

V. MANAGEMENT DISCUSSION AND ANALYSIS

(I) Business Review

In the first half of 2006, all the employees of the Company closely followed the administrative policies of the Company to enhance administrative efficiency and working capacity. As a result, production and operation tasks targeted for the first half of the year were completed, with production volume, revenue from principal business and net profit surpassed its historical peak compared to the corresponding previous period. In the first half of 2006, the Company recorded sales revenue of RMB2.01 billion. It produced 20 units of hydro turbine generators accounting for production volume of 705MW, 24 units of steam turbine generators accounting for production volume of 9405MW, 8 Units of AC Motors accounting for the production volume of 20.67MW and 23 units of DC motors accounting for production volume of 26.955MW. In addition, 164 sets of ancillary machine equipment were produced. New orders amounted to RMB1.8 billion.

(II) Operating status of the Company during the reporting period (prepared in accordance with PRC GAAP)

1. Principal operations by business or product

Unit: RMB'000

By business or product	Income from principal operations	Cost of principal operations	Gross profit margin (%)	Change in income from principal operations as compared with the same period last year (%)	Change in cost of principal operations as compared with the same period last year (%)	Change in gross profit margin as compared with the same period last year (%)
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By business						
Machinery manufacturing	2,012,965	1,439,890	28.47	71.12	85.73	Decrease of 5.63 percentage points
Total	2,012,965	1,439,890	28.47	71.12	85.73	Decrease of 5.63 percentage points
By product						
Power generation equipment	1,953,424	1,391,571	28.76	82.23	98.40	Decrease of 5.81 percentage points
Technological renovation, provision of services and others	59,541	48,319	18.85	-42.96	-34.57	Decrease of 10.41 percentage points
Total	2,012,965	1,439,890	28.47	71.12	85.73	Decrease of 5.63 percentage points
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2. Principal operations by geographical region

Unit: RMB'000

Region	Income from principal operations	Change in income from principal operations as compared with the same period last year (%)
The PRC	2,012,965	71.12

3. Reasons for significant changes in profitability of principal business (gross profit margin) when compared with the same period last year

- (1) the production cost of gas turbine generators, a new product of the Company, was relatively high which affected the profit in the period.
- (2) the Company increased outsourcing business in order to cater for the heavy production volume and alleviate the pressure of products delivery, which in turn increased the production cost and reduced the profit margin of fire and electricity power products.
- (3) among the sales revenue, sales of hydro and electric power products represented a higher percentage compared with the same period of last year, while hydro and electric power products carried a low profit margin, which affected the consolidated profit margin.

4. Reasons analysis of material change in profit composition when compared with the same period last year

- (1) Profit from principal business for the reporting period accounted to RMB571,887,000, dropped by 25.94 percentage points of the total profit compared with the same period last year. It was mainly due to the decrease in gross profit margin of products during the reporting period.

- (2) Operating expenses for the reporting period accounted to RMB159,756,000, dropped by 29.49 percentage points of the total profit compared with the same period last year. It was mainly due to the decrease in finance expenses during the reporting period.

(III) Financial Analysis of the Company (Prepared in accordance with HK GAAP)

1. Financial Status

As at 30 June 2006, the current assets of the Company amounted to RMB7,896,688,000 (31 December 2005: RMB7,706,536,000). The items with relatively significant changes and the reasons thereof are analysed as follows:

- (1) Cash and bank balances amounted to RMB3,296,972,000, representing a decrease of 18.14% compared with RMB4,027,493,000 as at 31 December 2005. The decrease was mainly due to the additional procurement of raw materials and outsourcing business in order to cater for the heavy production need.
- (2) Inventories amounted to RMB2,316,630,000, representing an increase of 29.13% compared with RMB1,794,023,000 as at 31 December 2005. The increase was mainly attributable to the increase in inventory level of raw materials and processing products in view of the long-term production volume.
- (3) Accounts receivable, deposit and prepayment amounted to RMB1,903,479,000, representing an increase of 17.24% compared with RMB1,623,534,000 as at 31 December 2005. The increase was mainly attributable to increased sales volume and investment in production.

As at 30 June 2006, the current liability of the Company amounted to RMB6,715,160,000, representing an increase of 1.32% compared with RMB6,627,398,000 as at 31 December 2005. The change was minimal.

2. Capital Structure

The funds of the Company were mainly from sales of products, majority of which was used for production and operation of the Company. As at 30 June 2006, the liability ratio of the Company was 369.80% (30 June 2005: 411.91%). The decrease was mainly attributable to the increase in profit in the reporting period, resulting in a significant increase in equity. The debt to equity ratio was 0.54% (30 June 2005: 2.10%). The decrease was mainly attributable to the Company's efforts in reducing its loans. At present, the Company maintains a strong debt repayment ability and a better fund raising ability in future.

3. Gearing Ratio

As at the end of the reporting period, the total assets and total liabilities amounted to RMB8,725,566,000 and RMB6,868,249,000 respectively. The gearing ratio was 78.71%, representing a decrease of 1.21 percentage points compared with 79.92% as at the end of last year.

4. The risk in fluctuation of exchange rate

The amount of deposit in foreign currency was minimal and therefore the Company was less susceptible to exchange rate fluctuation

5. During the reporting period, the Company did not incur any contingent liability or pledge of assets.

(IV) INVESTMENT OF THE COMPANY

1. During the reporting period, the Company had no proceeds raised or funds brought forward from previous periods.
2. The Company's investment in the reporting period was RMB98.12 million, comprising mainly the investment in equipment amounting to RMB56.40 million and investment in land construction amounting to RMB41.72 million.

(V) Problems and difficulties in operation

The major challenge encountered by the Company is to complete heavy production volume and to ensure delivery in accordance with schedule. As such, the Company has made efforts to reinforce the overall management of the entire production line, to ensure smooth coordination among production sectors, exploring internal potential and to enhance efficiency. In the meantime, the Company also placed emphasis on procuring raw materials and subcontracting for various products. Through the efforts, the Company accomplished its production and operating target.

(VI) Overview for the second half of 2006

Based on the production plan and the orders at hand, production task of the Company for the second half of 2006 and year 2007 will be heavy. Therefore, the Company will focus on improving efficiency so as to ensure tasks fulfilled for the second half of 2006. The major tasks are as follows: (1) to continuously improve production management based on particular features of a product, to explore potential capacity of resources, to enhance overall operating effectiveness so as to ensure a rapid, stable and sustainable development of production; (2) to ensure raw material supply, including procurement and delivery of raw materials and maintaining a reasonable inventory level of raw materials; (3) to promptly adjust its marketing strategies in response to market change, placing emphasis on exploring new market and at the meantime monitoring ongoing projects ; (4) to put efforts on related research, new product development and technological know-how, development of core technology in order to enhance Company's technological competitiveness.