

Management Discussion & Analysis

Sector Overview and
Review of Operations



THE ROAD TO PROSPERITY

China has travelled a long way down the road to prosperity and the resounding success of the Open Door Policy remains unprecedented in the economic history of the world. Today, the PRC economic engine produces a higher GDP output in just twelve days than the country generated in the entire year of 1952. All in all, this prolonged and vibrant period of economic prosperity has had a positive impact on the trade sector.

The PRC GDP surpassed US\$1 trillion for the first time during the Ninth Five Year Plan (1996-2000). In addition, the trade sector had a record-breaking run with figures buoyed by rising foreign investment. The US\$1 trillion milestone is a watershed in the prosperity of the Chinese people. This achievement is especially impressive considering the challenges faced by state-owned enterprise reform, a massive financial restructuring, a rise in world oil prices and a global economic slowdown.

Indeed, the economy maintained its fast pace throughout the 1990s. By 1995, China's GDP reached RMB5.8 trillion or 2.1% of the world total. This rose to RMB8.9 trillion or 2.4% of world GDP in 2000 for an average annual increase of 8% over the decade. Another important

economic indicator is the growing wealth of the average Chinese citizen. This improved purchasing power bodes well for the port sector, which expects to see a flood of imports when China opens its doors to WTO members.

Consumer demand powers economic growth and there are plans to increase investment to stimulate consumption. While strengthening the all-important agricultural foundation the government will improve the efficiency of secondary industries and develop more efficient tertiary industries, especially in the information and financial services sectors. Nonetheless, the current global economic slowdown will affect China and the government must commit to a policy geared to improving prosperity.

Growing Capital Pools

One measure of prosperity is the broad expansion of all sectors of the economy. The sectors of transportation, communications, infrastructure, energy and telecommunications are stronger than ever due to sustained growth and government support. Domestic enterprises are booming and the promise of future expansion is present. For instance, large-scale industrial enterprises registered a RMB426.2 billion profit in 2000, an 86% rise over 1999.

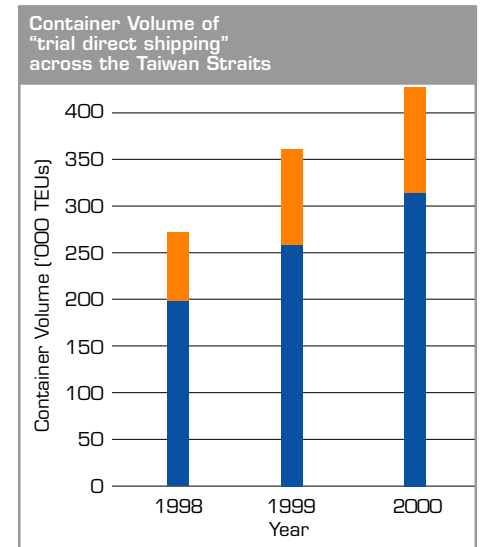
The world has taken notice of China's prosperity and the resilience of its market. As the largest recipient of foreign direct investment, accumulated foreign investment reached nearly US\$290 billion in the Ninth Five Year Plan, an 80% rise over the Eighth Five

Year Plan (1991-1995). China will attract an average of US\$57.6 billion a year or 6.5% of the global total, making it the fastest growing foreign direct investment recipient. In addition, by the end of June 2001 foreign currency reserves stood at US\$180.8 billion, compared with US\$92 billion in 1995. The formation of one of the world's largest foreign currency reserves is another sign of the influence of trade.

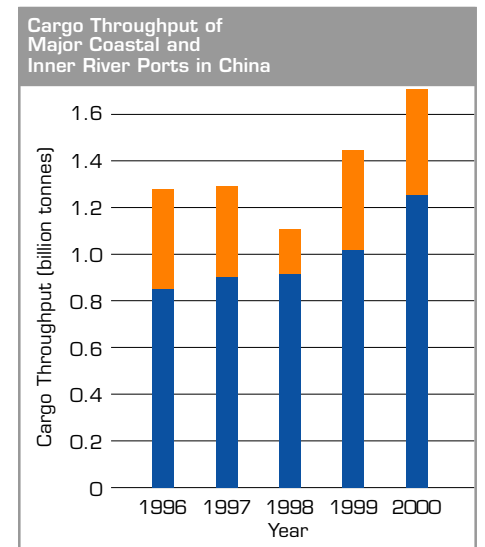
The fundamentals of the economy are strong and the port sector is a great beneficiary of the prosperity trend. With sweeping consumerism, the growing buying power of upwardly mobile urban dwellers and an impressive export potential the port sector is experiencing unparalleled growth. These factors, combined with accession to WTO, positions the port sector for greater expansion than any counterpart on the global stage.

Opportunities for Trade

Currently, China ranks as the seventh largest trading nation with import and export volumes of US\$474.3 billion in 2000. By 2005, the total value of imports and exports is expected to exceed US\$680 billion. This is good news for the port sector, as nearly 84% of all export cargo is handled by ship and 90% of imports and exports pass through ports. China's coastline is 18,400 kilometers in length with 11 coastal provinces, cities and regions accounting for some 40% of the population and 56% of total GDP. In terms of coastal prosperity the port sector is a fundamental part of



■ Xiamen <-> Kaohsiung ■ Fuzhou <-> Kaohsiung
Source: The 2000 Report on China's Shipping Development



■ Major Coastal Ports ■ Inner River Ports
Source: The 2000 Report on China's Shipping Development

development and the role of its 1,900 ports and 230,000 shipping vessels weighing in at over 50 million tonnes are essential.

From quantity to scope the port sector has taken major steps forward in recent years. In fact, in first quarter 2001 the speed of port sector growth surpassed that of Hong Kong, the world's largest container port. For the Tenth Five Year Plan (2001-2005) container handling is a prime focus. The government's stated goal is to achieve 20% growth per annum in the port sector and increase port-handling capacity to 60 million TEUs by 2005. This is an ambitious order for a country that has lagged behind in the containerisation of trade flows and the challenges presented to the port sector are formidable given a global recession.

Solid Port Performance

Overall, the port sector is a highlight of China's growth. With the development of e-commerce and the benefits of WTO accession, the port industry is entering a new growth period. Following the record-setting pace set in 2000, first quarter 2001 indicates another year of solid growth. Cargo handling throughput of Mainland major ports reached 1.6 billion tonnes, of which foreign cargo registered 570 million tonnes in 2000. The leading container ports handled a total throughput of 22.7 million TEUs with seaports processing 20.6 million and river ports dealing with 2.1 million.

As China's economy motors ahead cargo-handling capacity must rise to the occasion and support increased levels of

trade. With entry into the WTO container ports will have no choice but to adapt to a more competitive operating environment. According to a 2005 government forecast, cargo-handling throughput demand will reach 3 billion tonnes with coastal ports handling some 2.2 billion tonnes. Therefore, port development for the top ten container ports of Shanghai, Shenzhen, Qingdao, Tianjin, Guangzhou, Xiamen, Dalian, Ningbo, Zhongshan and Fuzhou should enter another growth phase.

Recently, the Ministry of Communications explained its vision for the Tenth Five Year Plan. The government initiative calls for 135 new deep-water berths and the renovation of 45 berths. In addition, inland river port construction will allow easier access to shipping routes as the Yangtze River shipping lanes between the Zhujiang and Yangtze deltas are rebuilt. During the Ninth Five Year Plan the government invested RMB23.1 billion in inland river transportation and another RMB27.6 billion is earmarked for investment in the Tenth Five Year Plan.

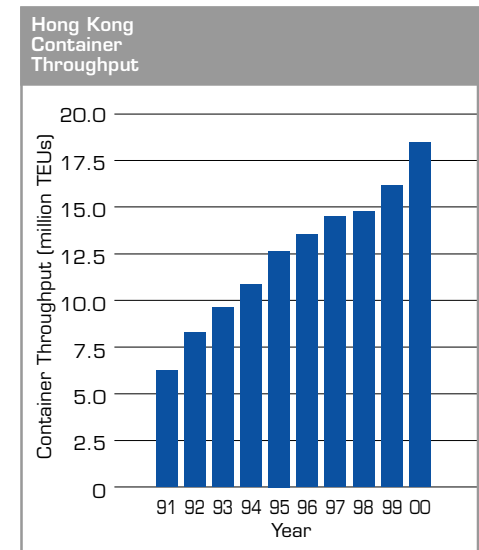
Hong Kong Challenge

Hong Kong is a two-edged sword to the port sector in terms of the PRC prosperity equation. On one hand Hong Kong is the international gateway to the Mainland; on the other Hong Kong competes with a range of ports in the South China Sea. Still, despite a strong and rising challenge posed by ports on the coast of Guangdong Province, most notably Shenzhen, Hong Kong is the busiest container port in the world.

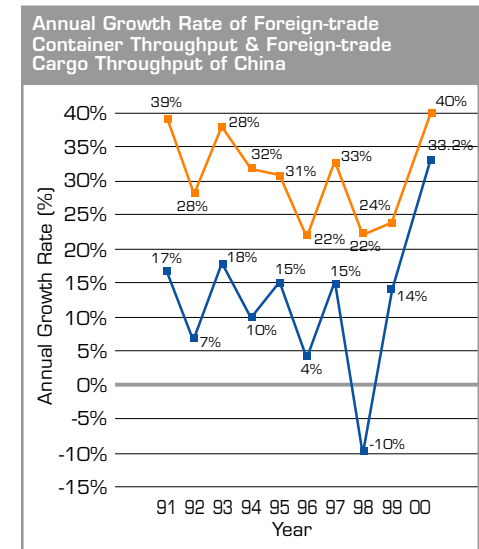
Presently, Hong Kong enjoys a reputation as the major hub port for intra-Asian trade, with container throughput of 18.1 million TEUs in 2000, accounting for an 12% increase over 1999. To improve its competitive advantage in the cargo handling sector Hong Kong is in the process of constructing Container Terminal No. 9 ("CT9"). Once CT9 is fully operational in 2004 the facility will boast six berths with an annual capacity of 2.6 million TEUs.

The increasing competition from ports in Shenzhen is an emerging challenge for Hong Kong. Shenzhen ports such as Yantian, Shekou and Chiwan have all experienced rapid growth over the past few years. They handled a total throughput of 3.99 million TEUs in 2000, a 34% increase over 1999. However, the issue of capacity constraint will not improve until 2003 and this state of affairs benefits Hong Kong in its battle to maintain a premier position among the South China ports. In addition, China's accession into the WTO is expected to further improve economic prosperity and trade flows in South China. In so doing, the demand for port facilities will far exceed the handling capacities of both Hong Kong and Shenzhen.

In the course of competing with Shenzhen ports, the reliability and efficiency of Hong Kong port operations play a crucial role in attracting frequent calls from the leading shipping lines. It will take time before the ports of Shenzhen can match these attributes and credentials. In terms of the cost



Source: Summary Statistics on Port Traffic in Hong Kong



Source: The 2000 Report on China's Shipping Development

issue, due to the rapid growth in business the terminal charges in Shenzhen are increasing faster than those in Hong Kong. This result is an ongoing narrowing in the cost differential between Hong Kong and its Shenzhen counterparts.

Hong Kong faces many challenges in the years ahead. One major challenge for Hong Kong is the ongoing liberalisation of shipping and trade links between Taiwan and the Mainland. Taiwan-Mainland trade traffic is primarily routed via Hong Kong and accounts for some 1 million TEUs or 6% of container throughput. However, when Taiwan-Mainland shipping links are liberalised, it is expected that 50% of Taiwan's traffic through Hong Kong will be routed via other ports, such as Xiamen.

Still, Hong Kong's competitive advantages are manifold. Barges provide a cost-saving alternative, especially for cargo trading with the western Pearl River Delta. On the productivity front, Hong Kong has a higher ratio of crane loads per hour than any competitor, thus hastening vessel the turnaround time. Hong Kong also has a higher frequency of calls, with over 440 vessels per week, and its harbour depth services 6,000-TEU container vessels, the best in Asia.

Highly developed and efficient logistics services combined with transparent customs requirements add to Hong Kong's competitive factors. In addition, world-class banking and financial institutions combined with a long experience in international trade make Hong Kong a premier hub for port activity that is hard to beat.

WTO Card

WTO opens China to the world and the world is planning to pay a visit. In the first five years after WTO accession, studies suggest GDP growth may rise by an additional 0.5% to 2% annually. If it is closer to the 2% scale or US\$20 billion, this means the addition of the equivalent of a Malaysian or Singaporean economy each year. China's WTO entry will further encourage economic growth by creating fair, unified and competitive conditions while providing opportunities for cooperation with foreign enterprises.

China ports face two major challenges in the post-WTO environment. First, the competition for cargo handling among regional ports will intensify. Second, the competition from international port developers and shipping companies will reach new heights. Although China has yet to become a WTO member, the competition level is already accelerating. Major foreign investments in China's port facilities have been announced in 2001 and more are to come.

WTO will increase capital flows into China and port construction will be a beneficiary. In coming years, ports will expand berths, build deep-water facilities, increase the containerisation rate and renovate facilities. This requires funding and WTO is expected to facilitate opportunities for businesses open to change. This entails the introduction of new management methods, the upgrade of port technology and a reduction in the competitive advantages between international and domestic port facilities.

WTO Check List

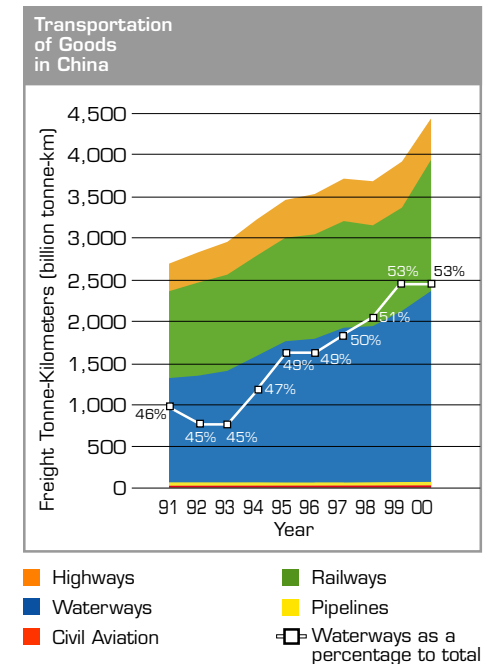
According to the Water Transportation Department of the Ministry of Communications, after China enters WTO the port sector will undergo the following changes:

- The market opening will be in-depth and fast paced with more foreign capital flowing to the port sector.
- The reform of the legal framework will quicken as foreign companies compete in the port sector and domestic enterprises strive to meet the competition.
- The competitive environment in international markets will assist the port sector in terms of improved efficiency.
- International trade volumes will increase and port sector demand will be strengthened.
- Foreign enterprises may enjoy preferential treatment from the government while domestic advantages will be cancelled.
- Human resources at state-owned port enterprises may depart to work in more rewarding companies.

The Future is Here

The port sector will continue to benefit from a strong economic trend and the ongoing flow of foreign investment. Nonetheless, in post-WTO China competition will be a consequence of

doing business and enterprises must be prepared to excel. Given a challenging but promising playing field, and faced with the short-term challenge of slowing global trade, the port sector in Greater China must rise to the occasion.



Source: China Statistical Yearbook 2001