# Report of the Directors

The directors present their report and the audited financial statements of the Company and the Group for the year ended 31 December 2006.

## Principal Activities

The principal activities of the Company are the design, manufacture and sale of products and the provision of related services in the power equipment, electromechanical equipment, transportation equipment and environmental protection industries. Details of the principal activities of the principal subsidiaries are set out in note 18 to the financial statements. There were no significant changes in the nature of the Group's principal activities during the year.

## Results and Dividends

The Group's profit for the year ended 31 December 2006 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 39 to 143.

The directors recommend the payment of a final dividend of RMB6.1 cents per ordinary share in respect of the year to shareholders on the register of members as at the date of 2006 Annual General Meeting of the Company. This recommendation has been incorporated in the financial statements as an allocation of retained profits within the equity section of the balance sheet.

## Use of Proceeds from the Company's Initial Public Offering

The proceeds from the Company's issue of new shares at the time of its listing on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") in April 2005, after deduction of related issuance expenses, amounted to approximately RMB4,678 million. Proceeds of RMB3,711 million have been applied by 31 December 2006 in accordance with the proposed applications set out in the Company's listing prospectus, as follows:

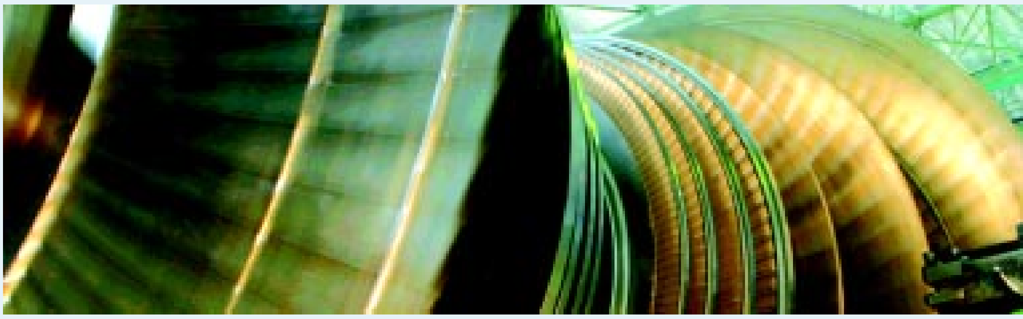
- Approximately RMB1,487 million was used in the power equipment division, comprising investments in technology improvement and capacity expansion of production facilities, new joint ventures and development of new products;
- Approximately RMB1,233 million was used in the electromechanical equipment division, comprising investments in technology improvement of production facilities and development of new products;
- Approximately RMB350 million was used in the transportation equipment division, comprising investments in production expansion and enhancement in product design capability;
- Approximately RMB221 million was used in the environmental systems division, comprising investments in solar cells business and sewage water treatment business; and
- Approximately RMB420 million was applied as additional working capital of the Group.

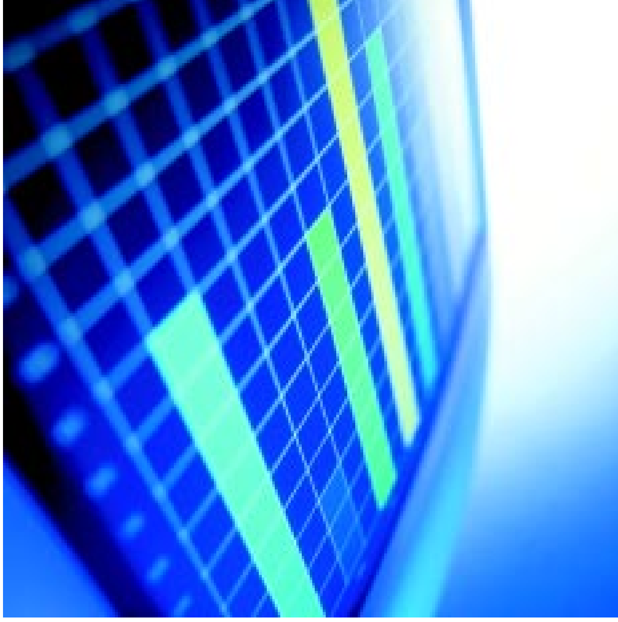
## Summary Financial Information

A summary of the published results and assets, liabilities and minority interests of the Group for the last five financial years, as extracted from the audited financial statements and restated/reclassified as appropriate, is set out on page 3 of the annual report. This summary does not form part of the audited financial statements.

## Property, Plant and Equipment

Details of movements in the property, plant and equipment of the Company and the Group during the year are set out in note 14 to the financial statements.





## Share Capital

There was no movement in either the Company's authorised or issued share capital during the year.

On 3 August 2006, the Company received a notification from the Shanghai No. 1 Intermediary People's Court that the 968,768,703 shares held by Fuxi Investment Holdings Co., Ltd. ("Fuxi"), representing 8.15% of the entire issued share capital of the Company, were judicially frozen with effect from 3 August 2006.

On 6 February 2007, the Company received a notification from Shanghai No. 1 Intermediary People's Court, pursuant to which the above-mentioned frozen shares were released. In addition, the shares of the Company respectively held by Fuxi and Shantou Municipal Mingguang Investment Co., Ltd. ("Mingguang") were judicially frozen with effect from 6 February 2007, as a result of certain contractual disputes brought against Fuxi and the controlling shareholder of Mingguang by Shanghai Electric (Group) Corporation ("SE Corporation"), the parent and ultimate holding company of the Company, and its subsidiaries.

On 21 March 2007, the Company received another notification from Shanghai No. 1 Intermediary People's Court, pursuant to which the Company was required to reduce the number of frozen shares held by Mingguang from 407,908,899 to 356,920,287 with immediate effect. As a result, 968,768,703 and 356,920,287 shares held by Fuxi and Mingguang, representing approximately 8.15% and 3.00% of the entire issued share capital of the Company, respectively, were judicially frozen.

Pursuant to the above notices from the court, any dividends in respect of the frozen shares should be withheld and no transfer of the frozen shares may be effected.

On 9 April 2007, the Company received a notification from SE Corporation. According to the notification, SE Corporation has entered into a share transfer agreement with Mingguang, pursuant to which Mingguang agrees to transfer the 356,920,287 shares to SE Corporation. The completion of the said share transfer is expected to take place as soon as practicable. Upon the completion of the said share transfer, Mingguang will own 50,988,612 shares in the Company, representing approximately 0.43% of the entire issued share capital of the Company. The shareholding by SE Corporation in the Company will increase from approximately 51.59% to approximately 54.58% of the issued share capital of the Company, as a result of the said transfer.

On 12 April 2007, the Company received a notification from Shanghai No.1 Intermediary People's Court, pursuant to which the previously frozen 356,920,287 shares held by Mingguang were released.

## Pre-emptive Rights

There are no provisions for pre-emptive rights under the Company's by-laws/articles of association or the laws of the People's Republic of China ("PRC") which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

## Purchase, Redemption or Sale of Listed Securities of the Company

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

## Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 43(b) to the financial statements and in the consolidated statement of changes in equity, respectively.

## Distributable Reserves

At 31 December 2006, the Company's reserves available for distribution, calculated in accordance with the relevant regulations, amounted to RMB2,660,747,000, of which RMB725,391,000 has been proposed as a final dividend for the year. In addition, the Company's share premium account, in the amount of RMB1,981,651,000, may be distributed in the form of fully paid bonus shares.

The amount for which the Company can legally distribute by way of a dividend is determined based on the lower of the retained profits determined in accordance with the generally accepted accounting principles in the PRC and the Hong Kong Financial Reporting Standards.

## Major Customers and Suppliers

In the year under review, sales to the Group's five largest customers accounted for less than 30% of the total sales for the year. Purchases from the Group's five largest suppliers also accounted for less than 30% of the total purchases for the year.

## Directors and Supervisors

Please refer to page 19 for a list of directors and supervisors of the Company.

The non-executive directors, independent non-executive directors and supervisors are appointed for a period of three years.

The Company has received annual confirmations of independence from Dr. Yao Fusheng, Dr. Cheung Wai Bun and Mr. Lei Huai Chin, and as at the date of this report still considers them to be independent.

## Directors' and Senior Management's Biographies

Biographical details of the directors of the Company and the senior management of the Group are set out on pages 16 to 18 of the annual report.

## Directors' Service Contracts

Except for Mr. Xu Jianguo, each of the executive directors of the Company has entered into a service contract with the Company on 28 March 2005. According to the terms of the service contracts, each of the executive directors agreed to be appointed as the Company's executive director until 28 September 2007. These contracts are renewable in accordance with the Company's articles of association and related listing rules, and are terminable at the option of the Company and the executive directors by giving three months' notice in writing or according to the terms of the contracts prior to the expiry of the contracts.

Apart from the foregoing, no director has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

## Directors' Remuneration

The directors' fees are subject to shareholders' approval at general meetings. Other emoluments are determined by the Company's board of directors with reference to directors' duties, responsibilities and performance and the results of the Group.

## Directors' and Supervisors' Interests in Contracts

No director or supervisor had a material interest, either directly or indirectly, in any contract of significance to the business of the Group to which the Company, its holding company, or any of its subsidiaries or fellow subsidiaries was a party during the year.

## Management Contracts

Pursuant to an agreement dated 28 March 2005 between the Company and SE Corporation, SE Corporation (either by itself or through its subsidiaries) provides various kinds of auxiliary services including labour secondment, property management, management of research centres and projects, water and electricity supply, auxiliary support, training and education, facility, security and maintenance services to the Group. The term of the agreement is three years, renewable at the option of the Company for another term of three years by giving three months' notice in writing prior to the expiry of the present term. During the year, the Company paid a management service fee of RMB6,967,000 under this agreement.


## Directors' Interests and Short Positions in Shares, Underlying Shares and Debentures

As at 31 December 2006, none of the directors had registered an interest or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")) that was required to be recorded pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers.

## Directors' Rights to Acquire Shares or Debentures

At no time during the year were rights to acquire benefits by means of the acquisition of shares in or debentures of the Company granted to any director or their respective spouse or minor children, or were any such rights exercised by them; or was the Company, its holding company, or any of its subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors to acquire such rights in any other body corporate.

## Contract of Significance

During the year, the Company has entered into various contracts of significance with SE Corporation and other connected persons. Further details of the transactions are set out in the section "Connected transactions and continuing connected transactions" below.

## Substantial Shareholders' and Other Persons' Interests in Shares and Underlying Shares

At 31 December 2006, the following interests of 5% or more of the issued share capital of the Company were recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO:

### Long positions:

| Name | Type of shares | Capacity and nature of interest | Number of ordinary shares held | Percentage of the company's issued share capital (%) |
|---|---|---|---|---|
| SE Corporation | Domestic | Directly beneficially owned | 6,134,387,334 | 51.59 |
| Fuxi | Domestic | Directly beneficially owned | 968,768,703 | 8.15 |
| Guangdong Zhujiang Investment Co., Ltd. | Domestic | Directly beneficially owned | 917,778,942 | 7.72 |

Save as disclosed above, as at 31 December 2006, no person had registered an interest or short position in the shares or underlying shares of the Company that was required to be recorded pursuant to Section 336 of the SFO.

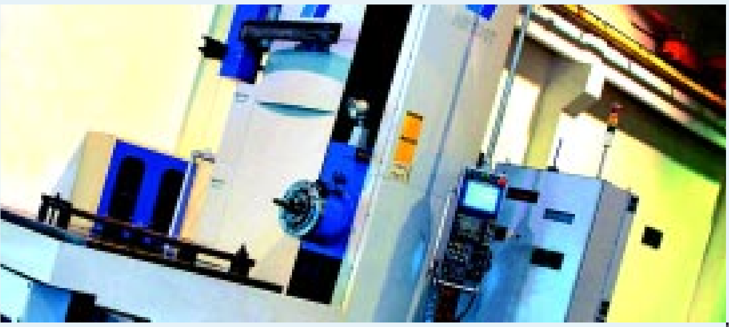
## Connected Transactions and Continuing Connected Transactions

During the year, the Company and the Group had the following connected and continuing connected transactions, certain details of which are disclosed in compliance with the requirements of Chapter 14A of the Listing Rules.

## Connected Transactions

The Company entered into an equity transfer agreement with SE Corporation on 24 January 2006 to acquire a 50.88% equity interest in Shanghai Ship-use Crankshaft Co., Ltd. ("Shanghai Ship-use Crankshaft") from SE Corporation for a cash consideration of RMB71.4 million, which was determined with reference to a valuation carried out by independent professional qualified valuers in Mainland China. The acquisition has been completed by 31 December 2006.

The Company entered into an equity transfer agreement with SE Corporation on 24 January 2006 to acquire the entire registered capital of Magine Machine Tool Co., Ltd. from SE Corporation for a cash consideration of RMB252.4 million, which was determined with reference to a valuation carried out by independent professional qualified valuers in Mainland China. The acquisition has been completed by 31 December 2006.



The Company entered into an equity transfer agreement with Shanghai Electrical Industry Investment Corporation ("Electrical Industry"), a subsidiary of SE corporation, on 24 January 2006 to acquire a 65% interest in Japan Ikegai Corporation from Electrical Industry for a cash consideration of RMB109.3 million, which was determined with reference to a valuation carried out by independent professional qualified valuers in Mainland China. The acquisition has been completed by 31 December 2006.

The Company entered into an equity transfer agreement with Electrical Industry on 24 January 2006 to acquire the entire registered capital of SMAC Werkzeugamaschine GmbH from Electrical Industry for a cash consideration of RMB8.9 million, which was determined with reference to a valuation carried out by independent professional qualified valuers in Mainland China. The acquisition has been completed by 31 December 2006.

Shanghai Rail Traffic Equipment Development Co., Ltd. ("Shanghai Rail Traffic"), an 83.3%-owned subsidiary of the Company, entered into an equity transfer agreement with SE Corporation on 24 January 2006 to acquire the entire registered capital of Shanghai Mass Transit Vehicle & Engineering Equipment Co., Ltd. from SE Corporation for a cash consideration of RMB30.9 million, which was determined with reference to a valuation carried out by independent professional qualified valuers in Mainland China. The acquisition has been completed by 31 December 2006.

Shanghai Electric Power Transmission and Distribution Equipment Co., Ltd., an 83.75%-owned subsidiary of the Company, entered into an equity transfer agreement with SE Corporation on 24 January 2006 to acquire the entire registered capital of Shanghai Relay Works Co., Ltd. from SE Corporation for a cash consideration of RMB23.9 million, which was determined with reference to a valuation carried out by independent professional qualified valuers in Mainland China. The acquisition has been completed by 31 December 2006.

Shanghai Mechanical & Electrical Industry Co., Ltd. ("Mechanical & Electrical"), a 47.28%-owned subsidiary of the Company, entered into an equity transfer agreement with SE Corporation on 29 June 2006 to dispose of a 24% equity interest in Shanghai Novel Colour



Picture Tube Co., Ltd., an associate of Mechanical & Electrical, to SE Corporation for a cash consideration of RMB268.7 million, which was determined with reference to a valuation carried out by independent professional qualified valuers in Mainland China. The disposal has been completed by 31 December 2006.

Shanghai Rail Traffic entered into an asset transfer agreement with Shanghai Electric Apparatus Industrial Co., Ltd. No.3 Machine Tool Electrical Apparatus Factory ("No.3 Machine Tool Electrical Apparatus Factory"), a subsidiary of SE Corporation, on 14 September 2005 to purchase a property from No.3 Machine Tool Electrical Apparatus Factory for a cash consideration of RMB27.4 million, which was determined with reference to a valuation carried out by independent professional qualified valuers in Mainland China. The purchase of the property has been completed by 31 December 2006.

Shanghai Rail Traffic entered into a property transfer agreement with Shanghai Rectifier Factory, a subsidiary of SE Corporation, on 24 January 2006 to purchase a property from Shanghai Rectifier Factory for a cash consideration of RMB32.6 million, which was determined with reference to a valuation carried out by independent professional qualified valuers in Mainland China. The purchase of the property has been completed by 31 December 2006.

On 23 June 2006, Shanghai Turbine Co., Ltd., Shanghai Turbine Generator Co., Ltd. and Shanghai Power Equipment Company Ltd., three joint venture companies indirectly owned by the Company (the "Three JVs"), entered into a merger agreement, pursuant to which the Three JVs would be dissolved and a new joint venture company ("NEWCO") would be established in the PRC. Further to the merger agreement, Shanghai Turbine Works Co., Ltd., Shanghai Electric Group Shanghai Electric Machinery Co., Ltd. and Shanghai Power Station Auxiliary Equipment Works Co., Ltd., three wholly-owned subsidiaries of the Company and the respective controlling shareholders of the Three JVs, entered into a joint venture agreement with Siemens Ltd., China ("Siemens China"), the joint venture partner of the Three JVs, in relation to the proposed establishment of NEWCO to take up all the business from the Three JVs. By the end of 31 December 2006, the merger of the Three JVs has not been completed.

Mechanical & Electrical, Mitsubishi Electric Corporation ("Mitsubishi Electric") and Mitsubishi Electric Building Techno-service Co., Ltd. ("MELTEC") entered into an agreement on 10 May 2006, pursuant to which (i) the name of Shanghai Mitsubishi Elevator Engineering & Technology Co., Ltd. ("SMET"), a joint venture company established and owned by Mechanical & Electrical, Mitsubishi Electric and MELTEC as to 40%, 40% and 20%, respectively, was changed to Mitsubishi Electric Shanghai Mechanical & Electrical Elevator Co., Ltd.; (ii) the registered capital of SMET has been increased from USD8 million to USD53 million ("Capital Increase"); and (iii) the investment amount of SMET has increased from USD20 million to USD90 million. The Capital Increase was contributed by Mechanical & Electrical, Mitsubishi Electric and MELTEC in accordance with their respective equity interests in the registered capital of SMET. Following the Capital Increase, the percentage of ownership of Mechanical & Electrical, Mitsubishi Electric and MELTEC remain unchanged.

## Continuing Connected Transactions

### *Framework land lease agreement*

The Company entered into a framework land lease agreement dated 1 January 2005 with SE Corporation, pursuant to which SE Corporation agrees to lease (either by itself or through its subsidiaries) parcels of land with a total area of approximately 2,110,954 square metres to the Group. The term of each lease is either 20 years, or the remaining term of operation of the Group's joint venture that occupies the relevant premises in the event that the remaining term of operation of the relevant joint venture is less than 20 years. The rental payment due to SE Corporation is RMB29.95 million per year for the first three years of the agreement. Rental payment is to be reviewed every three years, taking into account market conditions, and should not be higher than the rent applicable to a third party tenant.

In the year ended 31 December 2006, the rental payment payable to SE Corporation was RMB29.95 million.

### *Framework sale agreement*

The Company entered into a framework sale agreement dated 28 March 2005 with SE Corporation, pursuant to which the Group has agreed to sell, on a non-exclusive basis, certain products from its

various business divisions, both finished and semi-finished, to SE Corporation and its connected persons (the "Parent Group"). The framework sale agreement is entered into in the ordinary course of business and is on normal commercial terms. The approved annual caps for each of the three years ending 31 December 2007 were RMB430 million, RMB1,530 million and RMB530 million, respectively. The payments due to the Group from the Parent Group shall be:

- such prices as may be stipulated by the PRC Government (if any); and if there are no such stipulated prices,
- prices not lower than any pricing guidelines or pricing recommendations set by the PRC Government (if any); and if there are no such pricing guidelines or recommendations,
- prices not lower than market prices; and if there is no market price for a particular product,
- an agreed price consisting of the actual or reasonable cost incurred by the Group in supplying the products plus a reasonable profit.

The term of the framework sale agreement is three years, renewable at the option of the Company for another term of three years by giving three months' notice in writing prior to the expiry of the term.

In the year ended 31 December 2006, the Group's sales to the Parent Group amounted to RMB806.9 million.

### *Framework purchase agreement and supplemental framework purchase agreement*

The Company entered into a framework purchase agreement dated 28 March 2005 with SE Corporation, pursuant to which the Group has agreed to purchase (on a non-exclusive basis) raw materials and component parts from the Parent Group and the Parent Group has agreed to supply (on a non-exclusive basis) such raw materials and component parts to the Group. The pricing basis shall be:

- such prices as may be stipulated by the PRC Government (if any); and if there are no such stipulated prices,
- prices not exceeding any pricing guidelines or pricing recommendations set by the PRC Government (if any); and if there are no such pricing guidelines or recommendations,
- prices not exceeding market prices; and if there is no market price for a particular product,
- an agreed price consisting of the actual or reasonable cost incurred by the Parent Group in supplying the products plus a reasonable profit.

On 29 June 2006, the Company entered into a supplemental framework purchase agreement with SE Corporation, pursuant to which the approved annual caps for the purchase of certain component parts, equipment and raw materials for each of the three years ending 31 December 2008 are revised to/determined to be RMB2,440 million, RMB2,084 million and RMB1,944 million, respectively.

The term of the framework purchase agreement and the supplemental framework purchase agreement is three years, renewable at the option of the Company for another term of three years by giving three months' notice in writing prior to the expiry of the term.

In the year ended 31 December 2006, the Group's purchases from the Parent Group amounted to RMB821.0 million.

### *Framework financial services agreements*

The Company entered into framework financial services agreements dated 29 June 2006 with SE Corporation, pursuant to which Shanghai Electric Group Finance Co., Ltd. ("Finance Company"), a subsidiary of the Company, will resume and/or commence the provision of certain financial services to the Parent Group. The term of the framework financial services agreements is three years, renewable at the option of the Company for another term of three years by giving three months' notice in writing prior to the expiry of the term.

The details of individual framework financial services agreement are as follows:

(i) Framework deposit agreement

Finance Company would provide deposit services to the Parent Group to allow the Parent Group to deposit funds. The approved annual caps, representing the maximum daily balance of funds (including interests) that may be so deposited, for each of the three years ending 31 December 2008 are RMB2,500 million, RMB3,000 million and RMB4,000 million, respectively. The interest rates offered by Finance Company for the deposits placed by the Parent Group shall be:

- subject to the relevant guidelines and regulations of the People's Bank of China ("PBOC"); and
- with reference to the relevant savings rates set by PBOC from time to time and are in line with the market rate.

During the year ended 31 December 2006, the maximum daily balance of funds (including interests) placed by the Parent Group did not exceed the approved annual cap. In addition, the interest for deposits placed by the Parent Group amounted to RMB2.8 million during the year ended 31 December 2006.

(ii) Framework loan agreement

Finance Company would provide loan services to the Parent Group and would pay the face value of bills presented by the Parent Group. The approved annual caps, representing the maximum daily outstanding balance of funds (including interests), for each of the three years ending 31 December 2008 are RMB2,500 million, RMB2,500 million and RMB2,500 million, respectively. The interest rates offered by Finance Company for all loan services and purchases of discounted bills provided to the Parent Group shall be:

- subject to the relevant guidelines and regulations of the PBOC; and
- with reference to the relevant rates set by PBOC from time to time and are in line with the market rate.

During the year ended 31 December 2006, the maximum daily outstanding balance of loans (including interests) did not exceed the approved annual cap. In addition, the interest for loans services and bills discounting was less than RMB1 million during the year ended 31 December 2006.

(iii) Framework guarantee agreement and supplemental framework guarantee agreement

Finance Company entered into a framework guarantee agreement dated 28 March 2005 with SE Corporation before the listing of the Company, pursuant to which Finance Company decided not to provide any new guarantees in favour of the Parent Group except for the guarantees provided to the Parent Group prior to 30 January 2005 and which are still subsisting as at 28 April 2005.

The Company entered into a supplemental framework guarantee agreement with SE Corporation on 29 June 2006, pursuant to which Finance Company will provide corporate or credit guarantee for letters of credit, customer orders, project biddings, engineering projects and other liabilities of the Parent Group with a one-off

service charge based on the guaranteed amount. The approved annual caps, representing the maximum daily balance for financial services provided by Finance Company to the Parent Group, for each of the three years ending 31 December 2008 are RMB800 million, RMB1,000 million and RMB1,200 million, respectively. A one-off service charge of about 0.1% is equivalent to that currently charged by other independent financial institutions for guarantee services of similar nature and is in line with the current market rate.

During the year ended 31 December 2006, the maximum daily balance for financial services provided to the Parent Group did not exceed the approved annual cap. In addition, the service charge for corporate or credit guarantee was less than RMB1 million during the year ended 31 December 2006.

(iv) Framework intermediary financial services agreement

Finance Company has provided intermediary financial services to the Parent Group, mainly including corporate financial advisory services and credit agency services. The intermediary financial services provided by Finance Company to the Parent Group do not involve the use of funds of Finance Company. The approved annual caps for the fee of provision of intermediary financial services under the framework intermediary financial services agreement for each of the three years ending 31 December 2008 are RMB3 million, RMB6 million and RMB9 million, respectively. A one-off service fee of approximate 0.6% of the loan amount provided by the credit agency is charged, which is equivalent to that charged by other independent financial institutions and is in line with the current market rate; and the fees for the provision of financial advisory services is charged by Finance Company based on the actual or reasonable cost incurred plus a reasonable profit margin, not less than 20% normally, based on the type and nature of individual transactions.

During the year ended 31 December 2006, the total fee charged by Finance Company for the provision of intermediary financial services did not exceed the approved annual cap. In addition, the service charge for financial advisory services was less than RMB1 million during the year ended 31 December 2006.

## *Continuing connected transactions with Siemens*

The Group has had purchases of equipment, related components and technologies from Siemens Aktiengesellschaft ("Siemens"), who indirectly owns more than 10% of the registered capital in certain subsidiaries of the Company. Prior to the initial public offering of the Company, the Group had, in the ordinary course of business and on normal commercial terms, entered into several agreements with

Siemens on an "ad hoc" and "need be" basis. The aggregate amounts of transactions approved according to those agreements which fell within the years 2006 and 2007 were RMB1,450 million and RMB96 million, respectively. Due to the business expansion of the Group, the additional approved annual caps for continuing connected transactions for the purchases of equipment, related components and technologies from Siemens for each of the three years ending 31 December 2008 were RMB841 million, RMB1,274 million and RMB1,159 million, respectively. As a result, the total approved annual caps for the purchases of equipment, related components and technologies from Siemens for each of the three years ending 31 December 2008 were RMB2,291 million, RMB1,370 million and RMB1,159 million, respectively. The price of products to be sourced from Siemens is determined with reference to the then prevailing market price.

During the year ended 31 December 2006, the Group's purchases of equipment and components from Siemens totalled RMB1,466.7 million.

### *Framework equipment lease agreement*

The Company entered into a framework equipment lease agreement dated 29 June 2006 with SE Corporation, pursuant to which Shanghai Electric Equipment Lease Co., Ltd., a 95%-owned subsidiary of the Company, is allowed to provide both operating lease and finance lease services under its business licence to the Parent Group. The equipment leased to the Parent Group should be purchased from manufacturers and suppliers outside the Group and mainly include machine tools, grinders and machine centers. The approved annual caps of the equipment leasing to the Parent Group for each of the three years ending 31 December 2008 are RMB50 million, RMB50 million and RMB50 million, respectively. The pricing basis of leasing services shall be:

- such prices as may be stipulated by the PRC Government (if any); and if there are no such stipulated prices,
- prices not lower than any pricing guidelines or pricing recommendations set by the PRC Government (if any); and if there are no such pricing guidelines or recommendations,
- with reference to the market price; and if there is no market price for a particular product,
- an agreed price consisting of the actual or reasonable cost incurred by the Group in supplying the products plus a reasonable profit.

The term of the framework equipment lease agreement is three years, renewable at the option of the Company for another term of three years by giving three months' notice in writing prior to the expiry of the term.

During the year ended 31 December 2006, the Group did not provide any leasing service to the Parent Group.

### *Continuing connected transactions with Ersol*

On 30 January 2005, Shanghai Environment Protection Complete Engineering Co., Ltd. ("SEPCE"), a 100%-owned subsidiary of the Company, Ersol Solar Energy AG ("Ersol") and Shanghai Silverstone Terry Investment ("Shanghai Silverstone") entered into a joint venture agreement (the "JV Agreement") for the establishment of Shanghai Electric Solar Energy Co., Ltd. (the "JV Company"). The JV Company is owned as to 55% by SEPCE, 35% by Ersol and 10% by Shanghai Silverstone.

Pursuant to the JV Agreement, parties to the JV Agreement agreed, as part of the terms in the establishment of the JV Company, inter alia, that the: (i) Ersol will provide the required Photovoltaic ("PV") cells (a component used in the production of PV modules) to the JV Company based on production requirements from time to time; and (ii) the JV Company will sell certain percentage of finished products (PV modules) back to the Ersol Group. The approved annual caps, representing the aggregate amount of purchases/sales, for each of the three years ending 31 December 2008 are RMB176 million/RMB142 million, RMB235 million/RMB309 million and RMB293 million/RMB503 million, respectively. The prices of PV cells and PV modules are determined with reference to the then prevailing market price.

During the year ended 31 December 2006, the aggregate purchases of PV cells from Ersol and the sales of PV modules to the Ersol Group amounted to RMB41.4 million and RMB41.1 million, respectively.

### *Hudong framework sale agreement*

On 29 June 2006, the Company entered into a framework sale agreement with Hudong Zhonghua Shipbuilding Co., Ltd. ("Hudong Zhonghua"), who owns a 20.19% equity interest in Shanghai Ship-use Crankshaft, pursuant to which Shanghai Ship-use Crankshaft has agreed to sell ship-use crankshafts to Hudong Zhonghua at a price determined with reference to the then prevailing market price. The approved annual caps for each of the three years ending 31 December 2008 are RMB80 million, RMB234 million and RMB272 million, respectively.

The term of the framework sale agreement is three years, renewable at the option of the Company for a further term of three years by giving three months' notice in writing prior to the expiry of the term.

During the year ended 31 December 2006, the total sales of ship-use crankshafts to Hudong Zhonghua amounted to RMB36.7 million.

### *Alstom framework purchase agreement*

Shanghai Alstom Transport Co., Ltd. ("Altstom Transport"), an indirectly held 60%-owned subsidiary of the Company, entered into a framework purchase agreement dated 29 June 2006 with Alstom (China) Investment Co., Ltd. ("Alstom Investment"), who owns a 40% equity interest in Altstom Transport, pursuant to which Alstom Transport has agreed to purchase certain equipment and related components from Alstom Investment for manufacturing metropolitan railcar equipment. The framework purchase agreement is entered into in the ordinary course of its business and is on normal commercial terms. The approved annual caps for each of the three years ending 31 December 2008 are RMB 293 million, RMB 413 million and RMB 340 million, respectively. The price of products purchased under the framework purchase agreement shall be determined on the basis of the then prevailing market price.

The term of the framework purchase agreement is three years, renewable at the option of Alstom Transport for another term of three years by giving three months' notice in writing prior to the expiry of the term.

During the year ended 31 December 2006, the total purchases of products from Alstom Investment amounted to RMB71.3 million.

Pursuant to its letter dated 12 April 2005, the Stock Exchange has granted the Company a waiver of compliance with Chapter 14A of the Listing Rules for the continuing connected transactions till 31 December 2007 in respect of the framework agreements entered into between the Group and SE Corporation prior to the listing of the Company.

The independent non-executive directors of the Company have reviewed the continuing connected transactions set out above and in note 51 to the financial statements and have confirmed that these continuing connected transactions were entered into (i) in the ordinary and usual course of business of the Group; (ii) on normal commercial terms or on terms no less favourable to the Group than terms available to or from independent third parties; and (iii) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

## Sufficiency of Public Float

Based on information that is publicly available to the Company and within the knowledge of the directors, 23.75% of the Company's total issued share capital was held by the public as at the date of this report. The Stock Exchange agreed to exercise its discretion under Rule 8.08(1)(d) of the Listing Rules to allow the minimum prescribed percentage of the Company's total issued share capital which at all times must be held by the public to be 23.75%.

## Post Balance Sheet Events

Details of the significant post balance sheet events of the Group are set out in note 53 to the financial statements.

## Auditors

Ernst & Young retire and a resolution to appoint auditors of the Company will be proposed at the forthcoming annual general meeting.

On behalf of the board

Xu Jianguo
Chairman
Shanghai, PRC
13 April 2007