

# Management

## Discussion and Analysis

### RESULTS ANALYSIS

For the year ended 31 December 2002 (the “Year”), turnover of continuing operations of the Group, together with the Group’s share of turnover of associates and jointly controlled entities, amounted to HK\$621 million (2001: HK\$522 million) and represented an increase of 19% over the corresponding period of 2001. Profit attributable to shareholders was HK\$155 million (2001: HK\$251 million), a decrease of 38% over that of 2001. Basic earnings per share was HKcents 1.38 (2001: HK cents 2.25). As at 31 December 2002, total assets and net asset value of the Group were HK\$3,406 million (2001: HK\$3,113 million) and HK\$1,944 million (2001: HK\$1,791 million) respectively, both representing increases of 9% over those of 31 December 2001.

For the Year, the Group focused on strengthening its existing businesses and streamlining its internal management. After three years of asset consolidation and internal restructuring, the quality of the Group’s assets and earnings have been gradually improved.

### Logistics and Related Business

During the Year, the Group’s core business grew steadily along with the economic development of China. Total Logistics (Shenzhen) Co., Ltd. (“Total Logistics”) recorded a turnover of HK\$76.59 million (2001: HK\$30 million) and the substantial increase was mainly attributable to the rapid development of the logistics industry and the rapid growth of import and export trading volume of Shenzhen City during the Year. Total Logistics contributed a profit after taxation and minority interests of HK\$3.12 million (2001: HK\$2.38 million) to the Group, representing an increase of 31% over that of 2001. During the Year, Shenzhen Airport International Express Supervision Center Co., Ltd. (“Airport Express Center”), of which Total Logistics has 50% interest, recorded a turnover of HK\$46.69 million (2001: HK\$17 million) and profit attributable to shareholders of HK\$23.14 million (2001: HK\$5.22 million). The operation of Airport Express Center has received popular support from the market and has proven to have a promising development potential.

In February 2002, the Group increased its equity interest in Xin Tong Chan Development (Shenzhen) Co., Ltd. (formerly known as Shenzhen Freeway Development Company Limited (“XTC Development”)) by 23.2% to a wholly-owned subsidiary. As a result, the profit generated by Shenzhen Expressway Company Limited (“Shenzhen Expressway”), a principal associate in which XTC Development has 30.03% interest, was fully reflected in 2002 and contributed a profit after taxation of HK\$83.4 million (2001: HK\$81.63 million) to the Group. During the Year, turnover of Shenzhen Expressway was HK\$494 million (2001: HK\$462 million), representing an increase of 6.92% over the corresponding period in 2001. Profit attributable to shareholders was HK\$339 million (2001: HK\$397 million), a decrease of 14.61% over that of 2001. The decrease in profit was mainly attributable to the increase in enterprise income tax payment as a result of the termination of the preferential tax benefits previously enjoyed by Shenzhen Expressway, as well as the significant decrease in construction management service income in 2002.

On 18 March 2003, Shenzhen Expressway entered into a transfer agreement with Shenzhen Communications Bureau pursuant to which Shenzhen Expressway will transfer all its rights in NH107 (Shenzhen Section) and NH205 (Shenzhen Section) to Shenzhen Communications Bureau at a consideration of RMB1,930 million (approximately HK\$1,820 million). It is estimated that Shenzhen Expressway will realise a profit before taxation (including PRC income tax and business tax) of approximately RMB612 million (approximately HK\$577 million) from the transfer. The Group owns 30.03% interest in Shenzhen Expressway and will share a profit before taxation of approximately RMB184 million (approximately HK\$173 million) as a result of the above transfer.

For the Year, NH107 (Shenzhen Section) and NH205 (Shenzhen Section) have in aggregate contributed to approximately 40% (2001: 44%) and 32% (2001: 35%) of the turnover and profit after taxation of Shenzhen Expressway respectively. However, traffic congestion has limited the growth potentials of these two highways. As a result of the change in government policy, Shenzhen Expressway has an opportunity to realise its investment by disposing of these two highways and to use the sale proceeds to invest in other expressways with high growth potential in Shenzhen and other region of the PRC.

# Management

## Discussion and Analysis

Shenzhen Expressway believes that it is able to source and invest new projects and that earnings will be restored to the level prior to the transfer of the two highways within the next three years. The Group is confident with the prospect of Shenzhen Expressway and it is expected that the transfer would improve the asset portfolio of Shenzhen Expressway for its long term development.

### Investment Holding

On 2 April 2002, the Group subscribed for 50 million A shares in China Merchants Bank Co., Limited ("CMB") which are listed on the Shanghai Stock Exchange at a price of RMB7.3 (approximately HK\$6.88) per share. The total investment cost amounted to RMB365 million (approximately HK\$344 million). These A shares were subject to a lock-up period of 12 months and were restricted from trading until the lock-up period expired on 9 April 2003. In accordance with currently applicable accounting standards, the Group accounted for the CMB A shares at their market value. On 30 June 2002, the market price of these A shares increased to RMB11.5 per share, but subsequently decreased to RMB8.14 per share as at 31 December 2002. For the Year, these A shares contributed an unrealised profit of approximately HK\$39.6 million to the Group, but this represented a decrease in profit of approximately HK\$150 million when compared with the 2002 interim results. On 9 April 2003, the Group disposed of all the 50 million CMB A shares at a net price of RMB9.2 (approximately HK\$8.68) per share with a total consideration of RMB460 million (approximately HK\$430 million). The investment in CMB A shares contributed a total profit before taxation of HK\$90 million to the Group, out of which HK\$39.6 million has been recognised as unrealised profit in the 2002 results and the remaining balance of HK\$50.4 million will be recognised in the results of 2003.

The profit contribution of the Group's investment holding activities for the corresponding period of last year comprised of the gain on disposal of portion of B shares in CSG Technology Holding Co., Ltd. ("CSG") amounted to HK\$46.26 million, the dilution gain of HK\$48.19 million arising from the issue of additional shares by Shenzhen High-Tech Holdings Limited ("Shenzhen High-Tech"), and the gain on disposal of the Group's 60% interest in Shenzhen Shentou Transportation Group Co. Ltd. amounted to HK\$53.74 million. The above-mentioned one-off, non-recurring profit in 2001 amounted to approximately HK\$148 million in total, representing approximately 59% of the profit in 2001, and this is a major factor for the decrease in profit of the Group during the Year.

### Information and High-tech Related Manufacturing Business

During the Year, although CSG, a principal associate of the Group, was adversely affected by the general depression of the glass industry, it still recorded a profit attributable to shareholders of HK\$153 million (2001: HK\$144 million), representing an increase of 6.3% over the corresponding period in 2001. The Group shared a profit of HK\$37 million (2001: HK\$35 million). Following the entry into the World Trade Organisation, the PRC market has been liberalised and keen market competition has become inevitable. In order to mediate the adverse effect brought about by the price cut, CSG adopted a series of stringent cost control measures to improve its production efficiency, thus maintaining a healthy growth of its results as a whole.

Shenzhen High-Tech, another associate of the Group, recorded a loss attributable to shareholders of approximately HK\$181 million (2001: profit of HK\$16.65 million) in 2002, and the Group shared a loss

of approximately HK\$37 million (2001: profit of HK\$3.5 million). The loss sustained by Shenzhen High-Tech was mainly attributable to the decrease in profit margin of Dawning Information Industry Company Limited as a result of keen market competition, and the provisions for impairment loss of assets of approximately HK\$141 million made during the Year.

The Group commits to further improve and strengthen the fundamentals for the development of its existing logistics business, and expects that the earnings and cash flow of which will be stabilised in 2003.

### STRENGTHENING LOGISTICS RESOURCES AND OPTIMISING ASSETS OF THE GROUP

In 2002, the Group has executed a series of investment and acquisition projects and the total investments in its core logistics business amounted to HK\$560 million. Certain logistics related infrastructure typed business and assets in Shenzhen City were injected into the Group continuously and the asset structure and business model of the Group have been gradually building up and optimised.

#### Investment in South China International Logistics Center

In July 2002, the Group invested RMB111 million in South China International Logistics Center and owns a 50% interest. South China International Logistics Center is an essential part of Long Hua Logistics District which is one of the key projects of the six major logistics districts in Shenzhen City. South China International Logistics Center enjoys overwhelming advantages in terms of geographic location and information technology and will focus on the development of cross border container transportation business with a brand new operating model of international cargo transit center under the supervision of customs authorities. It will also become an intelligent and multi-functional logistics center.



SILC — South China International Logistics Center

At present, South China International Logistics Center has completed the first phase of the construction work as scheduled, including building of roads, water pipes, electricity supplies and communication networks, as well as the infrastructure of phase one's unloaded containers depot with a site area of 100,000 square meters. On the other hand, the proposal regarding the outward connection of South China International Logistics Center, namely South China Flyover Interchange and Minkang Road, has been approved by relevant governmental authorities and is under public tender. The development of

information systems for depot management and office operations has been completed by phases whereas South China Logistics Information Management System has also been nominated as one of the key development projects of information systems in Shenzhen City. In 2002, with the approval of Guangdong Provincial Communications Bureau, South China International Logistics Center has been

# Management

## Discussion and Analysis

granted the right to operate as an international containers transfer center. Its international cargo agency service has also been reported to and approved by the Ministry of Foreign Trade and Economic Co-operation of the PRC. South China International Logistics Center is well prepared for the first phase of its operation.

In 2003, South China International Logistics Center will focus on its construction and operation progress side by side. In accordance with the scheduled investment plan, the construction of the surrounding traffic network will be speeded up and a service complex and a warehouse will also be built to further complement various ancillary facilities in the South China International Logistics Center in 2003. It is expected that by the end of 2003, customs authorities, which is an essential condition for launching the loaded container business, will station in the container depot. Meanwhile, South China International Logistics Center will endeavor to attract companies engaged in customs declaration, cargo agency and towing services to set up offices therein. As a result, South China International Logistics Center will be functional and able to satisfy the requisite operating conditions for storing, loading and unloading and warehousing of containers.

South China International Logistics Center will soon commence its trial run of commercial operation. An unloaded container depot will be operated in a plot with a site area of 100,000 square meters and has a handling capacity of up to 400,000 TEUs per year. On the basis of an unloaded containers depot, South China International Logistics Center will make every endeavor to diversify into loaded containers activities and also to engage in warehousing operations in order to capture more business opportunities and a more extensive scope for commercial co-operation.

### **Joint Investment and Establishment of Shenzhen Western Logistics Co., Ltd. (“Shenzhen Western Logistics”)**

On 3 December 2002, the Group entered into an investment agreement with its controlling shareholder, Shenzhen Investment Holding Corporation (“SIHC”) and its subsidiary, Shenzhen Nanyou (Group) Holdings Limited for the investment and establishment of Shenzhen Western Logistics. The registered capital of Shenzhen Western Logistics is RMB180 million in which the Group owns 20% interest.



According to the analysis on the industry as a whole, Western Port Logistics District takes the pole position in the six major logistics districts in Shenzhen City. It is the hinterland of the western port district which may act as the base of warehousing services for western channels and is able to support the advantage of coordinated transportation packages offered by Pingnan Railway. It serves as a base upon which the western part of Shenzhen City can improve the capacity of collective and distributive transportation systems and realise the efficiency of the operation of logistics business.

Western Port Logistics District is situated in the junction of Mawan Avenue, Chanwan Road and Yueliangwan Avenue in Shenzhen and it occupied a planned site area of 2.58 million square meters. Currently, the construction of a depot for unloaded containers with a site area of 200,000 square meters, a depot of bulky building materials with a site area of 100,000 square meters and warehouses of various kinds occupying an area of 55,000 square meters have been completed within the district. At this initial stage, the district serves as a featured warehousing base for ancillary transportation of professional paper products and oil and grease products as well as a consolidating base for unloading containers of exported goods.

Shenzhen Western Logistics is established on the basis of the existing warehousing and transporting functions. It is, on one hand, striving to complete the construction of infrastructure and related ancillary facilities and enact the planning for sustainable development. On the other hand, it also works together with subsidiaries of the Company which involved in the provision of logistics information platforms to develop a centralised platform for public logistics information. All these efforts can demonstrate the Group's determination to become a comprehensive logistics service provider engaging in basic logistics operations and yet capable of rendering value-added services of information technological system.

2003 is a critical year to Shenzhen Western Logistics. Firstly, in respect of the establishment of the logistics district, Shenzhen Western Logistics will finalise the key features of the planning of the logistics district and outline its master pattern. Secondly, Shenzhen Western Logistics will submit, amongst others, applications for the land use right of the logistics district and the master pattern of the Western Port Logistics District to relevant government authorities of Shenzhen City for approval in accordance with applicable regulations and procedures. Shenzhen Western Logistics will also consider to acquire logistics related business and assets which are of outstanding growth potential, including infrastructure facilities such as warehouses and depots. Shenzhen Western Logistics will also make use of the existing customer base of its shareholders to generate cash inflow and earnings as soon as practicable.

#### **Acquisition of Interest in XTC Development to become a Wholly-owned Subsidiary**

In October 2001, the Group completed the acquisition of 76.8% interest in XTC Development. In order to intensify the Group's investment in quality infrastructure and logistics assets in Shenzhen City, the Group entered into an agreement with SIHC on 20 December 2001, pursuant to which the Group acquired the remaining 23.2% interest in XTC Development at a consideration of RMB350 million (approximately HK\$330 million). The transaction was approved by shareholders of the Company in a special general meeting held on 31 January 2002. As the relevant conditions precedent of the acquisition had been fulfilled and the Group had obtained actual management control, XTC Development became a wholly-owned subsidiary of the Company on that date. All other relevant legal formalities were completed on 10 September 2002.

# Management

## Discussion and Analysis

Following XTC Development became a wholly owned subsidiary of the Company, the profit contribution from Shenzhen Expressway, a principal associate of the Group in which XTC Development has 30.03% interest, has been fully reflected in the Group's results during the Year. This also contributes a more stable and recurrent earnings and cash flow to the Group, and is beneficial to the continuous development of the Group.



### Acquisition of Interest in Total Logistics to become a Wholly-owned Subsidiary

In October 2002, the Group acquired a further 30% interest in Total Logistics at a consideration of RMB48.15 million (approximately HK\$45.43 million) and Total Logistics became a wholly-owned subsidiary of the Company.

Since its incorporation in September 2000, Total Logistics has established an integral competition edge with strong growth during these two years of operation. It owns interests in certain logistics hubs and transportation systems and has extensive co-ordination techniques with its logistics information network service platforms. As a result, a brand name of "comprehensive logistics services" has been built gradually and Total Logistics is able to record satisfactory growth in its turnover and profit. Total Logistics currently holds quality logistics assets which are strategically important to the development of its business. These include 50% interest in Shenzhen Airport International Express Supervision Center Co., Ltd., 39% interest in Shenzhen EDI Co., Ltd. (formerly known as Shenzhen Container Transportation EDI Co., Ltd. "Shenzhen EDI"), 10% interest in Shenzhen Airlines and 50% interest in Guangzhou Changyun Total Logistics Co., Ltd. All these assets provide a promising prospect for the future development of Total Logistics.



The acquisition will enable the Group to strengthen the control of Total Logistics, thereby enhancing the synergy between the operation of Total Logistics and other logistics resources already held by the Group. These will further reinforce the Group's leading position in the logistics industry in Shenzhen City.

### Acquisition of 10% Equity Interest in Shenzhen Airlines

In May 2002, the Group acquired 10% equity interest in Shenzhen Airlines at a total consideration of RMB34.33 million (approximately HK\$32.38 million).

Shenzhen Airlines is a civil airline engaged in passenger and cargo flights with Shenzhen as its aviation base. At present, Shenzhen Airlines operates over 40 domestic routes and owns 18 Boeing 737 passenger and cargo aircraft. Since 1995, Shenzhen Airlines has recorded profits for eight consecutive years notwithstanding the stiff competition of the airline industry in the PRC. In addition,

various operational performance indicators of Shenzhen Airlines have outweighed those of its counterparts in the industry and this indicates that Shenzhen Airlines has an excellent market competitive edge. Shenzhen Airlines is the pioneer in the PRC which introduces the business model of “Joint Flight with Perfect Timing”. In this model, Shenzhen Airport acts as a connecting station whereas Shenzhen Airlines utilises its aircraft resources to transfer passengers from medium to small sized cities with limited joint and schedule flight services to other cities through Shenzhen Airport. This policy has been well received by the passenger transportation market and joint flight services have been extended to cargo transportation accordingly. Shenzhen Airlines creates substantial social and economic benefits in a number of major and medium-sized cities in the PRC by providing “International Cargo Transition Services” with Shenzhen Airport as a hub.

Total Logistics has access to advanced and modern logistics information technologies, efficient techniques and operational knowledge for logistics services as well as cargo airfreights. Once these factors are combined with the brand name and core transportation tools of Shenzhen Airlines, the quality and competitive edges of “one-stop service” of aircraft capacity of Total Logistics will be enhanced greatly whereas the collective and distributive functions of Shenzhen Airlines will also be reinforced. The close relationship between Total Logistics and Shenzhen Airlines is certainly beneficial to Total Logistics for the establishment of a



multi-functional logistics network with extensive coverage in the region within a short period, representing a great leap for Total Logistics in cargo air freight industry.

#### **Acquisition of 39% Equity Interest in Shenzhen EDI**

In February 2002, the Group acquired 39% equity interest in Shenzhen EDI at a total consideration of RMB5.66 million (approximately HK\$5.33 million).

Shenzhen EDI is a high-tech information technology company and its principal activities include electronic data interchange for transportation industry, integration of related computer networks, and provision of value-added services for transportation information. After the transformation and upgrade of its EDI platform, Shenzhen EDI’s platform has become an electronic logistics public data network platform in Shenzhen City recognized by Shenzhen Municipal Government and has a certain level of monopoly and is exposed to less pressure from market competition.

Through the EDI platform of Shenzhen EDI and its existing customer base, Total Logistics will achieve the objectives of sharing facilities, talent and information to expedite the goal of being developed into an integrated logistics service provider.



# Management

## Discussion and Analysis

### **PROSPECTS: ENHANCEMENT OF PROFITABILITY OF VARIOUS BUSINESS, PRUDENT ASSESSMENT OF INVESTMENT OPPORTUNITIES**

Since the Group established its strategy of developing logistics business in 2000, strategic adjustment and business restructuring have been accomplished successfully in the past three years. With continuous reinforcement under this direction, the Group will continue to capitalise on the advantages from shareholders' support, management, merger and acquisition. Through optimising our internal corporate structure and resources allocation, the business scope will be expanded further to enhance the quality of the existing assets and profitability. The exploration of value-added potential investment opportunities makes the core business more competitive and induces higher returns to shareholders.

In 2003, the Group's development will focus on the following aspects so as to gradually develop an unparalleled competitive edge for the Group:

- strengthening the management of its current logistics business and related resources
- consolidating existing assets and operation flow
- enhancing supply chain management technique and controls of various sections of the logistics business
- provision of quality and customised services
- fostering a close and strategic co-operation relationship with customers

With prudent assessment of investment progress and development opportunities, the management of the Company will maintain an optimal allocation and flexibility of its financial resources. The Company will also adopt different strategies to attain a high standard of corporate governance and to reach a reasonable profit level and healthy growth. The Company's management team is confident to achieve better results in 2003 and to progressively realise the Group's strategic development objectives.

In 2003, the Group will follow the established development strategy and capitalise on every valuable opportunity. We will make full use of shareholders' competitive edge and rely on competency of the management of the Company in order to secure a foothold in the four major sectors of modern logistics business in Shenzhen City and the country as a whole. These sectors include infrastructure, transportation systems, logistics and ancillary services, and logistics information and e-commerce services. The Group aims to establish a business system equipped with airports, harbours and land logistics resources and infrastructure projects and supported by logistics information platforms and supply chain management techniques.

## FINANCIAL POSITION

	<b>31 December 2002 HK\$ million</b>	31 December 2001 HK\$ million	Increase/ (Decrease) %
Total Assets	<b>3,406</b>	3,113	9
Current Assets	<b>761</b>	478	59
Current Liabilities	<b>592</b>	472	25
Net Current Assets	<b>169</b>	6	2,717
Net Tangible Assets	<b>2,155</b>	1,945	11
Net Assets	<b>1,944</b>	1,791	9
Issued Share Capital	<b>1,122</b>	1,122	—
Net Assets per Share	<b>HK\$0.17</b>	HK\$0.16	6
Cash and Bank Deposits	<b>286</b>	305	(6)
Bank Loans and Other Borrowings	<b>1,030</b>	888	16
Non-interest Bearing Convertible Note — SIHC	<b>330</b>	—	N/A
Net Borrowings	<b>653</b>	444	47
Ratio of Net Borrowings to Shareholders' Equity	<b>34%</b>	25%	9*

*\* Change in percentage point*

As at 31 December 2002, the Group's current assets increased by approximately HK\$283 million or 59% when compared with 2001. This is mainly attributable to the Group's subscription for 50 million listed A shares of CMB at a cost of HK\$344 million. The subscription of shares in CMB intensified the Group's Other Investments and in accordance with applicable accounting standards, the Group accounted for the A shares in CMB at market value which resulted an increase in carrying value of the investment to HK\$384 million. During the Year, the Group's investment in logistics assets including South China International Logistics Center and Shenzhen Airlines amounted to approximately HK\$150 million. Coupled with the profit contributions for the Year, the total assets of the Group increased by approximately HK\$293 million. The current liabilities of the Group has increased by approximately HK\$120 million during the Year as certain long-term bank loans were due for repayment within the next 12 months.

As at 31 December 2002, bank loans and other borrowings of the Group amounted to HK\$1,030 million (2001: HK\$888 million), of which 52%, 42% and 6% were due for repayment in the first year, the second year and the third year and after respectively. Bank loans and other borrowings increased by approximately HK\$140 million over the Year, which were applied to the investment in and the acquisition of logistics assets such as South China International Logistics Center and Shenzhen Airlines, as well as for meeting working capital requirement of the Group. These borrowings were mainly Renminbi denominated loans from banks and other institutions in the PRC. Since the business of the Group is mainly operated in the PRC, revenue and cash flow are primarily denominated in Renminbi, thereby minimising exchange exposures. Approximately HK\$99.02 million of the total borrowings of the Group are secured by investment properties and other assets of the Group, details of which are set out in note 26 to the financial statements.

# Management

## Discussion and Analysis

On 1 August 2002, the Company issued a five-year non-interest bearing convertible note with a principal amount of HK\$330 million to its controlling shareholder, SIHC, to finance the consideration for the acquisition of the remaining 23.2% equity interest in XTC Development. The conversion price of the note is HK\$0.365 per share and the convertible note was issued pursuant to the terms of the relevant acquisition agreement and the memorandum and articles of association of the Company.

As at 31 December 2002, the ratio of net borrowings to shareholders' equity of the Group was as follows:

	<b>31 December 2002 HK\$ million</b>	31 December 2001 HK\$ million
Shareholders' Equity	<b>1,944</b>	1,791
Cash and Cash Equivalents		
Cash and Bank Balances	<b>286</b>	305
Short Term Investment Securities	<b>421</b>	139
	<b>707</b>	444
Total Borrowings		
Short Term Bank Loans	<b>85</b>	129
Long Term Bank Loans due for repayment within one year	<b>217</b>	—
Short Term Loans and Others	<b>233</b>	276
Long Term Bank Loans	<b>321</b>	237
Other Long Term Loans	<b>174</b>	246
Non-Interest Bearing Convertible Note — SIHC	<b>330</b>	—
Total Borrowings Before Non-Interest Bearing Convertible Note	<b>1,030</b>	888
Total Borrowings	<b>1,360</b>	888
Net Borrowings Before Non-Interest Bearing Convertible Note	<b>323</b>	444
Net Borrowings	<b>653</b>	444
Ratio of Net Borrowings Before Non-Interest Bearing Convertible Note to Shareholders' Equity	<b>17%</b>	25%
Ratio of Net Borrowings to Shareholders' Equity	<b>34%</b>	25%

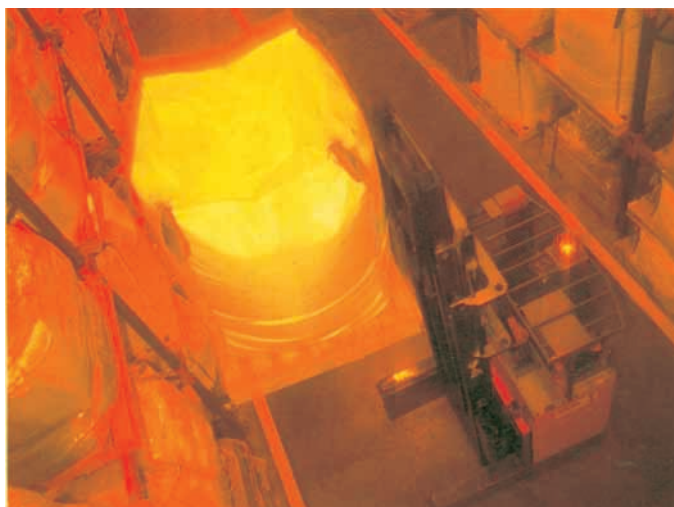
The Group's ratio of net borrowings to shareholders' equity increased from 25% as at 31 December 2001 to 34% as at 31 December 2002. The increase was mainly attributable to the issue of the non-interest bearing long term convertible note with a principal amount of HK\$330 million to SIHC and the increase in bank loans for financing capital investment expenditures and meeting working capital requirement during the Year. However, net borrowings before the non-interest bearing convertible note and the corresponding ratio to shareholders' equity were HK\$323 million (2001: HK\$444 million) and 17% (2001: 25%) respectively, representing decreases over 2001. This indicated that there are improvements in the financial position of the Group as compared with that of 2001.

Currently, the Group has standing banking facilities totalling HK\$1,100 million, of which approximately HK\$600 million has been utilised. The unutilised standing banking facilities can be applied to the Group's working capital and capital expenditure in the future. The Group reviews its existing capital structure regularly with a view to working out the most efficient funding channels to meet the demand for future development of the Group.

#### **PROSPECTS OF LOGISTICS BUSINESS IN CHINA**

In 2003, the economic growth of China will remain strong and the active trend of which will be sustained. China may even become the main drive of global economic growth in the following decade. According to the forecast made by the State Information Center, it is expected that the national economy of the PRC will experience another uprising period in 2003. Subject to the continuance of a positive yet healthy macro-economic policies, the growth rate of the annual gross domestic productivity will be as high as 8% as a result of the positive effect of the accession of China into the WTO being further realised and confidence of consumers will grow stronger.

In 2002, the size of the logistics market in the PRC was approximately RMB190,000 million and costs of logistics services accounted for approximately 20% of GDP. However, modern logistics business (i.e. third party logistics) is still at the initial stage of development and the market size of which is less than RMB50,000 million. There is therefore a great potential for market development. It is expected that the market size of logistics business in the PRC in 2003 will reach RMB240,000 million. Currently, over 10,000 entities in the PRC are engaged in logistics services and the annual growth rate of the



logistics market is as high as 30%, indicating the beginning of a rapid growth period of modern logistics business. In the coming three to five years, investments in infrastructure of transportation and communication will be a driving force to boost the economy of China. Improvement in infrastructure of transportation and communication will lay a solid foundation for the development of logistics business, which in turn will facilitate the growth of the economy.

# Management

## Discussion and Analysis

In October 2002, in order to foster the development of international trade, to lift the barrier of entering into modern logistics business for foreign players and to ensure the organic growth of logistics business, the Ministry of Foreign Trade and Economic Cooperation of the PRC issued a formal notice upon which three provinces, four municipalities directly under the central government and Shenzhen Special Economic Zone are allowed to commence the trial regarding the investment of foreign investors in logistics business. Authorised foreign logistics entities are free to engage in export and import businesses as a principal or an agent, thus revealing the gradual liberalisation of relevant policies.

### ADVANTAGES AND STRATEGIES FOR THE DEVELOPMENT OF LOGISTICS BUSINESS IN SHENZHEN CITY

In accordance with "Certain Opinions on Accelerating the Development of the Modern Logistics Sector in Shenzhen City" issued by Shenzhen Municipal Government in October 2002, the net production value of logistics business in Shenzhen City will be RMB60,000 million by 2005, representing approximately 20% of the GDP in Shenzhen City. The annual average growth rate of logistics business will be even higher than the overall economic growth rate of Shenzhen City by 2%. Besides, the logistics volume shared by modern logistics business will account for over 30% of the total logistics volume of the PRC, which will induce changes in the investment environment and the structure of social economy in Shenzhen City. Logistics business is now a "propeller" and "accelerator" of the economic growth of Shenzhen City and the role of which is of growing importance.

Shenzhen City proposes to speed up the implementation of the development strategy of "Led by Two Ports (harbour and airport) and Supported by Five Networks (Highway Networks, Logistics and Cargo Transportation Networks, Public and Track Transportation Networks, Railway Transportation Networks and Logistics Information Networks)". The set up of transportation and information platforms are based on this concept and the establishment of the six major supporting systems and the construction of six major logistics districts for logistics business are facilitated accordingly. As a result,



three major logistics systems, which will be focused on international logistics business and based on regional logistics business and supported by urban ancillary transportation logistics business respectively, are patterned, thereby realising the strategic goal of being a regional logistics center. In order to develop modern logistics business as one of the three "Pillar Industries" of Shenzhen City, it is intended that a total sum of RMB65,000 million will be injected into the logistics sector during the "Tenth Five years' Plan" period when a series of administrative measures will be adopted and concessions will also be granted to key industries and projects.

According to the statistical survey conducted by Shenzhen Communications Bureau, the development of logistics business in Shenzhen City progressed well in 2002 and further growth of the GDP generated by logistics business was recorded. The total cargo handling volume of land, sea, railway and air transportation modes was 56.83 million tons, representing an increase of 10.4% over the

corresponding period of 2001. The cargo throughput of ports was 87.667 million tons, representing an increase of 32% over the corresponding period of 2001. The container throughput of ports was 7.618 million TEUs, representing a substantial increase of 50.1% over the corresponding period of last year.

In 2003, Shenzhen City will further enact a series of policies to complement the development of logistics business and will initiate the research of site planning, function positioning and industry patterning of the 6 major logistics districts. The leading role of Shenzhen city will be highlighted to further intensify the investment and construction of seaports and airports, and research and preparatory works of cargo stations for ground transportation will commence as a result. All these factors will certainly speed up the development of Shenzhen city into a modern logistics hub in every aspect.

The growth of national economy and foreign trade and the priority granted by Shenzhen Municipal Government in respect of modern logistics business provide the Group with ample room for the development of logistics business. Logistics is an emerging business. However, merger and acquisition by foreign investors driven by capital flow around the world will intensify market competition and initiate races for strategic assets. The Group is familiar with the systems and markets in the PRC so it will capitalise on these factors to extend and consolidate its control over strategic resources by rationalising the business. On the other hand, the Group will also learn from various multi-national logistics corporations and make use of the experience therefrom to optimise the new corporate system and to improve management efficiency by upgrading the standard of corporate management. The competitiveness of the Group will grow stronger with time.

## **ANALYSIS OF MAJOR BUSINESS OPERATIONS**

### **Logistics and Related Business**

#### *Total Logistics*

During the Year, turnover of Total Logistics was HK\$76.59 million (2001: HK\$30 million), representing an increase of 1.55 times over the corresponding period of 2001. Total Logistics contributed a profit after taxation and minority interests of HK\$3.12 million (2001: HK\$2.38 million) to the Group, representing an increase of 31.1% over the corresponding period of 2001. Turnover of Total Logistics was mainly derived from the provision of agency services of ancillary transportation of cargoes, of which 49% (2001: 82%), 46% (2001: 2%) and 5% (2001: 16%) was by air, land and sea respectively. Revenue of Total Logistics' core business enjoyed continuous growth and the volume of traditional air, land and sea transportation services increase continuously, bringing about satisfactory performance and increase in revenue.

The overall volume of cargo airfreight business of Total Logistics had increased during the Year and this is mainly attributable to the launching of new international flights for its cargo airfreight business, coupled with the strike in the coastal area of western part of North America during the fourth quarter of 2002 which provided a short term extra volume growth. Besides, with respect to its supervised airfreight transportation business between Shanghai, Shenzhen, Hong Kong and overseas, Total Logistics endeavored to secure supports from customs authorities for its operation and became a logistics company which is capable of providing supervised airfreight transportation for both import

# Management

## Discussion and Analysis



and export cargoes. The land transportation business of Total Logistics experienced a rapid growth in 2002 at a rate higher than that of airfreight business and sea transportation business. The growth was mainly attributable to the enlargement of its major customer base and the provision of comprehensive logistics ancillary transportation services. Major customers included CSG, Jiangzhong Pharmacy Group (Holding) Company Limited, Shenzhen B&Q Decoration and Building Material Co., Ltd. ("B&Q"), Eagle Brand Holding Limited and Henan Genron Food Co., Ltd. B&Q is the third largest operator of modern construction and decoration materials in the world and Total Logistics has been appointed

as B&Q's logistics service provider of ancillary transportation for procurement, outlets and consumers delivery along with its market development in southern China. Meanwhile, Total Logistics has set up 25 logistics hubs throughout the PRC, including branch networks in Shanghai, Kunming, Guangzhou, Zhengzhou, Dongguan and Huizhou. Other domestic networks are also in gradual establishment in line with customers' demand and operational requirements.

In addition to the development of traditional logistics business, Total Logistics is also engaged in the development of a self-developed logistics information software system called "TotalLogisticsStar". During the Year, new service content has been added to the software system and existing functions of the system have also been upgraded. Besides the built-in third party logistics management system, warehousing management system, delivery center management system, transportation management system, total tracking service networks and eBusiness system, a logistics chain management system and an urban ancillary transportation management system have been newly launched. It is expected that "TotalLogisticsStar" will generate operating revenue to Total Logistics in 2003. In January 2003, "TotalLogisticsStar" has been recognised by Shenzhen Municipal Government as "The First Batch of Application Promotion Solutions for Information Usage in Shenzhen City" and was amongst the first group of companies which was awarded with this title.



This year is the first full financial year of Shenzhen Airport International Express Supervision Centre Co., Ltd. ("Airport Express Centre"), in which Total Logistics has 50% interest, since its commencement of operation in June 2001. Turnover and profit attributable to shareholders of Airport Express Centre were HK\$46.69 million (2001: HK\$17 million) and HK\$23.14 million (2001: HK\$5.22 million) respectively, representing an increase of 1.75 times and 3.4 times over 2001 respectively. In 2002, the express cargo volume handled by Airport Express Centre accumulated to 112,500 tons in total, of which 85,000 tons were export express cargoes and the remaining 27,500 tons were import

express cargoes. The higher cargo handling volume in the second half of 2002 was mainly due to the continuous improvement of facilities and service quality of Airport Express Centre. The promising customs declaration procedures and co-ordination functions of Airport Express Centre have been well acknowledged by courier companies stationed therein. In particular, the operating environment for export express cargoes has been improved significantly and as a result, the export express cargo volume increased by 1.2 times in the second half of 2002 when compared with the first half of the Year. It is expected that the business development of Airport Express Centre will be further strengthened with the introduction of new flights in 2003.

Total Logistics acquired 10% interest in Shenzhen Airlines at a total consideration of RMB34.33 million (approximately HK\$32.38 million) and the relevant legal procedures had been completed in June 2002. During the Year, Shenzhen Airlines converted to a joint stock company and newly acquired six aircraft to explore new markets for passenger and cargo transportation, thereby increasing passenger and cargo volume by 61.7% and 67.1% over 2001 respectively. In addition, Total Logistics has entered into an agreement for the acquisition of 100% interest in Beijing Whole Course Logistic Service Co., Ltd. ("Beijing Logistic"), which is a qualified international shipping agent as well as an international airfreight agent and is eligible for setting up branches. Beijing Logistic is strategically important for the development of Total Logistics' international cargo transportation agency business and is expected to provide Total Logistics with additional room for development. In February 2002, Total Logistics acquired 39% interest in Shenzhen EDI at a total consideration of RMB5.66 million (approximately HK\$5.33 million). In 2002, Shenzhen EDI achieved a break-even position and since the throughput of container ports in Shenzhen City is ever increasing, there will be substantial demand for EDI data exchange services.

In 2003, Total Logistics will continue to expand the market of third party logistics and comprehensive logistics business. It will also focus its resources on soliciting new clients and enlarging the market and will try its best to reduce operating costs and improve efficiency. Total Logistics will strengthen its existing customer base and business volume, upon which new business and customers with remarkable growth potential and market prospects will be explored. Total Logistics will make use of its existing logistics capacity and networks to identify and explore infrastructure type logistics facilities with strategic purposes through mergers, acquisitions and joint venture projects.

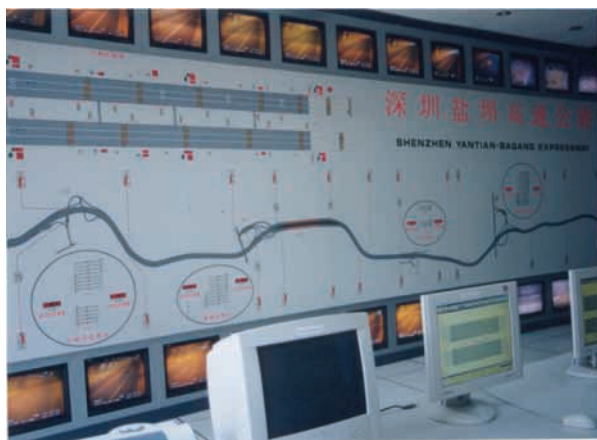
#### *XTC Development*

On 20 December 2001, the Group entered into an agreement with its controlling shareholder, SIHC, for the acquisition of the remaining 23.2% interest in XTC Development at a consideration of RMB350 million (approximately HK\$330 million) which was satisfied by the issue of a 5-years convertible note by the Company. The transaction was approved by shareholders in a special general meeting held on 31 January 2002 and XTC Development became a wholly-owned subsidiary of the Company. During the Year, XTC Development contributed profit after taxation of approximately HK\$83.4 million (2001: HK\$81.63 million) to the Group. The amount was mainly attributable by the profit generated by a principal associate of XTC Development, Shenzhen Expressway Company Limited ("Shenzhen Expressway") in which XTC Development held a 30.03% interest. In 2002, turnover and profit attributable to shareholders of Shenzhen Expressway was HK\$494 million (2001: HK\$462 million) and HK\$339 million (2001: HK\$397 million) respectively, representing an increase of 6.92% and a decrease of 14.61% when compared with those of the corresponding period of 2001.



# Management

## Discussion and Analysis



During the Year, the toll road operations of Shenzhen Expressway performed well as a whole, thus maintaining a steady growth of toll income. The expressways under the management of Shenzhen Expressway have become a major source of income growth. The western section of Jihe Expressway recorded a rapid growth and the daily average traffic volume and toll income increased by more than 30%. On the other hand, other expressways also experienced growth of different extent. However, NH205 (Shenzhen Section) and Jihe Expressway (Eastern Section) were affected by the material diversion effect brought by Shuiguan Expressway.

Owing to the termination of the preferential income tax treatments by which Shenzhen Expressway and its subsidiaries were previously exempted from PRC enterprise income tax for the first five profitable years and a 50% reduction for the five consecutive years thereafter, the tax paid by Shenzhen Expressway increased significantly during the Year. In addition, construction management service income decreased sharply in 2002 as compared with 2001. All these factors contributed to the decrease in profit attributable to the shareholders of Shenzhen Expressway during the Year.

In December 2002, Shenzhen Expressway acquired 40% interest in the newly launched Shenzhen Shuiguan Expressway and continued to develop its connecting sections to link up the urban area of Shenzhen City. As a result, Shuiguan Expressway enjoys remarkable potential growth of traffic volume as well as promising prospects for future development.

On 18 March 2003, Shenzhen Expressway entered into a transfer agreement with Shenzhen Communications Bureau pursuant to which Shenzhen Expressway will transfer all its rights in NH107 (Shenzhen Section) and NH205 (Shenzhen Section) to Shenzhen Communications Bureau at a consideration of RMB1,930 million (approximately HK\$1,820 million). It is estimated that Shenzhen Expressway will realise a profit before taxation (including PRC income tax and business tax) of approximately RMB612 million (approximately HK\$577 million) from the transfer. The Group owns 30.03% interest in Shenzhen Expressway and will share a profit before taxation of approximately RMB184 million (approximately HK\$173 million) as a result of the above transfer.



In order to focus on its core business, XTC Development entered into an agreement in January 2003 to dispose of its entire 25% interest in Shenzhen Tong Chan Industry Co., Ltd. ("STCI") at a consideration of RMB38.6 million (approximately HK\$36.4 million) from which the Group derived a gain on disposal of approximately HK\$1 million. The disposal of STCI enable the Group to better utilize its resources to develop its existing business and to capture business opportunity in the logistics business with higher development potential and investment value in the future.

## Information and High-Tech Related Manufacturing Business

### CSG

Turnover and profit attributable to shareholders of CSG for the Year were HK\$988 million (2001: HK\$963 million) and HK\$154 million (2001: HK\$144 million) respectively, representing increases of 2.6% and 6.9% over the corresponding period of 2001. The Group shared a profit of HK\$37 million (2001: HK\$35 million), representing an increase of 5.7% when compared with the corresponding period of 2001.



Following the entry of China into the WTO, the market in the PRC has been liberalised with intense competition. As certain countries implemented measures to protect local enterprises and markets in response to the continuous depression of global economy, the export of products from corporations in the PRC has suffered a material impact. From the 2002 third quarterly report of eight corporations which are engaged in manufacture of glasses and listed in or outside the PRC, profitability diminished in general with certain companies in a loss position, while unlisted manufacturers are in a more difficult position. CSG however is the only exception. To deal with the critical situation, CSG conducted a comprehensive market analysis and adjusted the quality of its products. The sales volume of CSG's core industrial products increased when compared with that of 2001 and the growth rate of advance processed glass products was particularly impressive. However, the selling price of CSG's core industrial products was lower than last year in general. Certain products recorded increased in turnover but a decreased in gross profit because of the substantial decrease in pricing. In order to mediate the unfavourable effect arising from substantial decrease in pricing, CSG implemented a series of stringent cost control measures in various production process to improve its production efficiency. The downward adjustment of electricity charges commenced in May 2002 also contributed to offset the increase in other production costs. In addition, with a higher gross profit margin of glass curtain wall products during the Year, the overall gross profit of CSG have achieved a slight increment.

During the Year, the installation, tuning and trial run of the main line, inspection system and ancillary facilities of the third production line for ITO electricity conductor coating of CSG have been completed. Since then, the production line



# Management

## Discussion and Analysis

commenced commercial operation and a number of production control indicators and product quality recorded promising outcomes which ensured the meeting of stringent demand from customers. In June 2002, Tianjin CSG Architectural Glass Co., Ltd. was duly established. The anticipated investment cost was RMB400 million, of which CSG owns 61% interest. It intends to produce environmental friendly and energy saving high-tech products, namely low radiation engineering glass, to meet the market demand of northern China and the construction projects of Beijing Olympic Game. All these measures will enhance the comprehensive productivity and competitiveness of CSG, thereby further strengthening its profitability.

### *Shenzhen High-Tech*

During the Year, turnover of Shenzhen High-Tech was HK\$264 million (2001: HK\$157 million), representing an increase of 68% when compared with the corresponding period of 2001. Loss attributable to shareholders was HK\$181 million (2001: profit of HK\$16.65 million), of which a loss of HK\$37 million (2001: profit of HK\$3.5 million) was attributable to the Group. The loss of Shenzhen



High-Tech incurred during the Year was mainly resulted from the provisions for impairment loss of assets of approximately HK\$141 million made during the year, and that Dawning Information Industry Company Limited (“Dawning”) suffered from the decrease in profit margin as a result of keen competition of the server market in the PRC. The price of servers decreased continuously during the Year and despite the increase in turnover of Dawning over the corresponding period of 2001, the decrease of marginal profit contributed to the operating loss incurred by Dawning for the Year. Dawning will implement further cost control measures to improve its operating efficiency and product quality in 2003 so as to enhance its competitiveness and achieve promising results.

The construction of Dawning Tower in Shenzhen High-Tech Park was completed on 2 August 2002. Dawning Tower is primarily the research and development center of Shenzhen High-Tech and occupation took place in October 2002. All office space available for leasing in Dawning Tower has been fully occupied and it is expected that stable rental income will be contributed to Shenzhen High-Tech.

## Property Investment

### *Hua Li Garden, Shenzhen*

During the Year, rental income of the Group's investment properties, mainly comprised Hua Li Garden in Shenzhen, was approximately HK\$18.9 million (2001: HK\$18 million), representing an increase of 5% over the corresponding period of 2001. The investment property is leased to a leading chain department store group in Shenzhen under a long-term lease. This provides a stable and continuous rental income to the Group.

## HUMAN RESOURCE

The management of the Company considers human resource as an invaluable asset and a key factor to profitability of the Group, and recruiting talents, rewarding staff with outstanding performance and provision of professional training are all essentials to the success of the Company. In order to attract talents and retain competent staff and to be impartial, employees' remuneration packages are determined by their qualification, competency and performance, and also by reference to market terms. The remuneration packages of Hong Kong staff include salary payments, medical subsidies, hospitalisation scheme and mandatory provident fund retirement benefit scheme and those of staff in the PRC include salary payments and retirement funds. In order to encourage and reward our staff, the Group operated an annual appraisal system to review the salary of employees and assess their performance during the Year, upon which the basis of payment of year-end bonus will be determined. In addition, eligible employees contributed to the results and business development of the Group may be granted options to acquire shares in the Company pursuant to the share option scheme of the Company. The Group also provides professional training to our employees to encourage them to continue studies and equip themselves.

As at 31 December 2002, the Group had 338 employees in total, comprising 25 employees in Hong Kong, the majority of whom were management and financial personnel, and 313 employees in the PRC, approximately 200 of whom served in logistics operation.