V. Management discussion and analysis

(1) Market conditions

The international shipping market has been slow since last year, and there remain a lot of uncertainties in the shipping market despite occasional indications that the world economy is beginning to recover. On the other hand, with the rapid growth of the domestic economy and foreign trade in the PRC, the domestic shipping market has been improving steadily. The balance between the supply and demand for shipping capacity has sustained in the PRC domestic shipping market. In addition, the freight rate has increased.

(2) Operating results

In the first half of 2002, the Company and its subsidiaries (the "Group") made active readjustments to its operating strategies and composition of its shipping capacity according to the changes in the shipping market conditions. Meanwhile, the Group, by controlling its operating costs and improving its operating efficiency, achieved good operating results and met the Company's target for the first half of 2002. The growth of the operating results of the Group continues to be strong.

Major financial data in accordance with the PRC accounting standards

Items	**January-June 2002 RMB'000**	January-June 2001 RMB'000	Increase (%)
Revenue from main operating activities	**2,145,988**	1,794,546	
Profit from operating activities	**597,523**	427,494	19.6
Net profit	**250,242**	206,909	39.8
Net increase (decrease) in cash and cash equivalents	**88,199**	(223,507)	20.9

Major financial data in accordance with HKGAAP

Items	**January-June 2002 RMB'000**	January-June 2001 RMB'000	Increase (%)
Revenue from main operating activities (before business taxes and surcharges)	**2,083,558**	1,757,504	18.6
Gross profit	**576,283**	406,986	41.6
Net profit from ordinary activities attributable to shareholders	**262,218**	178,200	47.1
Net increase (decrease) in cash and cash equivalents	**88,126**	(223,464)	

For the first half of 2002, the Company's turnover increased significantly as compared with the same period in 2001. This was attributable to the expansion in the Company's oil shipping capacity after acquisition of the 20 oil tankers from a subsidiary of its controlling shareholder, China Shipping (Group) Company.

For the first half of 2002, the Company adopted active measures to increase revenue and reduce its main operating costs, such as fuel costs and maintenance expenses. The aggregate volume of the Company's vessels has increased as compared with the same period of 2001. The revenue derived from the Company's main operating activities increased by approximately 40 per cent., representing a significant increase in its operating efficiency as compared with the increase in its operating costs. As a result, the net profit attributable to shareholders increased significantly as compared with the same period of 2001.

The main reason for the increase in cash and cash equivalents of the Company for the first half of 2002 was that the revenue from operating activities has increased, and the Company has made steady progress in trade debt recovery and has already made part payment in 2001 for the acquisition of the 20 oil tankers from a subsidiary of China Shipping (Group) Company.

(3) Financial analysis

Financial data prepared in accordance with the PRC accounting standards:

Items	**As at 30 June 2002** **RMB'000**	As at 1 January 2002 RMB'000	Percentage (%) increase/ (decrease)
Total assets	**8,736,408**	8,836,432	(1.1)
Shareholders' equity	**6,160,019**	5,084,481	21.2

Financial data prepared in accordance with HKGAAP:

Items	**As at 30 June 2002** **RMB'000**	As at 1 January 2002 RMB'000	Percentage (%) increase/ (decrease)
Total assets	**8,901,933**	9,007,693	(1.2)
Shareholders' equity	**6,293,518**	5,354,804	17.5

In the first half of 2002, China Shipping Container Lines Company Limited ("CS Container Lines"), an associate of the Company, suffered losses, which in turn caused a decrease in the Company's long-term investment and total assets accordingly.

As at 30 June 2002, the shareholders' equity increased by approximately 17.5 per cent. as compared with that of 1 January 2002, due to the A Share Issue in the PRC and the Company's better operating results.

As at 30 June 2002, the debt equity ratio of the Group was 29 per cent., representing a decrease of approximately 11 per cent. as compared with that of 1 January 2002.

As at 30 June 2002, the Group's borrowings mainly included the finance lease payables denominated in USD and Euro which were equivalent to RMB128,201,000 and RMB165,919,000 respectively. In addition, dividends are distributed in HK$.

The Group's income from international shipping is denominated and settled in USD. At present, the exchange rate for RMB is steady. Due to the fluctuation of the exchange rate of Euro, the Company recorded an exchange loss of RMB19,159,000 during the Period. Except for this, the Board does not expect that the Group would be subject to any significant foreign exchange exposure. However, the Group cannot guarantee that such exposure will not have any effect on its operating results in future.

(4) Business review

The main business of the Company consists of transportation for oil, coal and other dry bulk cargoes by sea in the PRC.

In the first half of 2002, there have been some fluctuations in the oil transportation market. The volume of oil transported by pipe for shipment in northern China has increased, whilst the volume of imported oil for transshipment continued to be stable, as compared with the same period of 2001. However, the shipping volume of offshore oil, refined oil and foreign trade oil decreased. Due to the changing market conditions, the Company promptly made adjustment to the composition of its shipping capacity. First, the Company leveraged from the resumption of transportation of oil from Shangdong Shengli Oilfield by sea, and captured all contracts concerning the delivery of oil from Qingdao to southern China. For the first half of 2002, the volume of oil transported by pipe was 2.8 million tonnes, representing an increase of 89 per cent., as compared with the same period of last year. Secondly, the Company deployed some crude oil tankers for the shipment of refined oil, with a view to capitalise on full utilisation of the capacity of crude oil tankers, and improved competitiveness in the refined oil shipping market. Much efforts have been devoted by the Company to shipment of imported and exported crude oil, and imported refined oil in order to explore the oil shipping market in the developing countries. The Company also focused on developing shipment of imported fuel oil from Russia. The shipping volume of oil carried by the Company for the first half of 2002 was 22.721 billion tonne nautical miles, representing an increase of approximately 26.4 per cent. as compared with the same period of 2001. The revenue arising from oil transportation for the first half of 2002 was RMB1.38 billion, increased significantly as compared with the same period of 2001, which was the highest record achieved by the Company.

During the first half of 2002, the demand for coastal dry bulk cargo transportation in the PRC was high, whilst the freight rate remained stable. The Company insisted on adhering to its policy of “continuing to develop coastal transportation and expanding ocean transportation”. Cooperation with major cargo owners has improved. At the same time, through the establishment of joint ventures, execution of mid-term or long-term contracts of affreightment (“COA”) with its major customers and chartered shipping agreements with shipowners, much efforts have been devoted by the Company to increase its market share despite the intense competition in the dry bulk cargo transportation market. For the first half of 2002, the shipping volume of dry bulk cargo under the COAs entered into by the Company accounted for approximately 70 per cent. of the target volume of dry bulk cargo to be carried by the Company for 2002.

In the first half of 2002, the volume of coal carried by the Company’s vessels was 15.14 billion tonne nautical miles, representing an increase of approximately 16.3 per cent., as compared with the same period of 2001. The revenue from coal transportation was RMB510 million, representing an increase of approximately 17.5 per cent., as compared with the same period of 2001. The shipping volume of other dry bulk cargoes and the revenue were 7.459 billion tonne nautical miles and RMB190 million, representing an increase of approximately 18.5 per cent. and 0.6 per cent., as compared with the same period of 2001 respectively.

The jointly-controlled entities jointly established by the Company and its major customers have played an active role in stablising and enhancing the Company’s market share, improving the Company’s shipping capacity, and improving the Company’s relationship with its major customers. The fleet managed by the three joint ventures, Shanghai Times Shipping Company Limited, Zhuhai New Century Shipping Company Limited and Shanghai Friendship Shipping Company Limited, have increased to 15 vessels with an aggregate shipping capacity of 375 thousand tonnes as at 30 June 2002, compared with 6 vessels of 157 thousand tonnes at 1 January 2002.The net profit achieved by the three joint ventures was RMB14.1986 million, and the return on investment of the Company was RMB6.77 million. By cooperation with large cargo owners, the Company further improved its market share in the shipping market.

During the first half of 2002, CS Container Lines (with 25% of its shares owned by the Company), also faced many market challenges. Recovery in the global international shipping.market remains uncertain. The lack of demand resulted in the significant deterioration of the operating results of all major container line companies in the world.

In the first half of 2002, the volume of loaded containers carried by CS Container Lines was 1.08 million TEU, representing an increase of 34 per cent. as compared with the same period of 2001 and accounting for 49 per cent. of the target volume for 2002. The revenue derived from container transportation was RMB4.258 billion, representing an increase of 12 per cent. as compared with the same period of 2001 and accounted for 43.5 per cent. of the target volume for 2002. Since the beginning of June 2002, the freight rate of container transportation on different lines and the shipping volume have increased. However, in general, CS Container Lines is still facing the great difficulties of over-supply in 2002.

(5) Information of shipping volume and geographical area of operations

1. Breakdown of turnover prepared in accordance with the PRC accounting standards:

Geographical area of operations	Business segment	**January-June 2002 RMB million**	January-June 2001 RMB million	Percentage Increase / (Decrease)
Domestic	Coal transportation	**566.88**	472.94	19.9
	Oil transportation	**923.27**	696.18	32.6
	Others	**47.46**	71.76	(33.9)
	Sub-total	**1,537.61**	1,240.88	23.9
International	Coal transportation	**6.47**	14.99	(56.8)
	Oil transportation	**459.22**	421.34	9.0
	Others	**142.69**	117.33	21.6
	Sub-total	**608.38**	553.66	9.9
Total		**2,145.99**	1,794.55	19.6
Business taxes and surcharges		**54.12**	43.62	
Net of business taxes and surcharges		**2,091.87**	1,750.93	

2. Breakdown of turnover prepared in accordance with HKGAAP:

Geographical area of operations	Business segment	**January-June 2002 RMB million**	January-June 2001 RMB million	Percentage Increase / (Decrease)
Domestic	Coal transportation	**503.88**	472.94	6.5
	Oil transportation	**923.27**	668.84	38.0
	Others	**47.46**	71.76	(33.9)
	Sub-total	**1,474.61**	1,213.54	21.5
International	Coal transportation	**6.47**	14.99	(56.8)
	Oil transportation	**459.79**	411.64	11.7
	Others	**142.69**	117.33	21.6
	Sub-total	**608.95**	543.96	11.9
Total		**2,083.56**	1,757.50	18.6
Business taxes and surcharges		**52.05**	43.62	19.3
Net of business taxes and surcharges		**2,031.51**	1,713.88	18.5

(6) Investment

1. The use of the proceeds from A Share Issue.

   The proceeds from the issuance of 350,000,000 A shares by the Company on 17 May 2002 after deduction of expenses and addition of interest income on the share subscription fund was RMB 825.30 million, which was used for the acquisition of the 20 oil tankers from Guangzhou Maritime (Group) Company Limited, a subsidiary of China Shipping (Group) Company, as stated in the A Share Issue prospectus.

(7) Prospects for the second half of 2002

In the second half of 2002, the international shipping market has started to show signs of recovery. The volume of transportation by sea will tend to increase. On the other hand, with the steady increase in the volume of domestic and foreign trade, the demand for shipment of coal, ores and oil will increase accordingly. This in turn will create favourable conditions for the Company to maintain its advantages in terms of coastal transportation as well as a healthy development of the Company. However, following the further opening of domestic coastal shipping market, the Company considered that shipping companies with international shipping capacity will enter into the PRC domestic shipping market and hence competition in the domestic coastal shipping market is expected to become fierce.

The Company will put every efforts to reform and standardise its operations, and improve its operating efficiency, so as to fulfil the Company's target for 2002 as set out by the Board. The Company will take the following measures:

1. The Company will monitor closely the changes in the shipping market and explore new sources of cargo for shipment. At the same time, the Company will further promote its cooperation with large cargo owners and other shipping companies, with a view to stabilise and improve its market share.

2. The Company will take active measures to decrease its operating costs, such as fuel costs, maintenance costs, management expenses and port charges. The changes in the world's conditions greatly affect the demand for and supply of oil. Since June 2002, the price of fuel oil has increased. We are highly aware of the price movement of fuel oil and will take various measures to control the cost of fuel oil.

3. The Company will further strengthen its management and operation of its fleet, and promptly adjust its fleet composition in accordance with the changes in the market conditions. The Company entered into a contract for the construction of four 74,000 tonnes dry bulk cargo vessels in April 2000, of which 2 vessels have been delivered and have commenced operation in the first half of 2002. The other 1 vessel was delivered in July 2002, and the remaining 1 vessel will be delivered in October 2002. The Company entered into another contract in December 2000 for the construction of four 42,000 tonnes oil tanker for transportation of crude and refined oil, and the four tankers are expected to be delivered at the end of 2002 or the beginning of 2003. The Company entered into a contract for the construction of two 110,000 tonnes tankers for the transportation of refined oil and crude oil on 27 June 2002. The Company entered into a contract for the construction of two 42,000 tonnes tankers for transportation of refined oil and crude oil on 9 August 2002. These four oil tankers are expected to be delivered for operation in 2004.