

Financial Review

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the financial information of the Group contained in the financial statements (together with the notes thereto) reproduced in this annual report. The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The selected historical results as discussed herein do not represent a prediction of the future business operations of the Group.

OVERVIEW

In the year ended December 31, 2003 ("Year 2003"), profit before taxation of the Group was approximately RMB272.3 million, representing a decrease of 40.8 per cent. over that in the year ended December 31, 2002 ("Year 2002"). EBITDA reached approximately RMB386.9 million, representing a decrease of 30.2 per cent. over that in Year 2002. Net profit was approximately RMB242.5 million, representing a decrease of 46.5 per cent. over that in the previous year. The decrease in profitability of the Group was mainly due to the fall in revenues from the Group's ETD and APP businesses and the fact that the Company had to start paying corporate income tax from the year 2003.

Basic and diluted earnings per share of the Company in Year 2003 were RMB0.27.

TOTAL REVENUES

The total revenues of the Group for Year 2003 amounted to RMB893.6 million, representing a decrease of approximately RMB83.8 million, or 8.6 per cent., from RMB977.4 million in Year 2002. The decrease resulted principally from a fall in average unit price of the Company's ETD and APP businesses following the strategic restructure of China's air travel industry. The decrease in total revenues reflected the following:

- ETD revenues represented 48.3 per cent. of the total revenues of the Group in Year 2003 as compared to 53.7 per cent. in Year 2002. ETD revenues decreased by 17.7 per cent. to RMB431.8 million in Year 2003 from RMB524.9 million in Year 2002. The decrease in revenues resulted primarily from the fall in average unit price of ETD business.
- APP revenues represented 26.0 per cent. of the Group's total revenues in Year 2003 as compared to 24.8 per cent. in Year 2002. APP revenues decreased by 4.3 per cent. to RMB232.1 million in Year 2003 from RMB242.6 million in Year 2002. The decrease resulted primarily from the fall in average unit price of APP business following increased usage of APP system service and a further integration of the domestic commercial airlines.
- Data Network revenues represented 17.8 per cent. of the Group's total revenues in Year 2003 as compared to 16.8 per cent. in Year 2002. Data network revenues decreased by 2.1 per cent. to RMB158.7 million in Year 2003 from RMB162.1 million in Year 2002. The decrease in data network revenues resulted from the suspension in use of the Company's data network by certain customers during a period following the outbreak of SARS in 2003.
- other revenues increased by 48.1 per cent. to RMB71.0 million in Year 2003 from RMB47.9 million in Year 2002. The increase was principally caused by a growth in revenues from new businesses including sales of electronic distribution system for air travel personal injury insurance and E-term.

NET REVENUES

Net revenues decreased by 8.8 per cent. to RMB861.6 million in Year 2003 from RMB944.8 million in Year 2002.

OPERATING EXPENSES

Total operating expenses for Year 2003 amounted to RMB637.3 million, representing an increase of RMB98.4 million, or 18.3 per cent., from RMB538.9 million in Year 2002. The increase is attributable to the continuous improvement in the Company's research and marketing strategies which thereby expanded its efforts in the research and development of new products and new technology, and partly because of the Group's continuous efforts in expanding its market as well as in strengthening its support for localisation of customers. The increase in operating expenses was also caused by the following:

- depreciation and amortization charge increased by 8.6 per cent., mainly due to an acquisition of a new large mainframe computer during the year;
- labour cost increased by 48.4 per cent., primarily due to a significant increase in the number of employees to support the development of business;
- operating rental expenses increased by 15.5 per cent., mainly due to additional offices rented by the Company for its significant increase in the number of employees; and
- though there were increases in revenue, other operating costs of the Group increased by 27.3 per cent., mainly attributable to the increase in related costs arising from continuous efforts of the Group's local distribution centres ("LDCs") in expanding its market as well as in strengthening support for localisation of customers in Year 2003.

As a result of the above changes in net revenues and operating expenses, the operating profit of the Group decreased by RMB181.6 million, or 44.7 per cent., to RMB224.3 million in Year 2003 from RMB406.0 million in Year 2002.

SHARE OF RESULTS FROM ASSOCIATED COMPANIES

Share of results from associated companies was RMB14.3 million in Year 2002, whereas share of results from associated companies amounted to RMB11.5 million, representing a decrease of RMB2.8 million in Year 2003. The main reason for such a decrease was due to a decrease in the profits of the associated companies.

MINORITY INTEREST

Minority interest increased by 92.7 per cent. to RMB6.7 million in Year 2003 from RMB 3.5 million in Year 2002. The reasons for such an increase were attributable to the improved profitability in Year 2003 of subsidiary companies newly established in 2002.

NET PROFIT

As a result of the above factors, the Group's net profit decreased by RMB210.7 million or 46.5 per cent. to RMB242.5 million in Year 2003 from RMB453.2 million in Year 2002.

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RESERVES AVAILABLE FOR DISTRIBUTION

After the appropriation of the statutory surplus reserve fund, the statutory public welfare fund and the discretionary surplus reserve fund from the net profit as reflected in the Company's statutory financial statements prepared under PRC GAAP, the reserves available for distribution as at December 31, 2003, as stated in note 27 to the financial statements, amounted to RMB292.7 million, which is the lesser of the amounts as determined according to PRC GAAP and IFRS.

DISTRIBUTION OF DIVIDEND

The Board of Directors (the "Board") recommends the payment of a final dividend of RMB0.102 per share for Year 2003, totalling RMB90.6 million. After the appropriation of the dividend, the reserves available for distribution as at December 31, 2003 became RMB202.1 million.

NET CASH FLOWS AND LIQUIDITY

The following table summarises the cash flows of the Group for the years presented:

| | Year ended December 31 | |
|--|------------------------|------------------|
| | 2003 | 2002 |
| | (RMB in million) | (RMB in million) |
| Net cash inflows from operating activities | 551.5 | 622.5 |
| Net cash used in investing activities | (272.4) | (94.7) |
| Net cash provided by financing activities | (137.6) | (27.2) |
| Net increase in cash and cash equivalents | 141.5 | 256.6 |

The Group's working capital for Year 2003 mainly came from operating activities. Net cash inflow for operating activities amounted to RMB551.5 million.

In Year 2003, the Group had no short-term or long-term bank loans, and the Group also did not use any financial instruments for hedging purposes.

As at December 31, 2003, cash and cash equivalents of the Group amounted to RMB2,035.0 million, of which 76.5 per cent., 21.0 per cent. and 2.4 per cent. were denominated in Renminbi, US dollars and Hong Kong dollars, respectively.

LONG-TERM INVESTMENT

As at 31 December, 2003, the Group held RMB100 million treasury bonds with an interest rate of 3% per annum. The maturity date of the treasury bonds is in December 2008.

CHARGE ON ASSETS

As at 31 December 2003, the Group had no charges on its assets.

CAPITAL EXPENDITURE

The total capital expenditure of the Group was RMB410.9 million in Year 2003, representing an increase of RMB340.0 million from RMB70.9 million in Year 2002.

The capital expenditure of the Group in Year 2003 consisted principally of purchases of hardware, software and software for equipment in accordance with the Group's ETD and APP business strategies.

The Board estimates that the Group's planned capital expenditure for year 2004 will amount to approximately RMB322.0 million, which is mainly for the development and gradual implementation of the new-generation ETD, APP systems and other new businesses.

The sources of funding for the capital expenditure commitments will include net proceeds from the initial public offering of the Group and internal cash flow generated from operations.

The Board estimates that the sources of funding of the Group in year 2004 will be sufficient for its capital expenditure commitments, daily operations and other purposes.

The Board estimates that completion of the development of the new-generation ETD system will require total capital expenditure of approximately RMB1.0 billion.

EXCHANGE RISKS

The Group is exposed to foreign exchange risks related to its capital expenditure since a substantial portion of its capital expenditure involves payments for the purchase of imported equipment which are denominated in U.S. dollars. Under the current foreign exchange system in the PRC, the Group is not able to hedge effectively against currency risks, except for the cash and cash equivalents that are denominated in foreign currency.

GEARING RATIO

As at December 31, 2003, the gearing ratio of the Group was 14.8 per cent. (2002: 9.1 per cent.), which was computed by dividing the total amount of liabilities and minority interests, by the total assets of the Group as at December 31, 2003.

CONTINGENT LIABILITIES

As at December 31, 2003, the Group had no material contingent liabilities.

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EMPLOYEES

As at December 31, 2003, the total number of employees of the Group was 1,416. Personnel expenses amounted to RMB147.8 million for the year ended December 31, 2003, representing 23.2 per cent. of the total operating expenses of the Group for Year 2003.

The remuneration of the employees of the Group includes salaries, bonuses and other fringe benefits. The Group has different rates of remuneration for different employees to be determined based on their performance, experience, position and other factors in compliance with the relevant PRC laws and regulations.

In Year 2003, the Group continued to provide its employees with opportunities to acquire skills in relation to the air travel industry, computer technologies and business administration and provide training on the latest development in areas such as computer technologies, personal development, laws, regulations and economics.

BASIC MEDICAL INSURANCE REGULATION

On 20 February 2001, the People's Government of the Municipality of Beijing in the PRC promulgated the "Basic Medical Insurance Regulation for the Municipality of Beijing" (the "Regulation"). Given the fact that relevant regulations concerning employees' medical insurance must be applied according to the policies applicable to the place in which a company is located, the head office of the Company in Beijing implemented the Regulation from September 1, 2002 onwards. For Year 2003, the Company incurred a total amount of RMB1,177,300 (a total amount of RMB311,900 was incurred in 2002) pursuant to the Regulation for employees' medical insurance. The Board believes that by implementing the Regulation, the financial position of the Company has not been materially affected.