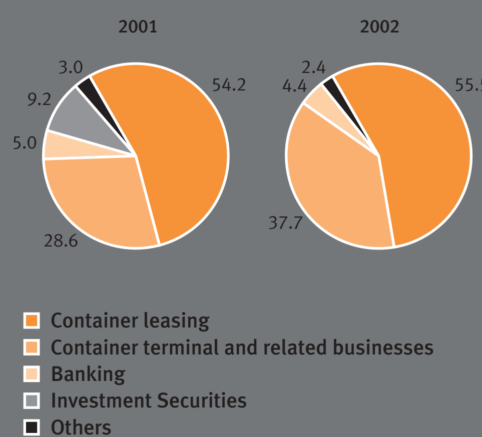
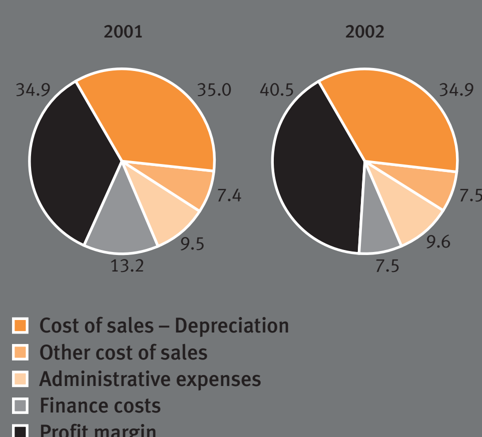
Management discussion and analysis

Analysis of profit attributable to shareholders (%)



Cost analysis (% of turnover)



FINANCIAL REVIEW

Turnover

Turnover for 2002 increased by 7.6% to US$241,644,000 (2001:US$224,671,000). The Group's turnover continued to derive mainly from container leasing, Zhangjiagang Win Hanverky Terminal and Plangreat Limited and its subsidiaries, which operate container stevedoring, container transport and storage. Turnover derived from associated companies or jointly controlled entities is not included in the Group's turnover.

The performance of the container leasing business was satisfactory, which rose by 7.5% to US$225,004,000 (2001:US$209,343,000). Of that amount, US$136,110,000 (2001: US$135,959,000) was rental income received from COSCON, whereas US$88,330,000 (2001: US$72,383,000) was rental income received from International Customers, and US$545,000 (2001: US$1,001,000) was interest income from finance leases, and the income from the new activity of container management was US$19,000 (2001: US$ Nil). Although average leasing rates dropped during the year, rental income received from International Customers rose by 22.0%, the Group successfully expanded the container fleet for International Customers to 378,862 TEUs (2001: 282,649 TEUs).

Benefitting from growth of China's trade and transportation, annual throughput at Zhangjiagang Win Hanverky Terminal rose by 25.5% to 202,348 TEUs (2001: 161,208 TEUs), whereas its turnover rose to US$7,850,000 (2001: US$5,720,000).

Turnover of Plangreat Limited and its subsidiaries amounted to US$8,790,000 (2001: US$9,608,000). The cargo volume at its depot slightly decreased due to shortage of empty containers.

Cost of sales and gross profit

Cost of sales for the year amounted to US$102,520,000 (2001: US$ 95,395,000), which mainly included depreciation, depot handling charges, maintenance costs and operating expenses. During the year, depreciation increased to US$85,393,000 (2001: US$78,733,000), representing 83.3% of cost of sales (2001: 82.5%). The increase was due to the expansion of container fleet. Other costs of sales rose by 2.8% only to US$17,127,000 (2001: US$16,662,000), which was resulted from the cost reduction programs carried out by the Group during the year and the reduction in direct expenses resulting from the increase in container utilisation rate. Gross profit margin for 2002 rose slightly by 0.1 percentage point to 57.6% (2001: 57.5%).

Other revenues

Other revenues mainly included US$7,048,000 (2001: US$6,885,000) of the sales revenues of Returned Containers, US$3,794,000 (2001: US$5,178,000) of interest income, and US$5,003,000 (2001: US$ Nil) of dividend income.

During the year, the disposal of Returned Containers from COSCON was 15,710 TEUs, against 12,151 TEUs in 2001, and therefore resale revenue increased. The decrease in interest income was due to the low level of interest rates in 2002. The performance of Yantian International Terminals in which the Group has a 5% equity interest was satisfactory. The company declared a dividend during the year and our share was US$5,003,000 (2001: US$Nil).

Administrative expenses

Administrative expenses increased by 8.9% from 2001, which was mainly due to staff costs as additional staff were employed to strengthen the marketing and project development teams. Moreover, travelling expenses increased, but professional fees decreased.

Other operating (expenses)/ income (net)

This category recorded net expenses of US$22,223,000 in 2002 against net income of US$8,149,000 in 2001, which was due to the following factors:

- Impairment losses of certain containers and corporate properties charged to the profit and loss account increased from US$5,680,000 in 2001 to US$15,997,000.

- During the year, the net book value of the disposed Returned Containers from COSCON increased by US$ 579,000 to US$8,929,000 (2001: US$8,350,000).

- At 31st December 2002, the provision for Returned Containers pending disposal increased by US$832,000.

- During the year, bad debts recovered amounted to US$2,999,000 (2001: US$41,000) and net provision for bad and doubtful debts amounted to US$1,142,000 (2001: US$514,000).

- In 2001, the Group recognised a profit of US$14,137,000 from the disposal of the B shares of Shanghai Zhenhua Port Machinery Co., Ltd. and reversed the provision of container repairs and maintenance expenses of US$6,156,000.

Besides, the Group continued to make a provision of US$3,296,000 (2001: US$3,450,000) against the shareholders' loan to River Trade Terminal.

Finance costs

Finance costs decreased by 39.0%. In 2001, interest rates reduced successively and remained at a lower level in 2002. The U.S. Federal Reserve cut interest rate by a further 0.5% in the second half year. The Group's average borrowing interest rate (including the loss of US$1,454,000 (2001: US$204,000) incurred by interest rate swap contracts) was 3.40% for the year (2001: 5.35%). During the year, the repayment of high interest loans also helped to reduce interest expenses.

Share of profits less losses from jointly controlled entities and associated companies

Share of profits from the six jointly controlled entities for the year was US$8,751,000 (2001: US$9,421,000). Although production volume at Shanghai Reefer increased 31.0%, the profit contribution remained the same as last year due to the increase in the price of raw materials and a decrease in the selling price. The share of profits from Shanghai Far East and Tianjin North Ocean were recognised according to the sub-contracting agreements signed in 2000 and 2001, and their profit contributions increased when compared with those of 2001. Due to intense competition, there was a decline in the overall profit contributions of two companies which produce special paints for containers and vessels. Throughput and profit of Qingdao Cosport International Terminals dropped due to the relocation of berthing of foreign trade cargo vessels.

As for the associated companies, the profit contribution for the year rose 18.7% to US$67,461,000 (2001: US$56,812,000). Throughput at COSCO-HIT achieved a record high in 2002. Its profit contribution increased significantly by 18.8%. Throughput at Shanghai Container Terminal rose by 16.8%. However profit declined due to the decrease in tariff rates. Twinbridge Corp. sold its interest in the Shanghai Yixian Road & Bridge Development Co., Ltd. during the year. Therefore its profit contribution from operations decreased, but the selling of the interest generated a one time profit of US$7,474,000. Liu Chong Hing Bank contributed a profit of US$8,455,000 (2001: US$9,007,000), a decline of 6.1%.

Taxation

The increase in taxation mainly reflected the increase in profit of COSCO-HIT and Zhangjiagang Win Hanverky Terminal.

Profit Attributable to shareholders

Profitable attributable to shareholders for the year increased to US$154,560,000 (2001: US$154,340,000). Basic earnings per share amounted to US7.2017 cents (2001: US7.2081 cents).

FINANCIAL POSITION

Cash flow

The cash flow of the Group remained strong during the year. Net cash inflow from operating activities amounted to US$220,537,000 (2001: US$212,123,000). Payment for capital expenditure on fixed assets of US$137,998,000 (2001: US$179,963,000), of which US$135,022,000 (2001: US$175,377,000) was used to purchase new containers. Moreover, the Group invested US$4,519,000 and US$19,941,000 in acquiring an 8% interest in Dalian Port Container Co. and a 17.5% interest in Shekou Container Terminals respectively. The Group raised loans of US$95,604,000 (2001: US$231,197,000) and repaid loans of US$184,468,000 (2001: US$145,304,000). As at 31st December 2002, the Group had cash of US$236,121,000 (2001: US$254,109,000), of which US$30,000,000 was part of the proceeds from the issue of new shares in May 1999. This amount was remitted to the Shanghai Pudong International Container Terminals Ltd. in February 2003 as part of the payment of the Group's 20% investment in that company.

Assets and liabilities

The Group continued to maintain a healthy balance sheet. As at 31st December 2002, total assets amounted to US$1,755,376,000 (2001: US$1,738,747,000), whereas total liabilities and minority interests amounted to US$467,474,000 (2001: US$538,453,000). Net assets amounted to US$1,287,902,000 (2001: US$1,200,294,000), an increase of 7.3% over the previous year. The increase was mainly due to retained profit for the year.

Cash balance as at 31st December 2002 amounted to US$236,121,000 (2001: US$254,109,000). Total outstanding borrowings amounted to US$420,674,000 (2001: US$509,538,000). The net debt-to-equity ratio further reduced to 14.3% (2001: 21.3%). With reduced interest expenses due to the continuous interest rate cuts, interest coverage expanded to 11.8 times (2001: 7.9 times).

As at 31st December 2002, the Group's bank deposits of US$7,817,000 (2001: US$8,174,000), together with certain containers with an aggregate net book value of US$278,378,000 (2001: US$253,778,000) were pledged to various banks and financial institutions to secure borrowings of US$156,578,000 (2001: US$162,532,000).

Contingent liabilities

As at 31st December 2002, the Group had no significant contingent liabilities (2001: the Group granted guarantees of US$585,000 for securing the banking facility of a jointly controlled entity).

FINANCIAL MANAGEMENT

During the year, the Group completed two major financing exercises. In July 2002, the Group entered into an agreement with a syndicate for a 5.5 year secured loan facility of US$90,000,000. US$63,027,000 of the loan facility was used to purchase containers and the balance was utilised to refinance an early repayment of a fixed rate borrowing with high interest rates. The fund-raising exercise was well received and had exceeded its target, which further demonstrated the confidence and support of the banking sector in the Group. COSCO-HIT, an associated company of the Group, engaged four underwriting banks for the arrangement of a syndicated loan of HK$2,000,000,000, which was intended for refinance and working capital. The loan agreement was signed in August 2002 and was instrumental for COSCO-HIT to reduce its interest expenses.

As at 31st December 2002, the Group had an aggregate amount of US$96,329,000 (2001: US$37,800,000) in committed facilities available from banks. In January 2003, the Group arranged with banks for a 5-year syndication loan facility which was intended for working capital and refinance. The syndication was also well received and had exceeded its target. The loan agreement of US$ 175,000,000 was signed on 17th February 2003.

Through the above financing arrangement, together with the Group's cash balance of US$236,121,000 at the end of the year (2001: US$ 254,109,000) and the expected cash inflow from operations in 2003, the Group will have adequate funds for repaying loans maturing in 2003 and for financing part of the planned capital expenditure. The Group will consider other finance plans to increase cash reserves in due course.

As at 31st December 2002, debt analysis was as follows:

	2002 (US$'000)	2002 (%)	2001 (%)
By repayment term			
Within the first year	210,189	50.0	21.3
Within the second year	67,410	16.0	41.5
Within the third year	67,839	16.1	14.3
Within the fourth year	31,314	7.5	13.7
Within the fifth year and after	43,922	10.4	9.2
	420,674	100.0	100.0
By type of loan			
Secured loans	156,578	37.2	31.9
Unsecured loans	264,096	62.8	68.1
	420,674	100.0	100.0
By denomination of loan			
U.S. Dollar	416,579	99.0	97.2
RMB	4,095	1.0	2.8
	420,674	100.0	100.0

The majority of the Group's borrowings are denominated in U.S. dollars and used primarily for container leasing, while revenues and expenses of the leasing operation are also mainly in U.S. dollars. Hence, foreign exchange risk is minimal.

The Group exercises stringent control over the use of derivatives for hedging purposes. During the year, the Group entered into interest rate swap contracts for US$100,000,000 to contain the risk of rising interest rates. As at 31st December 2002, the notional principal amounts of the outstanding interest rate swap contracts amounted to US$ 100,000,000 (2001: US$19,825,000), with the fixed interest rates ranging from 3.88% to 4.90% (2001: 5.70% to 5.80%). Besides, the Group made early repayment of part of the fixed rate borrowings carrying high interest rates. As at 31st December 2002, fixed rate borrowings of the Group amounted to US$4,095,000 (2001:US$ 45,671,000). The aforesaid interest rate swap contracts and fixed rate borrowings accounted for 24.7% of the Group's total borrowings in 2002 (2001: 12.9%).