

## 4. Management Discussion and Analysis

### (1) Analysis of principal operating results and financial position of the Company

The principal operations of the Company include hydro turbine generators, steam turbine generators, A.C. and D.C. electrical motors and controlling devices.

In the first half of the year, the Company focused on the directions and targets designed for 2004 and overcame the difficulties caused by the tight supply of raw materials and short delivery periods. The Company tapped deeply its potential, raised its operating efficiency and added steam to technological improvement and investment, thus accomplishing smoothly all the production and operating goals set for the first six-month period of the year and posting new historical highs in both output and sales revenue. Sales revenue amounted to RMB891,380,000. The Company built 10 hydro turbine generator sets with generation capacity of 1,192.5 MW; 15 sets of steam turbine generators with generation capacity of 5,000 MW; 40 sets of A.C. and D.C. electrical motors with generation capacity of 43.704 MW. In addition, the Company achieved satisfactory results in sales and marketing, as evidenced by the signing of a batch of milestone contracts in respect of the design and manufacture of four huge 700 MW hydro turbine generator sets for the right coast of the Three Gorges, one 600 MW hydro turbine generator set for Pubugou, one 1,000 MW supercritical steam turbine generator set for Zhouxian and one impact hydro turbine generator set for Tianwanhe. Orders received by the Company amounted to more than RMB6,000 million.

1. Analysis of revenue from and cost of principal operations (prepared under PRC Accounting Standards)

	Revenue from principal operations (RMB'000)	Percentage of revenue from principal operations (%)	Costs of principal operations (RMB'000)	Gross profit margin of principal operations (%)
Electric power generating equipment	835,247	93.7	547,250	34.48
Technology improvement services and others	56,137	6.3	35,684	36.43
Total	<u>891,384</u>	<u>100</u>	<u>582,934</u>	

2. Analysis of the Company's principal operating results and financial position (prepared under PRC Accounting Standards)
- (1) The Company's profit from principal operations for the reporting period amounted to RMB304,336,000, representing an increase of 102.22% over the previous comparable period, which was principally due to a significant growth in sales revenue.
  - (2) Profit from other operations for the reporting period was RMB8,573,000, representing an increase of 131.27% compared to the same period last year, which was attributable to a significant increase in profits from sales of materials and semi-finished products.
  - (3) Net profit for the reporting period rose 94.43% to RMB36,880,000, principally due to: a) an increase of RMB153,839,000 in profit from principal operations; b) a rise of RMB4,866,000 in profit from other operations; c) a reduction of RMB12,604,000 in finance costs resulting from repayment of long- and short-term loans.
  - (4) Cash and cash equivalents recorded a net increase of RMB462,835,000, which was a 216.93% growth compared to the previous corresponding period as a result of a substantial increase in monetary fund.
  - (5) Closing balance of total assets amounted to RMB4,724,481,000, increased by 27.18% from the end of last year. Main reasons include: a) an increase of RMB659,554,000 or 50.83% in monetary fund over last year due to the increased contract deposits arising from a significant increase in sales contracts signed in the reporting period; b) an increase of RMB151,648,000 or 26.09% in inventories, which was a result of the considerable rise in reserves of raw materials and products arising from significantly increased production tasks.
  - (6) Closing balance of total liabilities grew 35.18% to RMB3,737,357,000 from the end of the prior year. This was mainly because of an increase of RMB1,125,553,000 or 72.31% in prepayments received from clients over last year due to more sales contracts signed during the period.
  - (7) During the reporting period, the Company's gearing ratio was 79.11%, basically unchanged as compared with the previous year.

- (8) During the same period, gross profit margin of the Company's principal operations grew 5.82 basic points over the comparable period last year, and 9.69 basic points over last year, which was mainly attributable to increased output and sales revenue as well as a restructured product mix.
3. During the reporting period, there was no other business of the Company that had a significant impact on its net profit for the reporting period.
4. There was no income from the investment of a single company in which the Company had an equity interest that affected more than 10% of the Company's net profit.
5. Problems and difficulties in operation

The major difficulty encountered by the Company is how to ensure completion and delivery on schedule in the face of a heavy production workload. As such, the Company made efforts to strengthen the organization and management of the whole production process, ensure smooth coordination among all production sectors, explore its potential and raise work efficiency. In the meantime, the Company expedited the implementation of technological renovation projects aimed at expanding production capacity, while putting emphasis on market analyses of raw materials supply, optimizing reserves of raw materials by actively seeking suitable sources, and speeding up subcontracting for various products. As a result, the Company overcame all these problems and ensured the accomplishment of its production and operating goals.

6. Business outlook for second half of 2004

In view of the planned production and the outstanding orders, the Company will have to encounter a tougher production environment in the second half of 2004 and the coming year. Accordingly, the Company will keep on enhancing operating efficiency to ensure accomplishment of production tasks by focusing on the following work: Firstly, continuing the improvement of organization and management of production in line with product characteristics in order to further resources and potential exploitation, strengthen the integrated management of products, and build a high-speed, balanced and stable production model; secondly, securing the supply of raw materials by planning ahead and maintaining raw materials reserve at an appropriate level; thirdly, refining marketing strategies in a timely fashion, securing orders for the next few years and reinforcing control over projects underway through accurate analyses of external markets; and fourthly, expediting the progress of technical renovation to realize production capacity as quickly as possible.

## (2) Use of proceeds

In accordance with the undertakings stipulated in the Company's Prospectus for the issue of A shares and H shares, the proceeds of RMB752,548,000 from the A shares and H shares listing have to be applied in the four projects which involve the technological renovation for improving the electric power generation capacity of hydro turbine generator sets. Utilization of the proceeds up to 30 June 2004 was as follows:

Projects stipulated in the Company's Prospectus:

- (1) In respect of the technological renovation projects for improving electric power generation capacity of hydro turbine generator sets, the total planned investment was RMB 670,000,000. In the first half of the year, the actual investment amounted to RMB61,589,000. To date, the cumulative actual investment in this project amounted to RMB340,071,000. Through the implementation of the technological renovation plan, the electric power generation capacity and technology level of hydro and steam turbine generator sets of the Company have been enhanced and the competitiveness of the Company has been strengthened.
- (2) In respect of the capital inputs in joint venture projects with foreign investors for the production of large-scale hydro turbine generator sets and steam turbine generators, the total planned investment was RMB160,000,000. On 6 March 2001 and 27 May 2002, the Company convened an extraordinary general meeting and an annual general meeting for 2001 respectively, approving the Company to change the use of RMB160,000,000, which was initially intended to be contributed to the joint venture projects with foreign entities regarding large-scale hydro turbine generators and large-scale steam turbine generators, to the use as working capital due to insufficiency thereto. Currently, the change of use for this portion of the proceeds has been put into effect.
- (3) In respect of the additional working capital, the total planned investment was RMB150,000,000. The actual investment amounted to RMB150,000,000. The investment had been completed.
- (4) In respect of the repayment of the loans in the Seventh and Eighth Five-year Plans, the total planned investment was RMB75,000,000. The actual investment amounted to RMB88,449,000. The investment had been completed.

As at 30 June 2004, outstanding balance of the proceeds amounted to approximately RMB14,028,000. The Company has deposited the unused proceeds with domestic banks.

**(3) Net profit warning for the end of the next reporting period**

The Company anticipated a net profit of RMB10,346,000 for January to September 2003 under the PRC accounting standards. Because of several factors including a growth in sales volume, the Company anticipated a substantial increase in net profit for January to September 2004 as compared to the corresponding period last year. Concrete data will be disclosed in detail in the 3rd Quarterly Report of 2004.

**(4) Liquidity and financial resources**

As at the end of June 2004, the Company's borrowings amounted to RMB90,000,000. Since its incorporation, the Company has never delayed any repayment of due debts.

**(5) Employees**

As at 30 June 2004, the Company had 7,203 staff members, who were remunerated on a pay system linking wages with personal performance and achievements.

**(6) During the reporting period, the Company did not pledge any of its assets.**

**(7) Foreign exchange risk and any related hedging**

As the Company only holds foreign currency in US dollars and the amount is insignificant, there is no material exposure to foreign exchange risks. The Company also makes use of forward contracts to buy foreign currency when purchasing imported materials from abroad in order to off-set the potential risk of exchange rate fluctuations.

**(8) Contingent liabilities**

As at 30 June 2004, the Company had incurred no contingent liability.