and share with them the benefits of the Group's steady growth.

Finally, I would like to take this opportunity to thank all shareholders for their support to the Group. I would also like to express my deepest gratitude to the Directors, Supervisors, management and staff of the Group for their dedication and contribution to the Group during the past year.

### Xu Jianguo

Chairman  
Shanghai, PRC  
13 April 2007

