

## Chairman's Report

The Board of Directors (the "Board") 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 2005. The Group's results have been audited by Ernst & Young.



**Wang Chengming**  
*Chairman*

Turnover for 2005 was RMB34.4 billion (2004: RMB24.5 billion), representing an increase of 40.4% over last year. Profit attributable to equity holders of the Company was RMB1,672 million (2004: RMB1,089 million), representing an increase of 53.5% over last year. Basic earnings per share was RMB15.17 cents (2004: RMB11.85 cents). These figures keep growing at a fast rate. The Board recommends the payment of a final dividend of RMB4.1 cents per share.

### Business Review

The year under review saw significant changes for the Company. On 28 April 2005, the Company was listed on the main board of the Stock Exchange of Hong Kong as a result of the successful launch of its global offering of H shares. The Group attained encouraging operating results. Thanks to the concerted efforts of its management and staff and efforts of the various operating units. Rapid growth was recorded for power equipment division for the year in review and this rapid growth continues to be sustained.

In line with its goal of growing into a first-tier domestic and world-class equipment manufacturing conglomerate with capabilities for technology development and sustainable growth, the Group placed emphasis on research and development and implemented initiatives to upgrade its scale and its scope of operations, existing technologies and production capabilities, hence reinforcing its core competitiveness. During the year, the Group attained the following achievements:

#### **Expanded market presence and undertook various domestic and international key projects**

The Group undertook a project for the construction of two 600 MW power plant in Liulin, Shanxi, and a project for two 300 MW power plant in Yamuna, India. In the meantime, the Group capitalised on the favourable opportunities arising from the development of nuclear power industry in the PRC and secured a contract for the provision of key components for two 600 MW nuclear power generation units for Phase Two of Qinshan Nuclear Power Station, which has a total con-

tract value of RMB880 million. In addition, the Group also made aggressive effort to expand into the new area of environmental conservation projects. It secured a sewage project for the chemical industry zone in Yancheng, and a project in Rugao for 4X350 tonnes per day solid waste incineration with heat and electricity co-generation. Optimising on the opportunities in the power plant environmental conservation market, the Group endeavoured and secured a series of desulphurisation projects for two 600 MW power plants in Liyujiang, Hunan, marking the Group's full-scale entry into the desulphurisation and denitration market. Capitalising on its overall strengths, the Group secured a distribution control system ("DCS") project for four 600 MW thermal generation units, which is the largest domestic DCS project and represents a major breakthrough of the Group in the sector. In addition to the orders themselves, the undertaking of these major projects added to the brand image of the Group and enhanced the Group's market influence.

#### **Strengthened development of core businesses with a series of key projects and products**

Focusing on the long-term growth in the advanced equipment-manufacturing sector, the Group formulated a detailed operations proposal after studying and considering the advanced models of international equipment manufacturing bases. Accordingly, Shanghai Electric Lingang Heavy Machinery Company Ltd was established with the aim of building up a presence in the advanced equipment manufacturing industry of the PRC. Construction of Phase I of the Lingang Base commenced on 9 July 2005 and has since been progressing smoothly. The Group made tremendous efforts in the development of high-end products. In the past year, the Group made headway in the areas of 1,000 MW ultra-super-critical power generation units, 1,000 MW nuclear power generation units and gas turbines. In addition to the four 1,000 MW ultra-super-critical thermal power generation units of Yuhuan, the Group further undertook a project for two 1,000 MW ultra-super-critical power generation units for Phase III of Waigaoqiao Power Plant in Shanghai. Domestic manufacturing of gas turbines is launched in full-scale. The first gas turbine was completed and delivered to Shidongkou Power Plant in August 2005.

#### **Strengthened technology and product development efforts and successfully developed a series of innovative products and proprietary intellectual properties**

The Group established a technology planning development framework and identified a series of key industry-specific objectives, RMB1,820 million of the IPO proceeds were utilised in 2005, representing 74.3% of the proceeds of RMB2,450 million approved by the Board to be so utilised. The Group successfully applied for 261 patents and developed 173 key new products. In the first half of the past year, the Group also entered into the fourth batch of high technology and industrialisation agreements with the Chinese Academy of Science, embarking on a series of key research and development projects covering projects with a sales volume of over RMB12,000 million. The 100MN oil hydraulic dual-movement and pressing technology and equipment jointly developed by Shanghai Heavy Machinery Plant Co., Ltd. with Shandong Conglin Group and Xi'an Research Institute of Heavy Machinery was awarded "First-class Award for Technology Advancement of the State. Additionally, the 120KV high-pressure laboratory of Shanghai Power Transmission & Distribution Co., Ltd. passed State inspection in the past year.

**Strengthened the development of new business segments and expanded business scopes**

The Group actively diversified into new business areas through joint ventures, business cooperation and acquisitions. Solar energy is one of the new business areas in which the Group has expanded into in the year under review. Subsequent to the investment in and control of Shanghai Electric Solar Energy Co.,Ltd., the Group further acquired Shanghai Topsolar Green Energy Co., Ltd. Moreover, SE Equipment Leasing Co., Ltd. was established with capital investment, which achieved the organic fusion of finance and equipment manufacturing businesses. Our leasing business recorded over 30 transactions in the past year, promoting sales of approximately RMB100 million for the Group.

**Strengthened management and scientific and regulated operation**

The Group has strictly complied with the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules") and the applicable laws and regulations and ensured prudent and regulated operation. In 2005, the Group embarked on a series of effective corporate governance initiatives, including the establishment of internal control system pursuant to regulatory requirements. The implementation of refined management further heightened the corporate governance standard of the Group. In order to achieve institutionalised and regulated management, the Group formulated and further improved a series of management systems, including information disclosure regulations and various rules governing the technological statistics management, property rights management, management and appraisal over financial controllers, and inventory control system. Management of bank accounts of subsidiary companies was strengthened with requirements for fund centralization and management further tightened, so as to take advantage of the platforms provided by the finance company of the Group. Through the online bank settlement system jointly operated by the Group and the Industrial and Commercial Bank of China, innovative settlement approach was adopted and fund centralisation of over 80% for the Group was achieved. In the mean time, the Group strengthened its basic management work, regulated investment management, reinforced the construction of its internal control system and implemented a risk management system to maintain the sustained, healthy and steady economic growth of the Group.

**Future Outlook**

The "Eleventh Five-year Plan" period is a critical period for the development of the Group. The Group is facing a favourable external environment as the State Council's Certain Opinions on Rejuvenating the Equipment Manufacturing Industry indicated support for the advanced equipment manufacturing industry. In particular, Shanghai Municipal Government targeted to bring the advanced equipment manufacturing industry in Shanghai to a world-class standard. As for the internal conditions, the Group enjoys improved advantages through innovations in technologies and equipments and technology investment. In addition, the Group can tap into the financing channels of domestic and overseas capital markets. Leveraging on the premium geographical location and talent bank of Shanghai, the Group has the advantage and potential for future development.

Looking ahead, the Group will continue to implement its objectives of technology development, consolidate the reforms and refinement of its various internal control and management systems and mechanisms, improving new technologies and equipment, pursue breakthrough in both business and management enhancement, adopt dual focus on both the manufacturing and service businesses and attaining economies of scale and improving quality, thereby creating more value for the shareholders. Set out below are the development goals of the Group:

#### **Power Equipment Division**

During the "Eleventh Five-year Plan" period, the power generation equipment business aims at becoming a supplier with competitive edge in the global market while power transmission and distribution equipment business will strive to achieve breakthrough in high pressure and ultra high pressure key equipments and become one of the major contractors for power transmission and distribution projects in the PRC.



#### **Electromechanical Equipment Division**

With regards to our escalator and printing and packaging equipment businesses, we aim to maintain our leading position in the PRC with competitiveness in the international market. We will work towards enhancing and achieving integrated competitiveness of our products for our machine tools business. For our heavy machinery business, we plan to become a global supplier of large-scale casting and forging pieces for ship-building, ship use crankshafts, ship use heavy machinery and key components complementary to power station equipment production.



#### **Transportation Equipment Division:**

We target to become one of the major contractors of rail transportation projects in the PRC. For the diesel engine business, the objective is to achieve first-grade standard in the PRC in the aspects of adaptability, reliability, absorption of core technologies, economy and service quality.



**Environmental Systems Division:**

Our goal is to focus on the development of power plant desulphurization and denitration systems, urban waste treatment system, sewage treatment system, waste incineration and small to medium size power generation unit smoke purification system and solar photovoltaic cells business. We also target to become one of the important manufacturers of desulphurization and denitration systems in the PRC and to develop capability in environmental project undertaking and to expand the business scope of environmental projects. For the solar photovoltaic cells business, we plan to achieve major breakthrough in technology, system integration and engineering work application.



To this end, the Group will adopt three measures to ensure the attainment of its strategic goals for 2006 and the "Eleventh Five-year Plan" period:

**I. Persist in "dual focus" for business expansion**

Firstly, the Group will insist the pursuit of "new structure and mechanism, and new technology and equipment". It will establish a regulated corporate governance structure pursuant to modern corporate system requirements. Active efforts will be devoted to the reforms of systems and mechanisms of the Company and achieve business elevation with new technologies and equipment, thereby establish a technology-driven and more robust business. Secondly, the Group will focus on a grand scale in terms of projects, base and development, aiming to achieve breakthrough in grand-scale projects to drive construction of grand-scale base and achieve grand-scale development.

**II. Strengthen the Group's control over three major areas and optimise the Group's control and management system framework**

The Group will strengthen its control over the direction of development of its businesses and formulate top-to-bottom business development strategy to achieve business centralisation. It will also strengthen the control over technological innovation and lead industry development through reinforced coordination and leadership of technology development. In addition, it will strengthen the control over its assets to cover every aspects of control including budgeting, investment and assets disposal.

### **III. Adopt four initiatives to enhance the Group's competitiveness**

The first initiative is to promote proprietary innovations and implement technology innovation strategy. Leveraging on the Central Academy and on the basis of the Group's enterprise technology centres at national and municipal levels, the Group will endeavour to breakthrough the bottlenecks for the development of the equipment manufacturing business and acquire more proprietary technologies. The second initiative is to promote the extension of the business chain and aggressively explore new business areas. Building on the inherent advantage of its equipment manufacturing business, the Group will actively develop production service business and engineering business and enhance its system integration capability to open up new scopes of profitability. The third initiative is to optimise the Group's business structure and implement the strategy of business centralisation. The Group will focus on reinforcing the construction of the Lingang equipment manufacturing base with the aim of establish basic foundation in the first two years and achieving certain scale in the third to fifth years, building it into a representative symbol of the advanced equipment manufacturing industry of the PRC. The fourth initiative is to strengthen joint venture and acquisition efforts and implement the outbound development strategy. The Group will acquire potential and professional overseas companies as one of its means of business upgrade and implement the growth strategy of attracting overseas capital and achieving outbound development through capital markets.

The Group is fully confident in its future prospects. Through its relentless efforts, the Group will create more 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 of 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 over the past year.

**Wang Chengming**

*Chairman*

25 April 2006