Management Discussion and Analysis

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).

As at 31 December 2006, total assets of the Group were RMB64,048 million (2005: RMB55,165 million) and total liabilities were RMB40,550 million (2005: RMB33,979 million). Total equity was RMB23,498 million (2005: RMB21,186 million), of which RMB16,726 million was attributable to equity holders of the parent (2005: RMB14,880 million).

The Group recorded satisfactory results for 2006 with the Power Equipment Division and Electromechanical Equipment Division being the main driver of growth in profit, accounting for 95.3% of the operating profit of the Group for the year.

Business Review of Major Divisions

Set out below are the revenue and operating profits of individual business divisions:

	Revenue		**Operating Profit**	
(RMB million)	**2006**	**2005**	**2006**	**2005**
Power Equipment	25,707	19,491	2,624	2,555
Percentage of total	60.3%	56.7%	72.0%	75.8%
Electromechanical Equipment	12,351	11,041	848	706
Percentage of total	29.0%	32.1%	23.3%	20.9%
Transportation Equipment	3,434	3,143	12	20
Percentage of total	8.0%	9.1%	0.3%	0.6%
Environmental Systems	1,907	1,027	41	(20)
Percentage of total	4.5%	3.0%	1.1%	(0.6%)
Financial Business	-	-	512	385
Percentage of total	-	-	14.0%	11.4%
Other Businesses	376	299	823*	323*
Percentage of total	0.9%	0.9%	22.6%	9.6%
Consolidated adjustments and write-offs	(1,113)	(601)	(1,215)*	(599)*
Percentage of total	(2.6%)	(1.7%)	(33.3%)	(17.7%)
Total	42,662	34,400	3,645	3,370

* Included in operating profit of other businesses was dividend income of RMB958 million (2005: RMB383 million) from the Company's subsidiaries, which has been eliminated by consolidation adjustments and write-offs.

Power Equipment Division

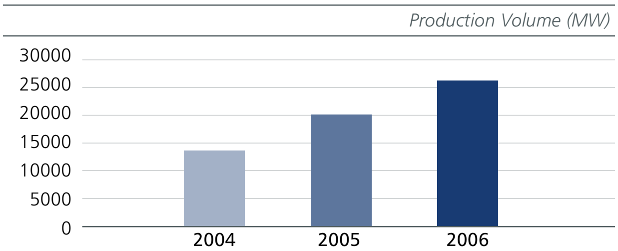
In 2006, the Group's delivery for power generation equipment has been over 26,500 MW in total capacity. Revenue of the Power Equipment Division was RMB25,707 million (2005: RMB19,491 million), an increase of 31.9% from last year. Following the increase in outsourcing as well as proportion of revenue from new businesses/products including EPC projects, gas-fired power generation equipment and 1,000MW coal-fired power generation equipment for this division, gross margin dropped to 18.2% (2005: 21.8%). With drop in gross margin and increase in other operating expenses, operating profit increased by 2.7% only to RMB2,624 million (2005: RMB2,555 million). As at 31 December 2006, outstanding orders for power generation equipment were over 66,000MW.

In January 2007, the National Development and Reform Commission and the Office of the National Energy Leading Group issued a circular titled *Several Opinions on Speeding up the Closing-down and Decommission of Small Thermal Power Generation Units*, which stipulated, within the 11th Five-year Period, the phase-out of power generation units of small capacity but high energy consumption and high pollution. At the same time, the building of large-scale power generation units is being encouraged with the introduction of "Big capacity units to replace small capacity units" policy. The Group sees a market potential for its big capacity, high performance parameters and low energy consumption power equipment. As to the overseas markets, rapid economic growth in Southeast Asian countries such as India, Vietnam, Pakistan, Iran and Thailand creates strong demand for electricity, opening up enormous markets for the Group's power equipment business in overseas.

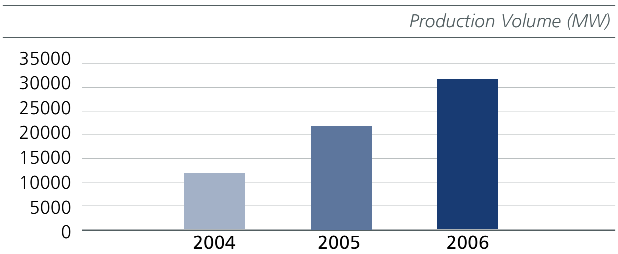
The Group will further streamline its product development framework to enhance product capacity level, and step up its expansion in overseas markets. Through strengthening its integrated management strategy, production and operating costs will be lowered. In addition to refining the provision of complete sets of power generation equipment business and after-sales services, the Group will improve its capability in undertaking EPC projects and add value to its products. In the meantime, the Group will continue its efforts to obtain further development in areas such as nuclear power and wind power, so as to maintain the continuous development of our power equipment business.

According to the 11th Five-year Plan, a total of RMB1,100 billion will be invested on power transmission and distribution network in PRC, the building of which the Government has decided to expedite. To accelerate growth of the power transmission and distribution equipment business, the Group will concentrate on expanding its power transmission and distribution project undertaking, while speeding up new product development. It is also the Group's endeavor to increase resources for technical upgrade and optimize its power transmission and distribution business structure. For 2006, revenue for power transmission and distribution equipment business was RMB2,285 million (2005: RMB1,808 million), representing an increase of 26.4% from last year.

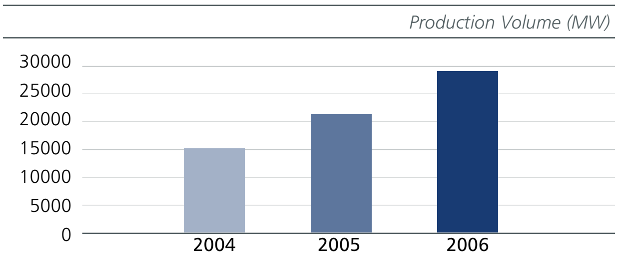
Changes in Production Volume
of Power Station Boilers over the Past Three Years



Changes in Production Volume
of Turbines over the Past Three Years



Changes in Production Volume
of Turbine Generators over the Past Three Years



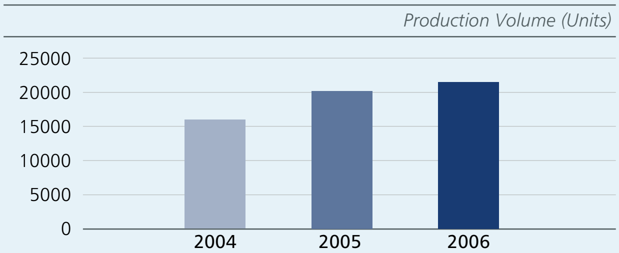
Electromechanical Equipment Division

Revenue of the Electromechanical Equipment Division reached RMB12,351 million for 2006 (2005: RMB11,041 million), representing an increase of 11.9% as compared to last year. Operating profit recorded 20.1% increase from last year to RMB848 million (2005: RMB706 million), mainly attributable to the completion of certain stages of the hot processing technology upgrading project under our Heavy Machinery business and super-large items processing and manufacturing capability gradually available in 2006 for our Heavy Machinery business. As a result, gross margin showed a slight increase.

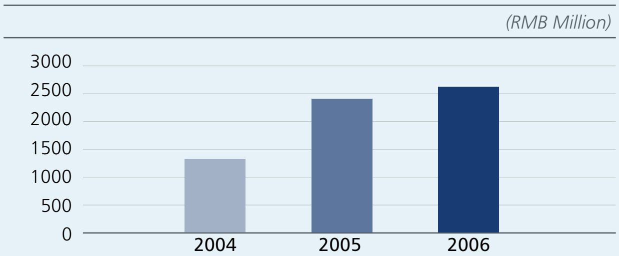
The accelerated urbanization of the PRC provides momentum for the growing demand for residential and commercial use elevators. There are still great potentials in the PRC market, where an increasing number of elevators are being installed, upgraded and modified. At the same time, intense competition has evidently diminished product differentiation. The Group's unremitting commitment to innovation will be reflected from its acquisition of new technologies and development of new products. Not only will the Group strengthen its repairs & maintenance and after-sales services, it will also further enhance its operation and sales systems and proactively recruit industry talents, all with the help of extensive utilization of information technology. The Group expects its sales and operation efficiency of the elevator business to remain at high levels, and its leading position in elevator market unchallenged.

The Group has achieved rapid growth in heavy machinery business in recent years as its products are used for the assembling of heavy equipment. The heavy machinery market of the PRC will see further growth in the coming few years. Through resources consolidation, the Group will move forward its business in nuclear island equipment for nuclear power plant. Building on the Group's achievement in improving its capability in large-scale casting and forging, it will further pursue technological advancement in enhancing production capacity of large-scale forging pieces and marine crankshafts. The Group will also strengthen its product development capability through working closely with academic institutions, so as to expand the product line and advance the technological level of its heavy machinery products. It is expected that the heavy machinery business of the Group will grow further rapidly in both size and scale for the coming years.

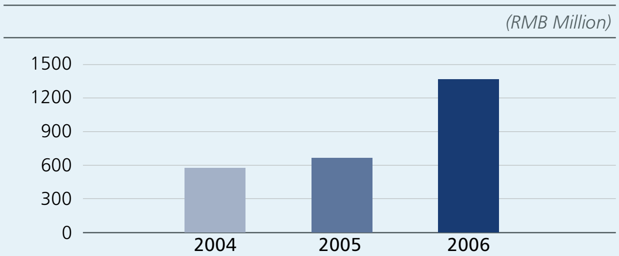
Changes in Production Volume of Elevators over the Past Three Years



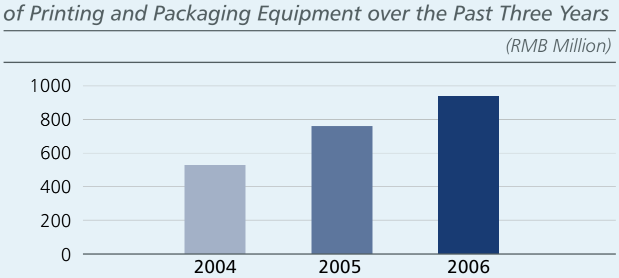
Changes in Sales Amount of of Heavy Machinery over the Past Three Years



Changes in Sales Amount of of Machine Tools over the Past Three Years



Changes in Sales Amount of of Printing and Packaging Equipment over the Past Three Years



Large-scale, high-precision, specialized and digitally-controlled machine tools and related accessories will continue to be mainstream and key products in the market. The Group will advance the technology levels of its products through synergistic technology exchanges with both domestic and foreign enterprises, and tap into local and overseas markets for industry talents to support product development, while further enhancing its production capacity through increased investment in technological upgrade.

The rapid economic growth of the PRC provides an enormous market for the production and sales of printing and packaging equipment. It is the Group's aim to promote growth of this business by leveraging on effective resource consolidation and synergy in technology exchange with entities acquired overseas. Through acquisition and development of new technologies, the Group aims to increase its share in the printing and packaging equipment market by enhancing its capabilities in scale production and provision of complete sets of high-speed high-quality single- and double-sided color offset printing equipment. The Group will maintain its fast development in printing and packaging equipment business.

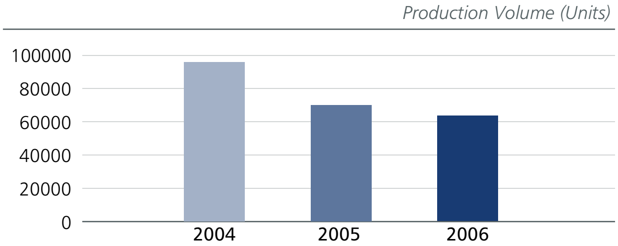
Transportation Equipment Division

In the second half of 2006, delivery of metropolitan railcars was made in accordance with delivery schedule of customers and revenue for Transportation Equipment Division increased by 9.3% as compared to last year. However, increase in research and development costs for localization of Type A railcars production resulted in a drop of operating profit for this Division for 2006.

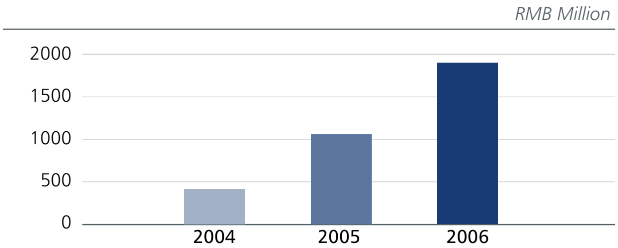
In addition, the drop in domestic demand for diesel engines for power stations and marine diesel engines led to a decrease in sales of these products of the Group. The Group will improve technology development capability, implement diesel engine business differential competition strategy, prepare for high-end product market, widen sales channels, so as to enhance the competitiveness in diesel engine business of the Group.

Sales for railcars, platform systems and power supply systems are expected to grow along with the progression of metropolitan rail transportation projects. The technical specifications of the Group's Type A large railcar, the brainchild of its independent research with collaborations from academic institutions, have been recently approved by a panel of experts. The Company will leverage on its competitive edge in railcars, platform systems and power supply systems to further hone its design and production technologies, fortify its production base, and enhance the provision of complete sets of metropolitan rail transportation equipment. Quality products and services are what the Group will deliver to customers.

Changes in Production Volume of Diesel Engines over the Past Three Years



Changes in Sales Amount for Environmental Systems business over the Past Three Years



Environmental Systems Division

In 2006, Environmental Systems Division showed further development in its businesses. Revenue increased by 85.7% compared to that of last year and operating profit reached RMB 41 million.

The accelerated economic development and urbanization of the PRC is expected to present immense pressure to the environment and at the same time tremendous potentials for the Environmental Systems Division of the Group.

Being a young business segment, the growth of the division will continue to be driven by complete sets equipment orders. Besides, solid waste incineration and industrial sewage treatment BOT projects of the Group are in good progress. Following the tightening of emission controls over thermal power plants by National Development and Reform Committee, the Group's power plant desulphurization and denitration systems business, for which we possess leading technology, will face better opportunities for further development.

Sales from the Group's solar cells business continue to expand at a high rate. Production capacity and quality have seen marked improvement after adding a new production line in 2005. Sales in solar cells surpassed 20MW in 2006 and will continue to grow while the expansion of production scale will be maintained by steady and solid refinement on production technology. The Group has built on the roof of Lingang Heavy Equipment Manufacturing Base Complex a 0.2MW photovoltaic power station - Shanghai's largest to date - as a demonstration project. The Group will speed up its undertaking of photovoltaic power station projects both in the domestic and overseas markets. The Group anticipates robust development in the production and sales of environmental systems equipment and solar cells, while growth in profit will remain strong.

Financial Business Division

Operating profit of financial business division increased by 33.0% as compared to last year, mainly due to the further centralization of funds of the Group for more efficient use.

Share of Profits and Losses of Associates

Share of profits of associates increased by 76.5% from last year to RMB436 million (2005: RMB247 million), mainly attributable to further growth in power transmission and distribution equipment business of associates and the sale of the Group's shareholdings in Shanghai Novel Colour Picture Tube Co., Ltd. ("Shanghai Novel") held under the Electromechanical Equipment Division and the Group shares no more losses of Shanghai Novel.

Finance Costs

Finance costs for 2006 amounted to RMB105 million (2005: RMB67 million), an increase of 56.7% from last year, mainly due to increase in borrowings for business operations of electromechanical equipment division.

Profit Attributable to Equity Holders of the Parent

As a result of the foregoing, profit attributable to equity holders of the parent for 2006 increased by 22.5% from last year to RMB2,049 million (2005: RMB1,672 million). Earnings per share attributable to equity holders of the parent was RMB17.23 cents (2005: RMB15.17 cents).

Cash Flow

As at 31 December 2006, the Group had cash, bank balances and deposits in central bank of RMB11,061 million (2005: RMB12,969 million), of which RMB1,693 million (2005: RMB1,417 million) being restricted deposits, representing a decrease of RMB1,908 million from the beginning of the year, mainly a result of increase in capital investments. During the year, the Group had net cash inflow from operating activities of RMB117 million (2005: net cash outflow RMB1,074 million), net cash inflow from investing activities of RMB119 million (2005: net cash outflow RMB2,135 million), and net cash outflow from financing activities of RMB723 million (2005: net cash inflow RMB2,230 million).

We anticipate further cash outflow for the Group following increase in capital investments.

Assets and Liabilities

As at 31 December 2006, the Group has total assets of RMB64,048 million (2005: RMB55,165 million), an increase of RMB8,883 million, or 16.1% compared to that of the beginning of the year. Total current assets increased by RMB5,599 million from the beginning of the year to

RMB49,462 million (2005: RMB43,863 million), accounting for 77.2% of the total assets. Total non-current assets were RMB14,585 million (2005: RMB11,302 million), representing an increase of RMB3,283 million from the beginning of the year and accounting for 22.8% of the total assets.

As at 31 December 2006, total liabilities of the Group were RMB40,550 million (2005: RMB33,979 million), which represented an increase of 19.3% compared with the beginning of the year. Total current liabilities increased by 19.0% to RMB39,579 million (2005: RMB33,262 million), while total non-current liabilities increased by 35.6% to RMB972 million (2005:RMB717 million).

As at 31 December 2006, total net current assets of the Group was RMB 9,884 million (2005: RMB10,601 million), representing a decrease of RMB 717 million from the beginning of the year. Liquidity ratio decreased from 1.32 to 1.25.

Source of Funding and Indebtedness

As at 31 December 2006, the Group had aggregate bank and other borrowings and debentures of RMB1,037 million (2005: RMB1,002 million), an increase of RMB35 million from the beginning of the year. Borrowings and debentures repayable within one year was RMB930 million which represented a decrease of RMB2 million. Borrowings and debentures repayable after one year was RMB107 million, representing an increase of RMB37 million compared with the beginning of the year.

As of 31 December 2006, all bank and other borrowings and debentures of the Group were interest-bearing at fixed rates. Except for unsecured bank loans of USD300,000 (2005: Nil), equivalent to RMB2,343,000, and HKD125,000,000 (2005: Nil), equivalent to RMB125,584,000, and JPY230,000,000 (2005: Nil), equivalent to RMB15,095,000, which are denominated in foreign currencies, all other borrowings are in Renminbi. Besides, secured bank loans of USD409,000, equivalent to RMB3,309,000, and EURO2,400,000, equivalent to RMB22,992,000, as at 31 December 2005 was also denominated in foreign currencies.

As at 31 December 2006, gearing ratio of the Group, which represents the ratio of debentures and interest-bearing bank and other borrowings to total equity plus debentures plus interest-bearing bank and other borrowings was 4.2%, a reduction from 4.5% at the beginning of the year.

Pledge of Assets

As at 31 December 2006, bank deposits of RMB1,392 million (2005: RMB1,417 million) of the Group have been pledged to banks. In addition, certain bank loans of the Group are secured by mortgages over the Group's certain land use rights, buildings and machinery, with an aggregate net book value of approximately RMB142 million as at 31 December 2006 (2005: RMB153 million).

Contingent Liabilities

Please refer to note 48 to the consolidated financial statements for details.

Capital Commitment

Please refer to note 50 to the consolidated financial statements for details.

Foreign Exchange Risks

During the year, the Group exported certain products as well as imported equipment, spare parts and materials. The exports and imports substantially hedged the risks of transactions in foreign currencies. As at 31 December 2006, cash and bank balances of the Group included HKD653 million, USD22 million, JPY956 million and other foreign currencies equivalent to RMB53 million in total. Apart from this the Group was not exposed to any material foreign exchange risks.