

MANAGEMENT'S DISCUSSION AND ANALYSIS



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Director and General Manager

This discussion and analysis should be read in conjunction with the audited consolidated financial statement and the accompanying notes appearing in the 2001 annual report of the Company. The consolidated results of the Company and its subsidiaries for the year ended December 31, 2001 were prepared in accordance with the International Financial Reporting Standards.

1. BUSINESS OVERVIEW

The principal businesses of the Company are railway passenger and freight transportation between Guangzhou and Shenzhen and certain long-distance passenger transportation services. The Company also operates the Hong Kong through trains under a cooperative arrangement with the KCR in Hong Kong. The Company provides services relating to railway facilities and technology. The Company also engages in commercial trading and other businesses that are consistent with the Company's overall business strategy. Other businesses include on-board and station sales, station dining services, as well as revenues from advertising and tourism.

2. RECENT DEVELOPMENTS

In 2001, the Company further developed its High Speed Programme. It operated 52 pairs of intercity express trains and nine pairs of Guangzhou-Kowloon through trains. The launch of the new schedule of the Guangzhou-Shenzhen intercity express trains which depart at every 15 minutes on average marks the initial realization of the Company's "As-frequent-as-buses" Train Project on the Guangzhou-Shenzhen route. The Company leased eight domestically made high-speed electric trains, the "Blue Arrow", which run at a speed up to 210 kilometres per hour. Together with the Xin Shi Su high-speed electric train purchased from Sweden, the high-speed electric trains have become the main trains used by the Company in its "As-frequent-as-buses" Train Project.

In order to explore new growth potentials, the Company began to run the Shenzhen-Yueyang long-distance trains from July 1, 2001 and the Shenzhen-Beijing long-distance trains from October 21, 2001. These new services demonstrated the Company's entry into the domestic long-distance passenger transport market.

3. REVIEW OF RESULTS OF OPERATIONS

The Company achieved impressive financial results in 2001. Total revenues increased by 8.7% from RMB1,980.4 million in 2000 to RMB2,153.6 million in 2001 as a result of the increase in both passenger transportation revenue and freight transportation revenue. However, the decrease of the revenue from other businesses slightly offset the increase of the total revenues. Revenues from passenger and freight transportation operations accounted for approximately 71.5% and 28.5%, respectively, of the total revenues generated by the railway business, and representing approximately 66.2% and 26.3%, respectively, of the total revenues of the Company.

Passenger Transportation

Passenger transportation is the largest business segment of the Company and it experienced a significant growth in 2001. Revenues generated from the passenger transportation business were RMB1,426.0 million in 2001, representing an increase of 15.3% from RMB1,237.3 million in 2000. The increase in the revenues from passenger transportation was mainly due to the increase in the number of passengers from 34.947 million in 2000 to 38.842 million in 2001 and increase in revenue per passenger from RMB35.40 in 2000 to RMB36.71 in 2001. The increase in the number of passengers and revenue per passenger was primarily attributable to the continued economic growth in the Pearl River Delta and the implementation of the "As-frequent-as-buses" Train Project. Starting from October 21, 2001, the intercity express trains operating between Guangzhou and Shenzhen run at an average interval of 15 minutes from a previous interval of 30 minutes. The total number of intercity express trains running between Guangzhou and Shenzhen also increased from 31 pairs to 52 pairs daily. At the same time, the total number of regular-speed passenger trains reduced from 16 pairs in 2000 to six pairs in 2001. During 2001, six pairs of long-distance passenger trains were added into the Company's service territory. These measures contributed to the growth of passenger transportation business of the Company.



The following table sets forth the revenues from passenger transportation and the volume of passengers for 2000 and 2001:

	Year ended December 31,		Increase (as compared with year 2000)
	2001	2000	
Revenues from passenger transportation (<i>in RMB thousands</i>)	1,426,010	1,237,289	15.3%
Total number of passengers (<i>thousand persons</i>)	38,842	34,947	11.1%
Revenue per passenger (<i>RMB</i>)	36.71	35.40	3.7%
Total passenger-kilometres (<i>millions</i>)	3,257.9	3,051.7	6.8%
Revenue per passenger-kilometres (<i>RMB</i>)	0.44	0.41	7.3%

Freight Transportation

Freight transportation business recorded a steady and continued growth in 2001. Revenues from freight transportation business in 2001 were RMB567.3 million, representing an increase of 3.2% from RMB549.7 million in 2000. The total tonnage of freight increased from 28.733 million tonnes in 2000 to 29.012 million tonnes in 2001, and the increase of revenue per tonne also increased from RMB19.13 in 2000 to RMB19.55 in 2001. This growth in freight transportation business in 2001 was mainly due to the continued domestic economic growth. As a result of the Company's adoption of price concession measures and enhancement of marketing strategies, the freight volume and revenues from freight transportation both increased despite increasingly keen competition from other modes.

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Set out below are the revenues from the freight transportation business and the freight volume for 2000 and 2001:

	Year ended December 31,		Increase (as compared with year 2000)
	2001	2000	
Revenues from freight transportation (RMB thousands)	567,276	549,694	3.2%
Total tonnage (thousands of tonnes)	29,012	28,733	1.0%
Revenue per tonne (RMB)	19.55	19.13	2.2%
Total tonne-kilometres (millions)	2,082.5	2,071.6	0.5%
Revenue per tonne-kilometre (RMB)	0.27	0.27	—

Other Businesses

Revenues from the Company's other businesses decreased by 17.1% from RMB193.4 million in 2000 to RMB160.3 million in 2001. Revenues from other businesses accounted for 7.5% of the total revenues of the Company in 2001. Due to the increase in frequency and speed of its passenger trains, the waiting time and travelling time involved was reduced. It led to a decrease in revenues from the Company's other businesses as consumption of food and beverages and other goods both in stations and on board was reduced.

The table below sets forth a breakdown of the different categories of other businesses:

Category of Activity (in RMB thousands)	Unit: RMB thousands	
	2001	2000
On-board and station sales	51,627	58,030
Station services	41,287	65,934
Tourism, advertising and others	67,392	69,451
Total	160,306	193,415

TOTAL OPERATING EXPENSES

Total operating expenses were RMB1,599.5 million, representing an increase of approximately 9.4% from RMB1,461.0 million in 2000, due mainly to the increase in railway operating expenses.

Railway operating expenses

The Company's total railway operating expenses increased by 12.6% from RMB1,297.5 million in 2000 to RMB1,460.6 million in 2001. The total railway operating expenses as a percentage of total railway operating revenue slightly increased from 72.6% in 2000 to 73.3% in 2001. Such increase was due primarily to the increase of depreciation expenses, labour and welfare expenses, materials and supplies expenses, and general and administrative expenses. Details are as follows:

Depreciation

Depreciation expenses increased by 12.2% from RMB305.3 million in 2000 to RMB342.5 million in 2001. It was due mainly to the further upgrading and expansion of the Company's railway networks as well as to the increase in corresponding capital expenditure.

Labour and benefits

Due to the increase in frequency of trains and the launching of newly-operated routes in 2001, there was an increase in workload and the number of employees. This resulted in an increase of labour and related welfare expenses by 23.0% from RMB260.7 million in 2000 to RMB320.6 million in 2001. In addition, the Company raised the remuneration packages offered to the employees to ensure that they were competitive and implemented a pay policy of linking performance to rewards under the existing pay and remuneration system.

Materials and supplies

Materials and supplies expenses consisted mainly of fuel, water and electricity expenditures. Materials and supplies expenses increased by 19.3% from RMB121.3 million in 2000 to RMB144.7 million in 2001. The increase was due primarily to an increase in fuel and electricity consumption resulting from the operation of two new long-distance trains in 2001 and the increase in frequency of the high-speed electric passenger trains.

General and administrative expenses

General and administrative expenses increased by 13.9% from RMB131.9 million in 2000 to RMB150.2 million in 2001. Provision for bad debts increased from RMB17.03 million in 2000 to RMB29.62 million in 2001 due primarily to provision for the rent and utility expenses overdue from tenants and certain overdue receivables from freight transportation customers.

Profit from operations

The profit from operations increased by 6.7% from RMB519.4 million in 2000 to RMB554.1 million in 2001. The operating profit from railway businesses increased from RMB489.5 million in 2000 to RMB532.7 million in 2001. However, the increase in profit from operations was slightly offset by the decrease of the operating profit of other businesses from RMB29.89 million in 2000 to RMB21.45 million in 2001.

Taxation

As the Company was registered and established in the Shenzhen Special Economic Zone, it is subject to income tax at a rate of 15%. Taxation payable by the Company and its subsidiaries was RMB99.30 million in 2001 and RMB99.38 million in 2000, reflecting an actual tax rate of 15.8% and 16.8%, respectively. The decrease of the income tax resulted from additional deferred tax assets was recognized in 2001.

Net Profit

Net profit of the Company and its subsidiaries increased from RMB492.1 million in 2000 to RMB533.5 million in 2001, representing an increase of 8.4%.

4. LIQUIDITY AND CAPITAL RESOURCES

The Company's principal sources of capital have been cash flow from operations. Its principal uses of capital are to fund capital expenditures, investment and payment of taxes and dividends.

The Company generated approximately RMB886.0 million net cash flow from operating activities in 2001. Substantially all of the Company's railway business revenues were received in cash, with accounts receivable arising primarily from long-distance passenger and pass-through freight transactions originating from other railway companies whose lines connect to the Company's railway. Similarly, some accounts payable arise from payments for railway transportation services that the Company collected on behalf of other railway companies. Accounts receivable and payable were generally settled either quarterly or monthly between the Company and the other railway companies. Most of the Company's revenues generated from other businesses were received in cash. There were also accounts payable associated with purchase of materials and supplies in other businesses.

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In 2001, other than the operating expenses, the Company's cash outflow were mainly related to the followings:

- capital expenditure of approximately RMB430.4 million, representing a decrease of 6% when compared with that of 2000; such expenditure was mainly used for the purchase of long-distance passenger coaches and renovation and expansion of other facilities; and
- payment of dividends of approximately RMB420.0 million.

Funds not needed for immediate use are kept in short and medium-term investments and bank deposits.

The Company's gearing ratio was 7.8% (the ratio of the total liabilities to the total assets) as of December 31, 2001. Temporary cash investments were approximately RMB1,377.0 million. Cash and cash equivalents were RMB365.5 million. The Company has no contingent liability.

The Company believes that it has sufficient fund to satisfy its current working capital requirements.

5. ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY

Unit: RMB thousands

	2001	2000	Increase (Decrease)
Current assets	2,471,529	2,423,470	48,059
Non-current assets	8,525,687	8,494,094	31,593
Total assets	10,997,216	10,917,564	79,652
Current liabilities	860,976	879,793	(18,817)
Non-current liabilities	—	2,333	(2,333)
Total liabilities	860,976	882,126	(21,150)
Minority interests	15,617	14,755	862
Net assets	10,120,623	10,020,683	99,940
Shareholders' equity			
Share capital	4,335,550	4,335,550	—
Reserves	5,785,073	5,685,133	99,940
	10,120,623	10,020,683	99,940

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Total assets were approximately RMB10,997.2 million as of December 31, 2001, representing an increase of RMB79.76 million when compared with RMB10,917.6 million as of December 31, 2000. Current assets were RMB2,471.5 million as of December 31, 2001, representing an increase of RMB48.1 million from RMB2,423.5 million as of December 31, 2000. Non-current assets were approximately RMB8,525.7 million as of December 31, 2001, representing an increase of RMB31.6 million from RMB8,494.1 million as of December 31, 2000.

Total liabilities amounted to RMB861.0 million as of December 31, 2001, representing a decrease of RMB21.2 million from RMB882.1 million as of December 31, 2000. Current liabilities were RMB861.0 million as of December 31, 2001, representing a decrease of RMB18.8 million from RMB879.8 million as of December 31, 2000. Non-current liabilities were nil as of December 31, 2001, representing a decrease of RMB2.333 million when compared with that of 2000 as a result of the recognition of deferred tax assets in 2001.

Shareholders' equity amounted to RMB10,120.6 million as of December 31, 2001, representing an increase of RMB99.9 million from RMB10,020.7 million as of December 31, 2000. There was no change in share capital during 2001. Reserves amounted to RMB5,785.1 million in 2001, representing an increase of RMB99.9 million when compared with RMB5,685.1 million as of December 31, 2000. It was due to an increase of RMB533.5 million in the net profit in 2001, less RMB433.6 million of dividends declared in 2001.

6. CASH FLOW

Cash and cash equivalents in 2001 increased by approximately RMB35.45 million. The table below sets forth the major items in the consolidated cash flow statements for 2001 and 2000 and the amount and percentage of changes from 2000 to 2001.

Principal items in Cash-flow Statement	2001	2000	Increase/ (decrease)	Changes (%)
	<i>(in RMB thousands)</i>			
Net cash generated from operating activities	886,016	729,189	156,827	21.5%
Net cash used in investing activities	(430,425)	(458,087)	27,662	(6.0%)
Net cash used in financing activities	(420,137)	(520,453)	100,316	(19.3%)
Net increase/(decrease) of cash and cash equivalents	35,454	(249,351)	284,805	—

Cash flow from operations and working capital

The Company's net cash generated from operating activities in 2001 was approximately RMB886.0 million, representing an increase of RMB156.8 million from RMB729.2 million in 2000. The increase resulted primarily from an increase of RMB41.32 million in profit before taxation after deducting minority interests, an increase of RMB37.15 million in depreciation, an increase of RMB20.87 million in non-cash disposals of fixed assets loss, and an increase of RMB12.59 million in provision for doubtful accounts.

In addition, the operating cash flow was affected by a net increase in working capital. The increase in working capital was attributable to a decrease of RMB4.597 million in accounts receivable, a decrease of RMB51.11 million in receivable from the Parent Company, an increase in accounts payable of RMB7.901 million, and an increase of RMB102.3 million in accrued expenses and other payables. The increase in the working capital was slightly offset by an increase of RMB141.1 million in prepayments and other current assets, an increase of RMB4.158 million in materials and supplies, a decrease of RMB28.08 million in due from affiliates, and a decrease of RMB5.084 million in due to affiliates.

Cash flow from investing activities

The total cash used in investing activities was approximately RMB430.4 million in 2001, representing a decrease of RMB27.7 million from RMB458.1 million in 2000. Cash used for investing activities in 2001 included RMB553.5 million for capital expenditure and long-term investments and the increase in interests in associates of RMB17.57 million. The cash outflow was partially offset by a decrease of RMB74.73 million in temporary cash investments and of RMB65.93 million in interest received.

Cash flow from financing activities

Net cash used in financing activities in 2001 was approximately RMB420.1 million. It consisted of payment of dividends of RMB420 million and distribution to minority shareholders of RMB0.18 million.

7. COMMITMENT*Capital commitments*

As of December 31, 2001, the Company had the following capital commitments:

	2001	2000
	RMB'000	RMB'000
Authorised and contracted for	15,640	55,340
Authorised but not contracted for	—	—
	15,640	55,340

In 2001, the Company had capital commitments of approximately RMB15.64 million for purchase of railway equipment for the Company's High Speed Programme.

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Operating lease commitments

	2001	2000
	RMB'000	RMB'000
Machinery and equipment		
— not more than one year	—	91,125
— more than one year but less than five years	399,375	455,625
	399,375	546,750

Total future minimum lease payments under non-cancelable operating leases as of December 31, 2002 were approximately 399.4 million.

8. FOREIGN EXCHANGE RISK

Under PRC law, Hong Kong dollar-denominated income from the Guangzhou-Kowloon through trains must be deposited to PRC banks in exchange for RMB at the rate set by the People's Bank of China. Subsequent payment of Hong Kong dollar-denominated and U.S. dollar-denominated dividends to the holders of H Shares and ADSs, respectively, can only be made after reconverting RMB at the applicable People's Bank of China rate into the relevant foreign currencies. Some of the Company's vendor contracts and equipment leases for the provision of equipment, parts and services, particularly with respect to the high-speed passenger train project, are also payable by the Company in foreign currencies. While the exchange rates used by the Company as set by the People's Bank of China is comparatively stable, in case the foreign currencies generated from transit train services are converted into RMB and subsequently reconverted into foreign currencies for the payment of dividends, the Company will be subject to foreign exchange risk. Despite all these, the management believes that the contingent exposures relating to foreign exchange rate fluctuations have not had and are not likely to have a material effect on the Company's financial position. Besides, the PRC government also has in a number of occasions pledged not to devalue RMB. Due to these reasons, the Company does not enter into any hedging transactions with respect to the Company's exposure to foreign currency movements. Furthermore, the Company is not aware of any effective financial hedging products that serve as protection against a possible Renminbi devaluation.

9. INTEREST RATE RISK

Funds not needed for immediate use are placed as temporary cash deposits or fixed deposits in banks and in the Railway Deposit-taking Centre of the MOR. The Company does not hold any market risk-sensitive instruments for trading purposes. As of December 31, 2001, the Company had no loans outstanding. Accordingly, the Company is not exposed to any material interest rate risks.

10. BUSINESS PROSPECTS

The Company plans to implement the following development projects in 2002:

1. The Company has decided to commence the construction of the suburb passenger railway track between Guangzhou and Xintang (the fourth track between Guangzhou and Xintang), the construction of a technical support and maintenance depot for passenger vehicles and its ancillary construction works in northern Shenzhen, and purchase of electric train-sets.
2. In relation to its passenger transportation business, the Company plans (1) to further improve its "As-frequent-as-buses" Train Project on the Guangzhou-Shenzhen route; (2) to further improve the operation of domestically made high-speed passenger trains; (3) to make more rational arrangement of the Company's long-distance passenger service on the Guangzhou-Shenzhen railway route; (4) to establish closer link of its railway system with the urban public transportation systems; (5) to establish and improve its ticketing system of the Hong Kong through trains and to establish online ticketing reservation and sales services; and (6) to establish a customer service centre.
3. In relation to its freight transportation business, the Company will: (1) continue to make efforts in organizing and maintaining the source of cargo in large quantities; (2) develop container freight transportation and further develop the logistics industry; (3) develop the logistics in Shenzhen and Dongguan; (4) conduct freight transport market research, and develop new products for the freight transportation; (5) enhance cooperation with ports, mines and factories; and (6) prepare for the new development of freight transportation by strengthening the sales team and establishing a sound system for sales analysis
4. Regarding the use of capital, the Company has the following plans: (1) issue of not more than 700 million A shares of the Company; (2) investment in the telecommunication business. The Company plans to subscribe shares in Railway Communication and Information Company Limited; (3) capital participation in Sino Rail; and (4) expanding its capital by ways of acquisitions and mergers. The Company plans to become one of the principal promoters of a joint stock limited company to be established by Zhuzhou Locomotives, and to invest in or acquire state-owned railway passenger transportation companies when circumstances allow.



Details of the above plans are set out on page 9 to page 10 of the Chairman's Statement.