Management Discussion & Analysis

Sector Overview

The strong correlation between economic growth and the expansion of global trade is clearly a macro-economic equation that favours the ongoing growth of PPC in the years ahead. The evolution of China's Open Door Policy has created tremendous prosperity in a relatively short time frame, thus delivering opportunities in the trade sector. Currently, the nation stands prepared for another exciting era of change, one that is fuelled by the recent entrance into the WTO.

This next stage in China's industrial revolution will see the domestic economy merge with the global economy. In so doing, the country will witness a major transformation in all aspects of its commercial life. At the forefront of this metamorphosis is the trade sector. After all, the main concept of the WTO is to form a world where trade flows in a smooth and orderly fashion. Within this global scenario, PPC is positioned to build on the explosive change that is sweeping through the port industry.

China continues to build momentum despite the slow recovery of the industrial economies after the post 9/11 Incident. Though Asia has suffered from the global recession, the Mainland economy has maintained its steady growth. This is primarily due to an unexpected surge in exports coupled with robust consumer demand. Above all, consumer demand is critical in powering economic growth and the PRC government hopes to stimulate spending by an increase in investment. This objective is to be achieved by strengthening key sectors such as port development, technology and financial services.

The Hong Kong SAR is facing structural changes in its economy given the downturn in the US market and integration with the PRC economy. However, Hong Kong is likely to emerge from recession in second quarter 2003 partly as a result of a rebound in trade. Near-term, the weak US dollar will assist the Greater China economy. The most direct benefit is in exports to Japan and Europe as products are more competitive against the Japanese Yen and Euro. In addition, exports should be able to win market share from Japanese products in the US and other overseas markets. With the rapid development of the PRC electronics industry, a larger part of exports can now compete with Japanese goods.

Opportunities for Growth

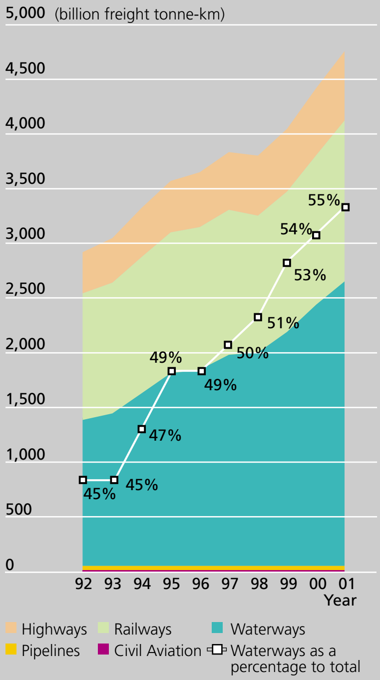
The potential of the PRC import market is enormous, though the current size is modest by any measure. Presently, the PRC share of world imports is following a dynamic upward course. The total share of global imports is in line to rise to 6% by 2005, up from 3.8% in 2001. Global imports totalled an estimated US$6.4 trillion in 2001, according to the WTO. If this sector continues to grow at 4% per annum during 2001-2005, and China reaches the 6% benchmark, this will result in a total import market of US$450 billion.

One of the major reasons for this rise in imports is a growing interaction with the emerging economies of Asia. According to PRC trade data, the share of imports that flow from Asia has fluctuated between 30% and 37% of the total since 1993. Even if the Asian region only manages to maintain a 35% level of total imports, the aggregate market size could be an additional US$47 billion to US$73 billion in terms of goods and services by 2005. This is on top of the already US$85 billion imported into China in 2001. Following this line of reasoning, Asian imports to China could be 55% to 85% larger within four years.

Port Prosperity

Strong export growth, a rising tide of imports and the emerging power of consumer spending are catalysts for rapid expansion in the port sector. Above all, the sector directly benefits from rises in trade flows as ports handle the vast majority of trade. Presently, ports handle over 80% of exports and 90% of imports. The 18,400 km coastline runs through 11 coastal provinces, cities and regions accounting for about 40% of the nation's population and more than half of GDP. Some 1,900 ports and 230,000 shipping vessels weigh in at over 50 million tonnes, representing a formidable presence. This dynamic drives the prosperity of the coastal region – and vice versa.

Transportation of Goods in China



Source: China Statistical Yearbook 2002

Annual Growth Rate of Foreign-trade Container Throughput and Foreign-trade Cargo Throughput of China

Source : The 2001 Report on China's Shipping Development (by The Ministry of Communications of the People's Republic of China)

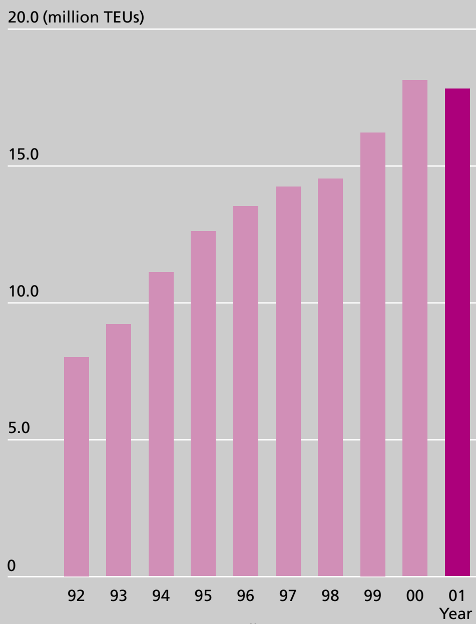
To take advantage of unprecedented opportunities developing in the port sector, the Tenth Five Year Plan (2001-2005) focuses attention on container handling. The stated government goal is to achieve 20% growth per annum in the port sector and increase port-handling capacity to 60 million TEUs by 2005. This is an ambitious plan for a nation that has lagged behind in the containerisation of trade flows. However, this challenge is not insurmountable for a port sector that has grown from strength to strength.

Hong Kong Port

A global economic downturn, a deflationary environment and a restructuring of the domestic economy have had a negative impact on the port industry in Hong Kong. Nonetheless, Hong Kong port remains the major gateway to Mainland China and its ranking as the busiest container port in the world is an accomplishment that cannot be downplayed.

The port sector has escaped the recent turmoil relatively unscathed when compared to other components of the domestic economy. Container throughput fell slightly by 1.5% to 17.8 million TEUs in 2001, but the numbers rebounded by 1% in the first five months of 2002. This indicates that the global economic downturn and weak domestic demand are gradually improving in first half 2002. In addition, Hong Kong's strength and reputation for operating efficiency as a port led to a strong improvement in business flows in June and July 2002.

Hong Kong Container Throughput



Source: Summary Statistics on Port Traffic in Hong Kong

Positive Factors

Hong Kong is a vital element in the PRC prosperity equation and PPC is most confident that Hong Kong port will sustain moderate throughput growth in the near future. There are several reasons for this confidence. For one, the absolute volume of throughput, especially along the bustling Pearl River Delta, is bound to increase rapidly due to the expansion of total foreign trade, especially now that China is more integrated with the world economy.

Events across the border are proving to bolster confidence in the future of Hong Kong port business. The cost difference between Hong Kong port and Shenzhen ports has narrowed with cross-border trucking costs reduced by nearly 30% in the past two years and an increase in service charges by Shenzhen terminals. These two factors are in part responsible for a strong recovery at the Kwai Chung terminals in June 2002. During that month alone, the growth rate of throughput volume surged by 9.4%. According to the latest statistics, the average annual throughput growth of Hong Kong port for the next 15 years should reach 4%.

Hong Kong port is still far superior in terms of service and efficiency than counterparts in China, including those surrounding Shenzhen. For one, most of the Pearl River Delta ports are not deep-water facilities. Meanwhile, continued investment in information technology will assist Hong Kong to achieve increased productivity and efficiency. Finally, the deep financial resources of the Hong Kong port are hard to match.

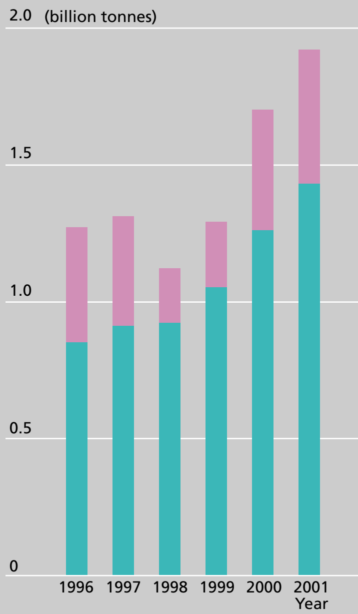
Currently, Hong Kong is proud of its status as one of the world's most efficient ports. For instance, the Container Terminal 3 facility can manage up to 40 crane moves per hour on average. Hong Kong has well developed and efficient logistics services supported by a straightforward and transparent customs service. Hong Kong boasts world-class infrastructure when it comes to banking, insurance, accounting and legal services. This includes expertise in international trade practices, such as the ability to facilitate timely payments and smooth document processing.

China Ports

PPC will maintain a strong presence in Hong Kong, but the strong growth market for container services is in China. WTO presents opportunities and new doors are swinging open. Within five years of WTO accession, studies suggest GDP growth may rise by an additional 0.5% to 2% annually. If the figure is closer to the 2% mark, it will translate into US$20 billion, or the addition of the equivalent of the annual economy of Malaysia or Singapore.

WTO certainly benefits the port industry. The only question is who will be the greatest beneficiary. As the WTO scenario unfolds, exports will expand and that will lead to cargo throughput growth. In addition, increase in the industrialisation rate will speed the restructuring of the port industry. Foreign investment rules will be further relaxed and this liberalisation will attract more investment in port facility construction. Finally, the port industry will benefit as new management methods and technology are introduced, thus narrowing the gap between international and domestic standards. All these factors combine to present tremendous opportunity in the port sector in the years ahead.

Cargo Throughput of Major Coastal and Inner River Ports in China



Source:The 2001 Report on China's Shipping Development