

BUSINESS REVIEW

The year under review was an eventful year for BALtrans. The Group continued with its strategy of expansion through acquisitions and on 30th January 2003, successfully acquired Jardine Logistics Group ("Jardine Logistics") which had a substantial impact on the overall performance of the Group in the year.

Despite the difficult environment due to the war in Iraq and the outbreak of Severe Acute Respiratory Syndrome ("SARS"), turnover increased significantly by 81.2% to HK\$2,381.94 million, as compared with the HK\$1,314.83 million recorded in the same period of the financial year 2002. This is attributable both to the robust organic growth of the existing business as well as revenue contribution from Jardine Logistics. However, profit attributable to shareholders was HK\$22.92 million, representing a decrease of 58.9% over last year's HK\$55.83 million. This was due to a combination of factors including the negative impact from the outbreak of SARS, the continuing Jardine Logistics losses in the six months post-acquisition, the one-time restructuring cost of HK\$22.55 million (mainly including impairment of fixed assets, expenses in connection with staff redundancy and office relocation) incurred in connection with Jardine Logistics and property revaluation losses of HK\$7.33 million, partially offset by a net gain on disposal of associated companies of approximately HK\$21.49 million.

Although Jardine Logistics continued to register losses, the Group has implemented prudent and effective measures to turn it around. We have, amongst other measures, revised its sales strategies with emphasis on gross margin rather than sales revenue, streamlined the organisation structure and reduced overheads through the sharing of Group resources. As a result, we have incurred a one time restructuring charge.

MARKETS

Hong Kong and Mainland China

Our operations in Hong Kong and Mainland China remained the largest contributor to the Group's overall business, accounting for 48.0% of total turnover. The acquisition of Jardine Logistics helped increase our turnover substantially in Hong Kong, but its overall weighting has decreased this year due to a more balanced business geographically, notably the increased weighting from Europe and South East Asia as a result of the acquisition.

The Hong Kong and Mainland China freight forwarding business suffered a decline in profitability due mainly to the adverse impact of the outbreak of SARS, which resulted in a significant reduction in flight frequencies and air cargo capacity. For a short period during the outbreak, we suffered a decline in volume. However, the situation has improved steadily since SARS came under control.

Third-party logistics is another key strength of Jardine Logistics in Hong Kong and Mainland China. Through a comprehensive service encompassing air and sea freight forwarding and logistics services, the Group has further strengthened its presence in the region's logistics market.

The exhibition forwarding business, in spite of SARS, achieved a significant growth of approximately 52.8% and approximately 115.1% in turnover and profit respectively, due to cyclical reasons. Our household removal business in Hong Kong remained stable.

We are confident that the Mainland China market will continue to boom on the back of strong economic growth, providing tremendous opportunities for growth. Continued expansion of our network through strategic acquisitions enables us to offer clients comprehensive coverage of the coastal regions of Mainland China.

The recently signed Closer Economic Partnership Arrangement ("CEPA") also provides the Group with an opportunity to tap into this market. The acquisition of a significant interest in a freight forwarder in Xiamen with branches in Fuzhou and Putian in Fujian province is yet to be completed and we are also in the process of finalising an acquisition of a freight forwarder based in Qingdao. Our plan is to merge the Qingdao forwarder with the aforementioned Xiamen company in order to extend our network of offices to cover major cities along the entire coastline of Mainland China. We will continue to identify and capture acquisition opportunities as part of our business expansion strategy.

Southeast Asia

The Taiwan operation of Jardine Logistics is very well-established and is an invaluable addition to our network in Asia. Following the completion of the acquisition in January 2003, the combined business in Taiwan continued to record stable performance.

During the year, the Group's business in Singapore, Malaysia, Thailand and Indonesia together recorded a loss. This was largely due to the adverse impact of SARS, the write-off of goodwill for several small acquisitions and continuing losses from Jardine Logistics' operations in the region.

The Group's operations in Sri Lanka has started to report contributions for the year, though the amount of profit is still insignificant when compared to other countries.

Turnover increased by approximately 142.3% to HK\$399.62 million. Leveraging the integrated logistics capabilities regionally and globally, we expect to see continued growth in these markets in the years ahead.

North America

The merger of BALtrans and Jardine Logistics has brought about synergies that are favourable to the North American market. Both import and export businesses in the U.S. and Canada achieved growth during the year. Notwithstanding a turnover increase of approximately 86.6% to HK\$612.44 million, the North American business incurred substantial losses due to continuing losses from Jardine Logistics. The U.S. operations of Jardine Logistics incurred the biggest losses among the different regions due to the legacy of inadequate internal controls and inefficient accounting systems. The Group has taken over the management and accounting functions since the acquisition and has since implemented prudent and cautious measures to improve turnover and profit margin. We expect to see more long-term benefits arising from the integration and rationalisation of the U.S. operations.

Europe

The broad geographical base of Jardine Logistics, especially in the U.K., complemented the Group's traditional strongholds in other major markets. The U.K. revenue contribution from the six months post-acquisition is close to 10% of Group revenue and the weighting will increase further with a full year contribution starting from 2004.

With enhanced strengths in the U.K. market as well as better access to new customers and resources, we benefited from Jardine Logistics' strong freight forwarding business through increased sourcing and import volume from Asia to the U.K. While we registered a loss in the year, we believe that we have a strong platform to achieve potential synergies and economies of scale which in turn will improve turnover and profit margin in the future.

SERVICES

Airfreight

Airfreight remained the Group's major revenue contributor, accounting for approximately 57.6% of the Group's total turnover for the year compared to 74.9% for the previous year. Turnover registered an increase of 39.3%, but profit margin decreased due to the outbreak of SARS resulting in fewer flights and rise in airfreight cost which we were unable to fully pass on to our customers, as well as continuing losses from the airfreight business of Jardine Logistics.

Seafreight

The seafreight business accounted for approximately 36.2% of turnover. For the year under review, seafreight business increased significantly by 286.7% after including the turnover contributed by Jardine Logistics. However, we incurred losses during the year due to the continuing losses from Jardine Logistics.

Nevertheless, we believe the strong seafreight capabilities of Jardine Logistics will have a positive impact on our future performance due to strengthened bargaining power, economies of scale, and more comprehensive network coverage and service offerings.

Third-party Logistics

Contributions from our third-party logistics business remained small as compared to the overall results. However, given the low penetration rate for third-party logistics in the region, we see vast potential for growth especially in Mainland China. With the addition of Jardine Logistics' third party logistics management platform, third-party logistics will be a key growth driver for the Group in the future. This also has a synergistic effect on our freight forwarding business.

The turnover of the third-party logistics business was approximately 115.4% higher when compared to last year.

Exhibition Forwarding and Household Removal

Turnover of the exhibition forwarding business registered a strong growth of 52.8% due to cyclical reasons while that of the household removal business decreased moderately by 6.3%. The two businesses together accounted for approximately 3.4% of the Group's turnover.

The operating profit increased substantially during the year as a result of strong revenue growth.

OUTLOOK

Looking ahead, we envisage an optimistic future for Hong Kong and the Group. Our business will be boosted by the close economic ties between Hong Kong and Mainland China as a direct result of CEPA where our local operations together accounted for approximately 48.0% of total turnover.

Although the outbreak of SARS and the acquisition of Jardine Logistics had a substantial negative impact on the financial results of the Group, we believe that we are taking the necessary steps to refocus Jardine Logistics on gross margin instead of sales revenue. We will continue to identify duplication and inefficiencies in organisation and cost structure in order to realise further synergies through reduction in overheads as well as sharing of resources within the Group.

We expect our business to improve as the cost of our restructuring was largely taken during the year. We expect to continue to turn around the profitability of Jardine Logistics. The outbreak of SARS and property revaluation losses are essentially non-recurring events which should have little or no impact on our future results as the economy improves.

From the strategic perspective, we believe that the acquisition of Jardine Logistics is a key milestone in the Group's commitment to growth through acquisitions. Jardine Logistics' core competence in seafreight business is highly complementary to the Group's strong airfreight capabilities. This combined global freight forwarding and logistics platform creates substantial synergies through combined cost savings, economies of scale as well as a more comprehensive global network to serve our customers better around the world.

Liquidity, Financial Resources and Funding

As at 31st July 2003, the Group possessed cash and cash equivalents of HK\$110.39 million (2002: HK\$110.37 million).

For the year ended 31st July 2003, total spending on fixed assets was lower than the same period last year. HK\$6.67 million (2002: HK\$52.47 million) was paid for the purchase of fixed assets. HK\$2.01 million (2002: HK\$1.19 million) was received for the disposal of fixed assets.

During the period under review, HK\$1.01 million (2002: HK\$22.52 million) was invested in subsidiaries while HK\$0.43 million (2002: HK\$2.88 million) was invested in joint ventures/associated companies.

The Group's funding requirements have been financed mainly by internal resources with some overdraft facilities granted by banks.

The Group's borrowings were mainly in HKD, USD and TWD. Overdraft facilities were granted to the Group at normal market interest rates.

As a matter of principle, the Group allows adequate working capital in overseas subsidiaries and transfers excess funds back to the head office. Some of our overseas subsidiaries may use overdraft facilities in foreign currencies. No hedging arrangement is considered necessary since we receive and pay mainly in local currency.

It should be noted that during the period under review there was no significant deviation from the policies above.

The majority of the Group's cash is in either HKD or USD, therefore, exposure to exchange rate fluctuations is minimal. The gearing ratio (total borrowings/total shareholders' funds) for the year was 17.3% (2002: 12.1%).

Charges on Group Assets

The whole first floor of Sunshine Kowloon Bay Cargo Centre and the whole 8th floor of New Mandarin Plaza, Tower A are charged to a bank in exchange for general banking facilities for the Group. The Group has placed fixed deposits totaling HK\$2.45 million (2002: HK\$ 2.27 million) as securities for banking facilities extended to the Group.

Core Investments and Acquisitions

The BALtrans Logistics agency network, Fondair agency network, Supreme agency network and Jardine Logistics network constituted the core investments of the Group during the year.

On 24th December 2002, the Group entered into a Sale & Purchase Agreement with Jardine Pacific Holdings Ltd. and Jardine Asian Holdings Inc. to acquire 100% of Jardine Logistics at a consideration of 60,300,100 shares of our company. The vendors warranted that the Net Asset Value of Jardine Logistics would not be less than HK\$90.00 million in which there should be a net cash balance of HK\$12.00 million. The transaction was completed on 30th January 2003 following approval at the Special General Meeting held on 28th January 2003. One-off expenses of about HK\$22.55 million have been incurred on the restructuring of Jardine Logistics.

On 10th January 2003, the Group increased its interests in Supreme Airfreight Co. Ltd. from 74% to 86.5% by acquiring 12.5% from a minority shareholder. Consideration paid amounted to HK\$8.23 million which is subject to adjustments in accordance with the earnings of the next three years.

On 24th January 2003, the Group entered into a Sale & Purchase Agreement with Wilson Denmark Holdings A/S to dispose of the Group's interests in Wilson Freight (Far East) Ltd. and Wilson (FE) Ltd., in which the Group held 49.5% each, at considerations of HK\$60.00 million and HK\$3.00 million respectively. During the same period, the Group disposed of investments in Vectra Group resulting in a loss. These disposals altogether resulted in a net gain of HK\$21.49 million. These operations were considered to be distinct and separate entities over which the Group exercised little management control and from which little strategic benefits or synergies could be derived. As a result, the Group had decided to dispose of these associated companies at what we considered to be a reasonable price.

The Group is now free to enter the Scandinavian market from which it was excluded because of the agreement with Wilson Group.

Contingent Liabilities

Details of the contingent liabilities of the Group are set out in note 27 to the accounts.

Staff and Employment

As at 31st July 2003, the Group employed a workforce of 1,330 (2002: 572) of which 602 are from the existing BALtrans operations and 728 are from Jardine Logistics. Total staff remuneration for the year ended 31st July 2003 was HK\$192.36 million including pension expenses of HK\$7.97 million (2002: HK\$109.95 million including pension expenses of HK\$5.27 million). No share options were granted to staff during the period.

The Group's remuneration policies, including both salaries and bonuses, are in line with the local practices where the Group and its subsidiaries operate.

The Group follows a policy of encouraging its subsidiaries to send their staff to attend training classes or seminars that are related directly or indirectly to the Group's businesses.