Management discussion & analysis

Financial management

Issuance of 10-year notes

The global low interest rates environment in 2003 prompted bond investors to fright for premium quality investments in view of surplus funds available in the international bond market. Capitalising on such opportunity, the Company appointed three investment banks, ABN AMRO Bank N.V., Citigroup Global Markets Limited and Goldman Sachs (Asia) L.L.C., as joint bookrunners in arranging the issuance of 10-year fixed rate notes of US$300,000,000 in September 2003. No credit ratings have been sought for in respect of the notes. The notes were offered and sold outside the United States in accordance with Regulation S under the United States Securities Act of 1933. Responses from investors in Europe, Hong Kong, China mainland, Singapore and other Asian countries were overwhelming with total subscriptions in excess of US$1,620,000,000, or 5.4 times of the issued amount.

At an issue price of 99.367% and a coupon rate of 5.875%, the notes carried an interest yield of 5.96% (i.e. an equivalent of 10-year US Treasury Bill yield plus 185 basis points). The issue was well sought for by international investors with interest spreads narrowed in the secondary market, demonstrating investors' confidence in the creditworthiness of the Company.

Net proceeds of the notes, after deducting issuance expenses, were primarily deployed as investments in new terminal projects and for refinancing. Such fund raising exercise hallmarked the Company's success in exploring the international bond market as financing channels, diversifying its sources of funds and enhancing its debt structure by extending the average maturity period from less than 3 years to 7.4 years. This has laid solid foundation for the Company's sustainable development and will help the Group in obtaining more favourable terms in future from the capital market.

Other financing

During the year, the Group secured a total of US$245,000,000 of committed bank loan facilities. A subsidiary of the Group entered into an agreement with a banking syndicate on 17th February 2003 for a 5-year term loan facility of US$175,000,000 that was designated for working capital and refinancing. Apart from being oversubscribed with very favourable terms at finance costs of London Interbank Offered Rate ("LIBOR") plus 65 basis points, this fund raising exercise further reflected the Group's sound creditstanding and its supports from the banking community.

Treasury policy

The Group monitors its exchange rate risks by raising funds in the denominations of its principal operating assets or cash revenue.

Most of the Group's borrowings were denominated in US dollars, a majority of which was primarily used for container leasing operation that had its revenues and expenses mainly in US dollars. Hence, exposure to exchange rate risk is minimal.

In respect of associated companies and jointly controlled entities, such as COSCO-HIT and COSCO-PSA Terminal, all material borrowings were denominated in Hong Kong and Singapore dollars respectively, with corresponding hedging being effected.

The Group exercises stringent control over the use of derivatives for hedging against its interest rate risks and monitors its debt portfolio of fixed and floating interests regularly to reflect market trends. During the year, the Group entered into interest rate swap contracts to swap US$200,000,000 of its 10-year notes into floating rates at average rates of 6-month LIBOR plus 112.5 basis points for 10 years.

In addition, as at 31st December 2003, notional principals of outstanding interest rate swap contracts amounted to US$100,000,000 (2002: US$100,000,000), at fixed interest rates ranging from 3.88% to 4.90% per annum (2002: 3.88% to 4.90% per annum). Through aforesaid interest rate swap contracts and fixed rate borrowing arrangements, the ratio of fixed- to floating-rate borrowings stood at 42.0%: 58.0% as at 31st December 2003 (31st December 2002: 24.7%: 75.3%) of the Group's debt portfolio.

Financial analysis

Overall results

Turnover of the Group for 2003 rose by 6.6% over last year to US$257,495,000 (2002: US$241,644,000). Profit attributable to shareholders was US$154,331,000, up 8.5% over US$142,189,000 (as restated) for 2002. Earnings per share were US7.1871 cents (2002: US6.6253 cents, as restated). Excluding major non-recurring items (2003: loss of US$2,192,000 on disposal of its 10% interest in River Trade Terminal; 2002: profit of US$7,474,000 arising from disposal of the Shanghai Yixian Road Project), profit attributable to shareholders in 2003 saw a year-on-year increase of 16.2%.

Financial review

Turnover

Turnover of container leasing and related business for 2003 rose by 6.5% to US$239,689,000 (2002: US$225,004,000). Rental income from COSCON was US$130,567,000 (2002: US$136,110,000). During the year, the number of containers leased by COSCON was 310,444 TEUs (2002: 329,028 TEUs) as the number of Returned Containers exceeded the number of containers under new leases. Rental income from International Customers was US$108,479,000 (2002: US$88,330,000). The Group further developed its market and actively expanded the size of its container fleet for International Customers to 498,381 TEUs (2002: 378,862 TEUs). Despite declines in average achieved rental income per TEU, rental income from International Customers has surged significantly by 22.8% with growth in the utilisation rate. Interest income from finance leases was US$484,000 (2002: US$545,000), and income from container management, a new activity since 2002, was US$99,000 (2002: US$19,000). Income from the leasing of generator sets, a new activity in 2003 in response to market demands, was US$60,000 (2002: nil).

Annual throughput at Zhangjiagang Win Hanverky Terminal grew by 22.2% to 247,306 TEUs (2002: 202,348 TEUs), whereas its turnover rose to US$9,045,000 (2002: US$7,850,000).

Plangreat Limited together with its subsidiaries generated a turnover of US$8,761,000 (2002: US$8,790,000), a slight drop from last year, with an increase in container storage at its depots and the drayage but the operation at the terminal declined.

Cost of sales and gross profit

Cost of sales amounted to US$112,417,000 in 2003 (2002: US$102,520,000), mainly comprised depreciation, depot rental, maintenance and operating expenses. During the year, as a result of the expansion of container fleet, depreciation rose by US$7,657,000 to US$93,050,000 (2002: US$85,393,000). Depreciation accounted for 82.8% (2002: 83.3%) of cost of sales. Other cost of sales rose by US$2,240,000 to US$19,367,000 (2002: US$17,127,000), primarily because of the Group's strategy in repositioning 20,669 TEUs (2002: 14,819 TEUs) containers from Europe and the Americas to satisfy demands from the Asian market. Accordingly, repositioning expenses increased to US$4,932,000 (2002: US$3,500,000). Gross profit margin was 56.3% (2002: 57.6%).

Other revenues

Other revenues mainly included US$20,421,000 (2002: US$5,003,000) of dividend income, US$10,762,000 (2002: US$7,048,000) of sales revenue of the Returned Containers and US$2,343,000 (2002: US$3,794,000) of interest income.

Performance of Yantian International Terminals, Shekou Terminals and Dalian Port Container Co., Ltd., in which the Group held beneficial interests, were satisfactory. Dividends were declared by these investee companies during the year and the Group's share of these dividends declared amounted to US$20,421,000 (2002: US$5,003,000 of share of dividend declared by Yantian International Terminals), a three-fold increase. During the year, sales revenue of the Returned Containers increased as the disposal of Returned Containers increased to 23,619 TEUs (2002: 15,710 TEUs). Reduction in interest income was the result of deposit interest rate being lower than that of 2002 and the reduction in the Group's cash balances due to early repayments of some of its bank loans during the year.

Administrative expenses

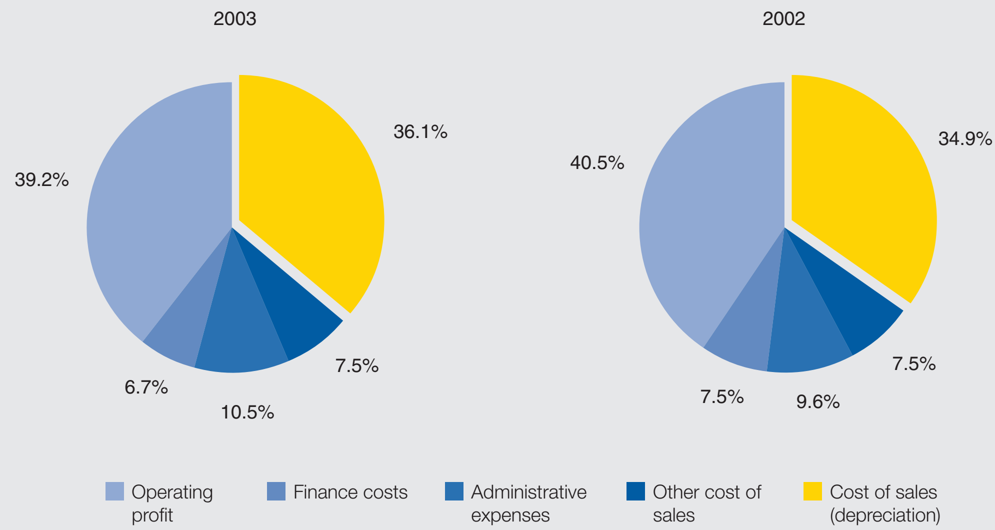
Administrative expenses increased by 16.3% over 2002. During the year, human resources, marketing, office, professional consultation, entertainment and travelling expenses rose as the Group continued to strengthen its marketing and new project development.

Other operating expenses (net)

Other net operating expenses amounted to US$25,511,000 (2002 : US$22,223,000) and included the following:

- Impairment losses of certain containers and corporate properties charged to the profit and loss account amounted to US$9,865,000 (2002: US$15,997,000).
- During the year, net book value of the Returned Containers disposed of increased by US$4,393,000 to US$13,322,000 (2002: US$8,929,000).
- During the year, bad debt recovered amounted to US$1,047,000 (2002: US$2,999,000), while net provision for bad and doubtful debts made in 2003 was US$1,370,000 (2002: US$1,142,000).
- In June 2003, the Company recognised a loss of US$2,192,000 from the disposal of its 10% interest in River Trade Terminal whereas a provision of US$3,296,000 was made against shareholders' loan advanced to the said project in 2002.

Cost analysis (percentage of turnover)



Finance costs

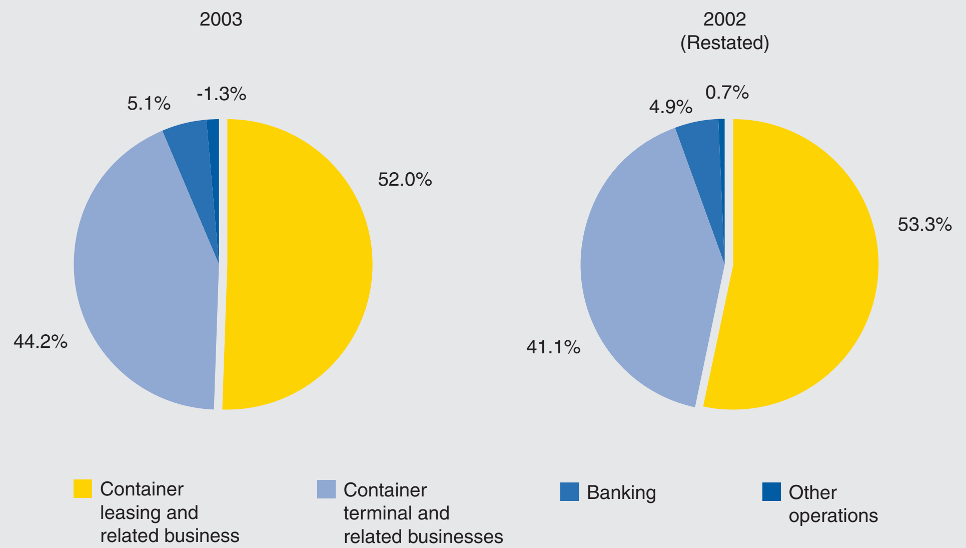
Finance costs improved by US$870,000, of which interest expenses reduced by US$3,541,000 and incidental borrowing costs rose by US$2,671,000. Interest rate remained at low levels in 2003 with a further cut of 0.25% by the U.S. Federal Reserve in June 2003. The Group's average borrowing costs (including net loss of US$1,193,000 (2002: US$1,454,000) arising from interest rate swap contracts) were 3.22% (2002: 3.40%).

Incidental borrowing costs rose primarily as a result of larger financing facilities being arranged in 2003 (including the issue of US$300,000,000 notes). In accordance with the Group's accounting policy, incidental borrowing costs were charged against the profit and loss account in the year when incurred.

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

Profit contributions from jointly controlled entities were US$6,711,000 (2002: US$8,751,000). The decline was primarily due to the shift in handling Qingdao Port's trade cargo from exports to domestic since 2003 by Qingdao Cosport Terminals. As a result, throughput reduced to 244,159 TEUs (2002: 454,528 TEUs). Production volume of Shanghai CIMC Reefer Containers Co., Ltd. went up by 5.4% in 2003 whereas profit contribution declined when compared to last year due to increases in raw material prices and intense market competition. Profit contributions from Shanghai CIMC Far East Container Co., Ltd. and Tianjin CIMC North Ocean Container Co., Ltd., which were accounted for according to the sub-contracting agreements signed in 2000 and 2001, are both increased over 2002. Throughput and performance of the newly established COSCO-PSA Terminal, which became operational since November 2003, were better than expected with contribution in profit. There was no profit contribution from Qingdao Qianwan Terminal in 2003 as the Group's investment was not in place until late December 2003.

Breakdown of profit attributable to shareholders (percentage)



In respect of the associated companies, profit contributions in 2003 declined by 3.8% to US$64,915,000 (2002: US$67,461,000). As Twinbridge Development Corp. had disposed of its interests in the shareholding company of the Shanghai Yixian Road Project in 2002, there was no profit contribution for 2003 (2002: share of operating profit and gain on disposal of interest totalled US$9,095,000). Throughput of COSCO-HIT fell by 0.8% over 2002, its profit contribution declined by 5.6% due to changes in cargo mix. Throughput and performance of the Group's 20% equity interest, Shanghai Pudong International Terminals which has commenced operation since March 2003, were satisfactory. Profit contribution from Shanghai Terminals rose as a result of an 11.5% increase in throughput. Liu Chong Hing Bank contributed a profit of US$9,762,000 in 2003 (2002: US$8,456,000).

Taxation

Taxation aggregated US$24,424,000 for 2003 (2002: US$23,886,000, as restated). In accordance with the requirements of the new SSAP 12, provisions in respect of deferred tax liabilities and assets were made by the Group. Net deferred tax provision was US$12,488,000 for 2003 (2002: US$12,371,000).

Profit attributable to shareholders

Profit attributable to shareholders for the year amounted to US$154,331,000 (2002: US$142,189,000, as restated). Basic earnings per share was US7.1871 cents (2002: US6.6253 cents, as restated).

Financial position

Cash flow and available facility

Cash inflows of the Group remained steady. During the year, net cash inflow from operating activities amounted to US$217,757,000 (2002: US$220,540,000), coupled with net proceeds of US$298,101,000 (2002: nil) from the issuance of the US$300,000,000 10-year notes. The Group accelerated its efforts in investments in 2003. On the terminal side, investments included a 20% interest in Shanghai Pudong International Terminals, a 20% interest in Qingdao Qianwan Terminal, a 49% interest in COSCO-PSA Terminal and a beneficial interest of 4.45% in Yantian International Terminals Phase III, involving cash injections of US$45,770,000, US$14,800,000, US$23,062,000 and US$16,723,000 respectively in 2003 (2002: US$4,519,000 for subscribing a 8% interest in Dalian Port Container Co. and US$19,941,000 for acquiring a 17.5% interest of Shekou Terminals). The acquisition of Shanghai Pudong International Terminals was partly funded by US$30,000,000 derived from proceeds from issuance of new shares in May 1999. During the year, cash payments of fixed assets amounted to US$198,410,000 (2002: US$137,998,000), of which US$193,661,000 (2002: US$135,022,000) were for new containers. The Group drew US$89,620,000 (2002: US$95,604,000) bank loans and repaid US$330,097,000 (2002: US$184,468,000) of bank loans during the year. As at 31st December 2003, the Group held cash balances of US$283,835,000 (2002: US$236,121,000).

As at 31st December 2003, the Group had committed but unutilised bank loan facilities of US$297,908,000 (2002: US$96,329,000). Cash balances and banking facilities held by the Group as at the end of 2003 amounted to US$581,743,000 (2002: US$332,450,000). These were adequate to meet all of the debts due in 2004 and capital commitments contracted for prior to 31st December 2003. In January 2004, the Group further injected US$61,131,000 into Qingdao Qianwan Terminal, with balances of the investment amount payable in the next few years in accordance with the construction schedule of the terminal. Formalities and procedures in respect of the acquisition of the Group's 49% equity investment in COSCO LOGISTICS were also completed in January 2004, and the Group injected RMB1,180,410,000 in equivalent US dollars as agreed.

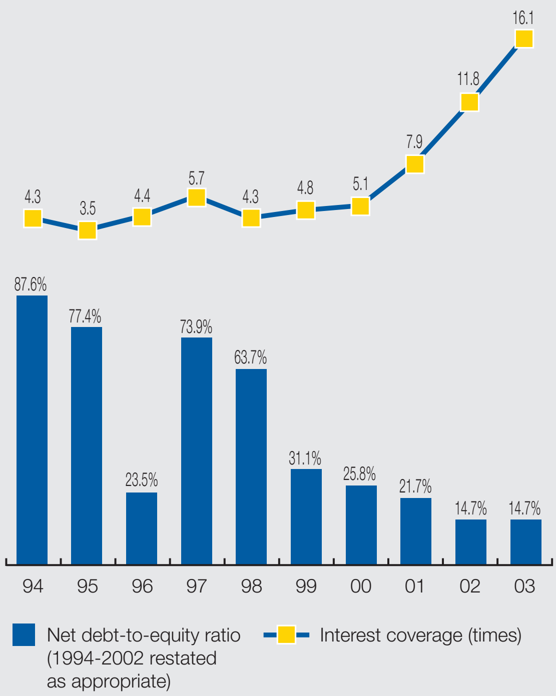
Assets and liabilities

The Group continued to implement a healthy policy in financial management. As at 31st December 2003, total assets amounted to US$1,900,266,000 (2002: US$1,743,797,000, as restated), whereas total liabilities and minority interests amounted to US$579,102,000 (2002: US$490,749,000, as restated). Net assets amounted to US$1,321,164,000 (2002: US$1,253,048,000, as restated), representing an increase of 5.4% which was primarily attributable to retained profit for the year.

Cash balances as at 31st December 2003 amounted to US$283,835,000 (2002: US$236,121,000). Total indebtedness amounted to US$478,360,000 (2002: US$420,674,000), with a net gearing ratio of 14.7% (2002: 14.7%, as restated). As interest rates continued to stay at low levels with average borrowings being reduced, interest coverage further expanded to 16.1 times (2002: 11.8 times). Our debt maturity profile was significantly improved through the issuance of the 10-year notes. Total debts due in 2004 will amount to US$32,848,000 only.

In view of the fact that the Group's indebtedness stood at a relatively low level with strong repayment capability, the Group will continue to resort to increasing its indebtedness principally for financing capital expenditure in 2004. It is expected that the increase in the Group's net gearing ratio should enhance return on shareholders' equity.

Low net debt-to-equity ratio & strong interest coverage



Debt analysis as at 31st December 2003

	As at 31st December 2003 US$	(%)	As at 31st December 2002 US$	(%)
By repayment term				
Within the first year	32,848,000	6.9	210,189,000	50.0
Within the second year	32,608,000	6.8	67,410,000	16.0
Within the third year	41,046,000	8.6	67,839,000	16.1
Within the fourth year	54,108,000	11.3	31,314,000	7.5
Within the fifth year and after	317,750,000*	66.4	43,922,000	10.4
	478,360,000	100.0	420,674,000	100.0
By type of borrowings				
Secured borrowings	177,523,000	37.1	156,578,000	37.2
Unsecured borrowings	300,837,000	62.9	264,096,000	62.8
	478,360,000	100.0	420,674,000	100.0
By denomination of borrowings				
US Dollar	475,686,000	99.4	416,579,000	99.0
RMB	2,674,000	0.6	4,095,000	1.0
	478,360,000	100.0	420,674,000	100.0

* Including the US$300,000,000 notes less discount which will mature on 3rd October 2013.

As at 31st December 2003, certain of the Group's containers with an aggregate net book value of US$318,976,000 (2002: US$278,378,000) and bank deposits of US$12,056,000 (2002: US$7,817,000) were pledged to various banks and financial institutions as security against borrowings totalling US$177,523,000 (2002: US$156,578,000).

Contingent liabilities

As at 31st December 2003 and 2002, the Group had no significant contingent liabilities.