

FINANCIAL REVIEW

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the financial information of the Group contained in the financial statements (together with the notes thereto) included elsewhere in this annual report. The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The selected historical results as discussed herein is not a prediction of the future business operations of the Group.

OVERVIEW

In the year ended December 31, 2001 ("Year 2001"), profit before taxation of the Group was approximately RMB411.6 million, representing an increase of 16.6 per cent. over that in the year ended December 31, 2000 ("Year 2000"). EBITDA was approximately RMB479.3 million, representing an increase of 5.8 per cent. over that in Year 2000. Net profit was approximately RMB407.9 million, representing an increase of 59.0 per cent. over that in the previous year. The increase in profitability of the Group was mainly due to the growth of the Group's businesses, the increase in financial income and the reduction and exemption of income tax.

Basic and diluted earnings per share of the Company in Year 2001 was RMB0.48.

TOTAL REVENUES

The total revenues of the Group for Year 2001 were RMB830.8 million, representing an increase of approximately RMB88.8 million, or 12.0 per cent., from RMB742.0 million in Year 2000. The increase resulted principally from growth in the businesses of the Group and usage of the Group's services, which can be attributed to the growth of the PRC economy and the PRC air travel and tourism industries. The increase in total revenues reflected the following:

- * ETD revenues represented 55.4 per cent. of the total revenues of the Group in Year 2001 as compared to 59.2 per cent. in Year 2000. ETD revenues increased by 4.7 per cent. to RMB459.9 million in Year 2001 from RMB439.1 million in Year 2000. The increase in revenues resulted primarily from increased usage of ETD services due to the growth of the PRC economy and the PRC air travel and tourism industries,

as well as increased usage of ETD services by foreign and regional airlines and an upward adjustment of the distribution price of airline booking services for foreign and regional airlines.

- * APP revenues represented 24.5 per cent. of the Group's total revenues in Year 2001 as compared to 21.0 per cent. in Year 2000. APP revenues increased by 30.9 per cent. to RMB203.6 million in Year 2001 from RMB155.5 million in Year 2000. The increase resulted primarily from increased sales of APP services to airports which only adopted APP services during Year 2000, which sales were not fully reflected in the revenues for Year 2000, new airports adopting APP services during Year 2001, increased usage of APP services by existing consumers of the Group who installed the APP system before Year 2001 and from airports which newly installed APP system in Year 2001.
- * Data network revenues represented 13.8 per cent. of the Group's total revenues in Year 2001 as compared to 14.7 per cent. in Year 2000. Data network revenues increased by 5.2 per cent. to RMB114.6 million in Year 2001 from RMB109.0 million in Year 2000. The increase in data network revenues resulted from the growth in the number of travel suppliers and travel agencies connected to the systems of the Group and the expansion of the Group's businesses through newly established LDCs.
- * Equipment sales and other revenues increased by 37.5 per cent. to RMB52.7 million in Year 2001 from RMB38.4 million in Year 2000. The increase principally reflected an increase in sales of equipment and APP contract revenues, as well as the transfer of freight contract revenues in relation to Air China and China Eastern Airlines Corporation Ltd. from SITA to the Group starting from January 1, 2001, pursuant to an agreement between the relevant parties.

NET REVENUES

Net revenues increased by 11.7 per cent. to RMB801.1 million in Year 2001 from RMB717.3 million in Year 2000.

OPERATING EXPENSES

Total operating expenses for Year 2001 amounted to RMB434.7 million, representing an increase of RMB64.9 million, or 17.5 per cent., from RMB369.8 million in Year 2000. The percentage increase in operating expenses was higher than the increase in total revenues mainly due to the build up of the Group's new-generation ETD system and the expansion of its operations to support the continuing growth of the Group's businesses. The increase in

operating expenses also reflected the following:

- * cost of network usage decreased by 11.2 per cent. as a result of the diversion of part of the lines of the Company from SITA's nodes in Beijing to SITA's cheaper nodes in Hong Kong after adopting various technological measures and benefiting from the pricing policy of SITA, together with the growth of ETD and APP businesses of the Company;
- * labour cost increased by 81.6 per cent. primarily due to an increase in the number of employees and their remuneration level to support the development of the Group's businesses and a higher remuneration level for the employees of InfoSky which commenced operations in Year 2001;
- * operating lease rentals increased by 11.9 per cent. due to an increase in the area leased for the headquarters of the Company as a result of business expansion;
- * technical support services increased by 40.4 per cent. due to additional technical support expenses associated with the development of the new-generation ETD system of the Group;
- * repairs and maintenance expenses decreased by 30.3 per cent. in Year 2001 due to the adoption of various measures which reduced the fees for components and spare parts;
- * commission and promotional expenses increased by 64.1 per cent. due to the growth in new APP consumers and the implementation of the Group's APP promotional programmes; and
- * other operating costs increased by 20.7 per cent. due to additional cost in relation to the growth of businesses and the listing of H shares of the Company pursuant to its offering in Year 2001.

As a result of the above changes in net revenues and operating expenses, the operating profit of the Group increased by RMB19.0 million, or 5.5 per cent., to RMB366.4 million in Year 2001 from RMB347.4 million in Year 2000.

NET FINANCIAL INCOME

Net financial income was RMB4.9 million in Year 2000, whereas net financial income amounted to RMB42.0 million in Year 2001, representing an increase of RMB37.1 million. The main reason for this increment was a substantial increase in the interest on bank

deposits.

TAXATION

Taxation decreased by 96.6 per cent. to RMB3.2 million in Year 2001 from RMB94.2 million in Year 2000 as the Company was granted certain tax benefits principally arising from its establishment in Zhongguancun Haidian Science Park as a new technology enterprise, which in accordance with relevant PRC laws entitles the Company to certain tax relief. On February 20, 2001, the Company obtained a tax exemption approval from the relevant authority, the effect of which is that the Company will not be subject to any enterprise income tax for the period from October 1, 2000 to December 31, 2002.

MINORITY INTEREST

Minority interest decreased by 78.9 per cent. to RMB0.5 million in Year 2001 from RMB2.3 million in Year 2000. The reason for such a decrease was attributable to a loss recorded for the year by InfoSky which commenced operation in 2001.

NET PROFIT

As a result of the above factors, the Group's net profit increased by RMB151.3 million, or 59.0 per cent., to RMB407.9 million in Year 2001 from RMB256.6 million in Year 2000.

RESERVE AVAILABLE FOR DISTRIBUTION

After the appropriation of statutory surplus reserve fund, the statutory public welfare fund and the discretionary surplus reserve fund from the net profit as reflected in the Group's statutory financial statements prepared under PRC GAAP, stated in note 16 to the financial statements, the reserve available for distribution as at December 31, 2001 was RMB235.4 million, which is the lesser of the amounts determined in accordance with PRC GAAP and IFRS.

DISTRIBUTION OF DIVIDEND

The Board of the Company recommends the payment of a final dividend of RMB0.184 per share for the year ended December 31, 2001, totalling RMB163.4 million. After the appropriation of the dividend, the reserve available for distribution as at December 31, 2001 was RMB72.0 million.

NET CASH FLOWS AND LIQUIDITY

The following table summarises the cash flows of the Group for the years presented:

	Year ended December 31,	
	2000	2001
	(RMB in millions)	
Net cash inflows from operating activities	414.1	605.1
Net cash used in investing activities	(67.3)	(808.6)
Net cash provided by financing activities	74.9	1,255.6
Net increase in cash and cash equivalents	421.7	1,052.1

The Group's working capital for Year 2001 mainly came from operating and financing activities. Net cash inflow from operating activities amounted to RMB605.1 million. Increase in cash from financing activities reflected the net proceeds from the offering of H shares of the Company in February 2001.

In Year 2001, the Group had no short-term or long-term bank loans, and the Group also did not use any financial instruments for hedging purposes.

As at December 31, 2001, cash and cash equivalents of the Group amounted to RMB1,636.8 million, which were denominated in Renminbi, US dollars and Hong Kong dollars as to 51.9 per cent., 14.7 per cent. and 33.4 per cent. respectively.

CAPITAL EXPENDITURES

The total capital expenditures of the Group was RMB252.1 million in Year 2001, representing a substantial increase of RMB188.0 million from RMB64.1 million in Year 2000.

The capital expenditures of the Group in Year 2001 consisted principally of purchases of hardware, software and equipment in accordance with the Group's ETD business strategy and software for ACS.

The total capital expenditures of the Group in Year 2001 were lower than the estimated amount of RMB335.5 million. This was due to the decision of the Company to reduce the amount of certain capital expenditures, given the concern about the possible material impact on the Group's businesses from global economic recession in Year 2001 and the "September

11" terrorists attack in the United States.

The Group's planned total capital expenditures in year 2002 are approximately RMB265.3 million, which is mainly for the development and gradual implementation of the new-generation ETD and expansion of the APP, the ACS and other new businesses.

The sources of funding for the capital expenditure commitments will include net proceeds from the offering of the Company and internal cash flow generated from operations.

The Board of Directors estimates that the sources of funding of the Group in year 2002 will be sufficient for its capital expenditure commitments, daily operations and other purposes.

The Board of Directors estimates that completion of the development of the new-generation ETD system will require total capital expenditures of approximately RMB1.0 billion through to year 2004.

EXCHANGE RISKS

The Group is exposed to foreign exchange risk related to its capital expenditures because a substantial portion of its capital expenditure involves payments for the purchase of imported equipment which is denominated in U.S. dollars. Under the current foreign exchange system in China, the Group is not able to hedge effectively against currency risks, except for the cash and cash equivalents that are denominated in foreign currency.

GEARING RATIO

As at December 31, 2001, the gearing ratio of the Group was 15.8 per cent. (2000: 37.3 per cent.), which was computed by dividing the total amount of liabilities and minority interests, by the total assets of the Group as at December 31, 2001.

CONTINGENT LIABILITIES

As at December 31, 2001, the Group had no material contingent liabilities.

EMPLOYEES

As at December 31, 2001, the total number of employees of the Group was 912. Personnel expenses amounted to RMB72.0 million for the year ended December 31, 2001, representing 16.6 per cent. of the total operating expenses of the Group for 2001.

The remuneration of the employees of the Group includes their salaries, bonuses and other fringe benefits. The Group has different rates of remuneration for different employees which are determined based on their performance, experience, position and other factors in compliance with the relevant PRC laws and regulations.

In Year 2001, the Group continued to provide its employees with opportunities to learn skills in relation to the air travel industry, computer technologies and business administration and provide training on the latest developments in areas such as computer technologies, personal development, laws, regulations and economics.