# Management Discussion and Analysis

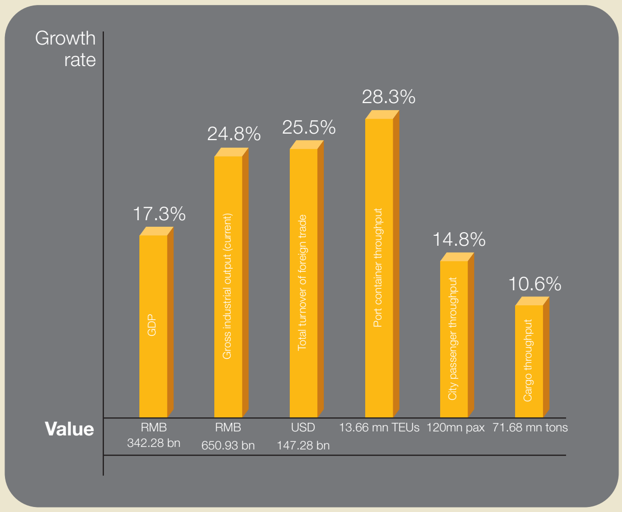
## Business Review

Benefiting from China's sound economic growth and reform policies coupled with geographic proximity to Hong Kong, the Pearl River Delta region has been standing out as one of the most rapidly-growing regions in terms of economic growth and foreign trade cooperation against the backdrop of the rapid, consistent and healthy development of the Chinese economy in recent years. While providing home bases to various manufacturing industries and serving as an important passage for passenger and cargo flow, the Pearl River Delta region now assumes an important position in the global economy.

The gradual implementation of CEPA coupled with the formation of the "9+2" Pan Pearl River Delta Economic Zone is set to provide further drive to the Pearl River Delta economy, resulting in a direct boost of traffic flow on toll roads. Shenzhen's characteristics as an externally driven economy are underscored by its unique geographic position at the gateway of the Pearl River Delta region supported by a sound investment environment and favourable policies. Shenzhen's average GDP growth rate for the past five years was 15.4% per annum, while in 2004 it was 17.3%. In 2004, Shenzhen registered trade turnover of US$147.3 billion, ranking first among large and medium-scale cities in China for 12 consecutive years. Port container throughputs reached 13.66 million TEUs, firmly establishing the city among the four largest container transportation hubs in the world.

Economic growth in the Pearl River Delta region has resulted in increased personal income for local residents and a faster pace of urbanisation, as the region leads the nation in terms of the number of established counties and towns, population density, personal income level and vehicle ownership rate. In 2004, Shenzhen had a population of over 11 million and topped the nation with an average annual income per capita close to RMB60,000. Shenzhen is also one of China's cities with the highest density of private vehicles, accommodating close to 700,000 motor cars at present, including around 120,000 new cars registered in 2004. All these factors point to faster development of the local highway industry to cope with rising travelling needs and the demand for road passage with higher quality.

**Major Economic Indicators of Shenzhen 2004**




## Operating Results

In 2004, the Group achieved a turnover of RMB 482,540,000 and profit attributable to shareholders of RMB418,870,000, whilst earnings per share amounted to RMB0.192. A detailed financial analysis is set out on pages 39 to 46 of this annual report.

## Toll Road Business

***Traffic volume and toll revenue***

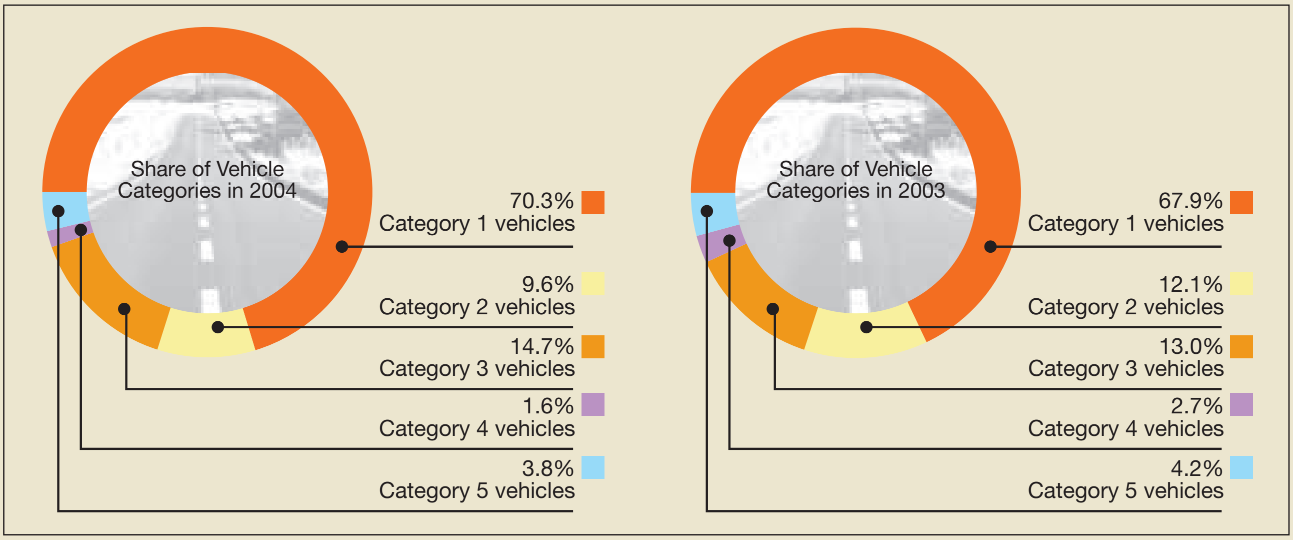
Details of the operation of the toll roads during the reporting period are as follows:

| Toll Road | Average daily mixed traffic volume 2004 (number of vehicle) | 2003 (number of vehicle) | Change (%) | Average daily toll revenue 2004 (RMB) | 2003 (RMB) | Change (%) |
|---|---|---|---|---|---|---|
| Meiguan Expressway | 64,199 | 46,397 | 38.37 | 707,711 | 560,477 | 26.27 |
| Jihe East | 44,446 | 33,308 | 33.44 | 631,107 | 499,489 | 26.35 |
| Jihe West | 35,257 | 28,284 | 24.65 | 593,856 | 484,467 | 22.58 |
| Yanba A and B* | 9,427 | 7,423 | 27.00 | 89,165 | 61,171 | 45.76 |
| Shuiguan Expressway | 39,733 | 30,397 | 30.71 | 382,291 | 300,079 | 27.40 |
| Changsha Ring Road | 4,623 | 3,454 | 33.84 | 55,170 | 46,836 | 17.79 |
| Geputan Bridge | 2,888 | 2,706 | 6.73 | 22,512 | 24,359 | -7.58 |

* Yanba B was completed and opened to traffic in June 2003.

Driven by robust economic growth and substantial increase in the number of vehicles, our toll road operations sustained rapid growth during the reporting period.

For most road sections, the growth in toll revenue lagged behind slightly the growth in traffic volume as small vehicles accounted for an increasing share of total vehicle ownership in the region, with Category 1 vehicles accounting for a 70.3% share of total traffic volume on average in 2004, as compared to 67.9% in 2003.



*Meiguan Expressway*

During 2004, traffic flow on Meiguan Expressway increased rapidly by 38% over the previous year. Following the opening of the Nonglin Feeder Road of Guanshen (Dongguan-Shenzhen) Expressway in Dongguan in July 2004, a significant volume of Dongguan-Shenzhen traffic on other roads in Dongguan was diverted to Guanshen Expressway and Meiguan Expressway. In the second half of 2004, traffic flow between Guanshen Expressway and Meiguan Expressway accounted for 44% of the total traffic flow, creating favourable conditions for Meiguan Expressway to score record highs in traffic volume and toll revenue. The rise in traffic volume on Meiguan Expressway was also attributable to the Company's increased effort to improve traffic flow on major peripheral driveways, which resulted in increased traffic volume on certain sections in addition to effectively alleviating congestion on these peripheral driveways.

*Jihe Expressway*

Small vehicles from Shenzhen accounted for the largest share of traffic volume on Jihe Expressway, one of the outer-ring roads of Shenzhen. Meanwhile, expedited construction of logistic parks and trade centres in the surrounding areas of Jihe Expressway provided further drive to rapid traffic growth on Jihe Expressway, particularly Jihe East, whose traffic flow grew 33% in 2004 (2003: 25%). When Guanghui (Guangzhou-Huizhou) Expressway was opened to traffic at the end of 2003, it became the preferred passage for outskirt border-passing vehicles in the northern areas of Humen commuting between Huizhou and Chaozhou/Shantou, causing diversion from Jihe Expressway at the initial stage of its operation. However, the impact of diversion to Guanghui Expressway was short-lived given significant traffic growth driven by thriving economic and trade activities, and consequently Jihe Expressway still sustained strong growth in traffic volume for the year 2004. Traffic flow of Jihe Expressway is expected to maintain rapid growth in the future as industrial centres and logistic parks with a gross area of over 100 sq km are being planned along Jihe Expressway.

*Yanba Expressway*

Yanba Expressway's under-par performance in toll revenue in the short term was attributable to the absence of holistic network coverage as connection with the highway network within Huizhou had yet to be realised. However, real estate development was prospering in the surrounding area of Yanba Expressway as real estate developers were upbeat about the traffic convenience and economic activities brought about by the commissioning of Yanba A and B. Beginning from the fourth quarter of 2004, vehicles related to construction works had brought additional traffic flow to Yanba Expressway of which traffic volume increased by 27% on a year-on-year basis. Yanba Expressway is expected to enjoy more significant growth in traffic flow and toll revenue when Yanba C becomes operational and when more improvements are concurrently made to the internal road network of Huizhou, thereby bringing the networking effect into play.

*Shuiguan Expressway*

Shuiguan Expressway has smoothened the traffic flow between the Longgang Industrial Zone and downtown Shenzhen. With a planned area of 38 sq km, the Longgang Industrial Zone is estimated to yield an annual industrial output of RMB22.9 billion upon its completion. Given the rapid development of the Longgang Industrial Zone and the fast-growing population and logistics activities in the satellite counties and towns surrounding Shenzhen, traffic volume on Shuiguan Expressway increased by 31% in 2004.

Shuiguan Extension and Nanping Freeway, both of which are currently under construction, will improve the peripheral networks of Shuiguan Expressway when they become operational, so that these networks can play a more effective role in smoothening traffic flow at the Shenzhen East checkpoint and will facilitate further traffic growth for Shuiguan Expressway.

*Changsha Ring Road*

Stronger measures against vehicle overloading adopted by Shenchang Company in September 2004 had achieved positive results. Changsha National Highway Ring Expressway (south-western section), which connects with Changsha Ring Road, was operational in November 2004. Apart from enhancing the networking effect, this has made vehicle passage more convenient and faster as combined toll collection was implemented for the two roads to reduce the number of toll stations, and has contributed to growth in traffic flow.

***Toll rates***

In 2004, the Ministry of Communications proposed toll rate reductions for certain type of trucks. The proposal requires the formulation of implementation plans by relevant communications and pricing authorities at provincial levels and the approval of provincial governments. As of now, the Company has not received any policy documents from the Guangdong Provincial Government in connection with toll rate adjustments. Therefore, we are not in a position to give any meaningful estimates regarding the impact of the policy on the Company's results. Nonetheless, Category 4 and Category 5 vehicles respectively accounted for only 3% and 12% of the Group's toll road revenue, and traffic flow on highways is likely to increase as a result of adjusted toll rates. Therefore, it is expected that the policy will not have any significant impact on the Group's overall operating income.

***Repair and maintenance of highways***

The maintenance and repair policies adopted by the Company for highways are preventive in nature, emphasising an integrated and comprehensive maintenance and repair programme so that highways and their facilities are maintained at superb working conditions to assure safe, smooth and comfortable driving for roadsters. The Company focuses on management of maintenance and repair skills, while taking proactive and appropriate maintenance and repair measures to enhance the quality of highways. The Company formulated a new maintenance and repair management system in 2004 to further improve relevant processes. The Company's performance quality on toll road maintenance and repair is maintained at an index of above 80, whilst adaptability of its bridges' loading reached 100%.

At the present stage, maintenance and repair works of the Company mainly involve intermediate and minor repair and routine maintenance. Daily operations are administered in accordance with pre-designed plans. Maintenance and repair service providers are selected through invitation for tenders such that expenses incurred are reasonably under control.

The surfaces of toll roads operated by the Company have an operating life of 15 to 20 years. Based on the prevailing good conditions of road surfaces, major repair works of road surfaces are not anticipated for the coming two to three years.

***Inter-road network toll collection***

Currently, the highway network in Guangdong Province is divided into six districts, namely Guangdong East, Guangdong West, Guangdong North, the Pearl River Delta region, Guangzhou and Shenzhen for the implementation of inter-road network toll collection. According to relevant planning, inter-road network toll collection will ultimately be implemented throughout the entire province on a uniform basis without any district divisions. Inter-road network toll collection within Guangdong Province will enhance the capacity of the road networks and will facilitate inspection on toll collection.

The Group's inter-road network toll collection system is operating smoothly at present after completion of the modifications in early November 2004 with subsequent approval by relevant authorities of Guangdong Province. To ensure effective performance of the inter-road network toll collection system, the Company compiled the "Rules Governing Inter-network Toll Collection in Shenzhen" (《深圳片區聯網收費管理辦法》). At a press conference held by the Guangdong Provincial Government in December 2004, the Company was named an Advanced Organisation in Inter-road network toll collection modification by the Guangdong Economic and Trade Commission and the Guangdong Communications Bureau.

## Construction and Development

Building upon the operation and management of its existing toll roads, the Company capitalised on its concession rights to develop and operate expressway projects planned by the Shenzhen Government, laying solid foundations for the future expansion of the Company's asset portfolio and income base. The Company took full advantage of its strengths and experience to engage in project construction and management on its own, in order to ensure the attainment of its targets on quality, construction costs, construction schedules and safety.

The Company's projects currently under construction or at the preliminary stage include Yanpai Expressway, Nanguang Expressway and Yanba C. These projects will be funded solely by the Company and will be, upon completion, run by the Company in terms of toll collection and operational management. These projects are located at prime geographical areas and will play a unique role in providing connections and traffic smoothening functions upon completion, thus having excellent development potential. In particular, Yanpai Expressway and Jihe Expressway will provide links to Yantian Port and Shenzhen airport and form, together with Meiguan Expressway, an express passage for prompt traffic diversion at Yantian Port, playing a significant role in relieving traffic pressure caused by the rapid growth of container throughput at Yantian Port and upon the full operation of Phase 3 construction at Yantian Port. Nanguang Expressway is an express passage connecting the core industrial area of Bao'an with downtown Shenzhen. It is also an essential supporting project of the Hong Kong-Shenzhen Western Corridor aimed at facilitating swift direction of traffic in the western port area of Shenzhen. Yanba Expressway is the main outreaching route for the eastern coastal area of Shenzhen that plays a significant role in meeting increasing traffic demand in eastern coastal Shenzhen and requirements of container transportation at Yantian Port, as well as facilitating tourism and economic activities in eastern Shenzhen.

*Yanpai Expressway*

The construction of Yanpai Expressway commenced in July 2003. Its estimated total investment budget was approximately RMB1,149 million. As at the end of the reporting period, RMB281 million or 25% of the above-mentioned budget had been utilised. Completion of the project is scheduled at the end of 2005.

*Nanguang Expressway*

The feasibility study report for Nanguang Expressway, with an estimated total investment budget of approximately RMB2,876 million, was approved by the Guangdong Communications Bureau in November 2004. A proposal for toll rates has been submitted to the same bureau through the Shenzhen Communications Bureau pending approval, while other governmental approval procedures are currently in progress. Construction of the project is expected to commence in the first half of 2005 with an estimated construction period of 2.5 years.

*Yanba C*

Yanba C is the final section of Yanba Expressway with an estimated investment budget of RMB515 million. Preliminary work is currently underway and construction is expected to commence by the end of 2005.

### Investment and Development

It is the Company's stated strategy to focus on toll road operations as its principal business and for future development, with Shenzhen as its base expanding towards other areas in the Pearl River Delta region as well as other economically developed regions in China. During the reporting period, the Company made inroads in increasing its market share by investing in toll roads outside Shenzhen, as it capitalised on opportunities arising from the disposal of equity interests in toll road projects by Guangdong and other provinces.

| Project | Investment budget (RMB'000) | Amount paid (RMB'000) | Proportion of interest |
|---|---|---|---|
| Yangmao Expressway | 271,680 | 271,680 | 25% |
| Jiangzhong Expressway | 308,270 | 205,090 | 25% |
| GZ W2 Expressway | 250,000 | 62,500 | 25% |
| Nanjing Third Bridge | 270,000 | 270,000 | 25% |
| Shuiguan Extension | 60,000 | 60,000 | 40% |
| Guangwu Expressway | 179,180 | – | 30% |

*Yangmao Expressway*

On 5 March 2004, the Company entered into an agreement with Guangdong Expressway Company Limited for the acquisition of a 25% equity interest in Yangmao Company at a consideration of RMB271.68 million. Upon completion of the acquisition, Guangdong Expressway Company Limited, Guangdong Transportation Investment Company Limited and the Company hold 60%, 15% and 25% equity interests in Yangmao Company, respectively.

Commencing operation in November 2004, Yangmao Expressway connects with operating expressways at its ends. As a result, it has already achieved good operating performance even at its initial stage of opening. Average daily toll revenue amounted to approximately RMB400,000. Upon completion of the project, the major east-to-west trunk expressway along the coastal line of Guangdong running from Shantou to Zhanjiang through Guangzhou was completely opened to traffic. The expressway serves as a convenient transportation route in Guangdong Province connecting Hainan, Guangxi and other south-western provinces. The traffic volume on Yangmao Expressway will further increase subsequent to the economic development in Yangjiang, Maoming and surrounding areas as well as continuous industrial construction along the expressway.

*Jiangzhong Expressway*

On 7 April 2004, the Company entered into an agreement with Guangdong Province Highway Construction Company Limited to acquire 25% equity interest in Jiangzhong Company at a consideration of RMB169,500,000. Upon completion of the acquisition, Guangdong Province Highway Construction Company Limited, Yue Expressway Development Company Limited and the Company hold 60%, 15% and 25% equity interests in Jiangzhong Company, respectively. Apart from the payment of consideration to Guangdong Province Highway Construction Company Limited in connection with the equity transfer, the Company might also be required to contribute project funding to Jiangzhong Company at an amount of approximately RMB138.77 million in accordance with the project schedule and in proportion to the Company's shareholding. An amount of RMB2,120.85 million or 67% of the total investment had been utilised as at the end of the reporting period and completion is scheduled for October 2005. Upon completion, Jiangzhong Expressway will form part of the trunk highway network in southwestern Guangdong, reducing the traffic distance between the eastern and western wings of the Pearl River Delta (with Guangzhou as the centre) by nearly 60 km.

*GZ W2 Expressway*

On 24 May 2004, the Company entered into a joint venture agreement with Guangzhou Highway Development Company and Guangzhou Yue Peng Information Ltd., a wholly-owned subsidiary of GZI Transport Limited, to form GZ W2 Company for the joint investment in the construction and operation of GZ W2 Expressway. The Company, Guangzhou Highway Development Company and Guangzhou Yue Peng Information Ltd. will hold 25%, 40% and 35% equity interests in GZ W2 Company, respectively. The total investment amount is estimated at approximately RMB3,003 million, of which RMB1,000 million will be registered capital. The Company will contribute RMB250 million. As at the end of the reporting period, a total of RMB306.31 million or 10% of the total investment amount had been utilised. When it is operational, GZ W2 Expressway will be connected with expressways and national highways at the periphery of Guangzhou and will serve as the only route connecting western Guangzhou to Huadu International Airport.

*Nanjing Third Bridge*

In June 2004, the Company invested in Nanjing Third Bridge Company (南京三橋公司) by way of equity participation with an investment amount of RMB270 million. The Company, Nanjing Communications Construction and Investment Holdings Company Limited, Bright Oceans Corporation and Nanjing Pukou Economic Development Corporation hold 25%, 45%, 25% and 5% equity interests in Nanjing Third Bridge, respectively. Construction of Nanjing Third Bridge commenced in May 2003 and the total investment amount is estimated at approximately RMB3,301.487 million. As at the end of the reporting period, RMB 1,673.76 million had been utilised, and the project was about 51% completed. Nanjing Third Bridge is the most convenient passage along the Shanghai-Chengdu national highway trunk (Hurong Line) crossing over Yangtze River at Nanjing. Upon completion in 2006, Nanjing Third Bridge will complete the Jiangsu Section of Hurong Line, contributing to the formation of the east-west highway trunk and the enhancement of the overall national traffic network.

*Shuiguan Extension*

Shuiguan Extension is an investment of Huayu Company (華昱公司) and is expected to involve a total investment amount of RMB510 million. On 26 May 2004, Shenzhen Huayu Investment Development Joint Stock Company Limited (華昱投資開發股份有限公司), its subsidiary Shenzhen Haorancheng Industrial Company Limited (深圳市浩然成實業有限公司) and the Company entered into share transfer agreements, whereby 10% and 30% equity interests in Huayu Company would be transferred respectively to the Company at a total consideration of RMB20 million. In July 2004, the registered capital of Huayu Company was increased from RMB50 million to RMB150 million, with the additional capital to be applied to finance the construction of the project. The Company has contributed RMB40 million as additional capital.

Shuiguan Extension commenced construction in 2003. As at the end of the reporting period, RMB450 million or 88% of the total investment amount had been invested in works and the construction had been 95% completed. The project, scheduled to become operational by mid-2005, is expected to improve the road network of Shuiguan Expressway and enhance the role of Shuiguan Expressway in alleviating passenger and cargo flow along the line. Upon completion of the project, it will be solely managed by Qinglong Company, which also operates and manages Shuiguan Expressway. The Company holds a 40% interest in each of Qinglong Company and Huayu Company.

*Guangwu Expressway*

On 8 December 2004, the Company entered into an agreement with GDRB Company to acquire a 30% equity interest in Guangyun Company at a consideration of RMB179.18 million. Upon completion of the acquisition, GDRB Company, Yunfu Expressway Construction Company and the Company will hold 67%, 3% and

30% interests in Guangyun Company, respectively. Guangwu Expressway, owned by Guangyun Company, was opened to traffic in December 2004 and is set to become an important passage for transportation in western Guangdong by providing to the Pearl River Delta region an economic and transportation link with Guangxi, Yunnan, Guizhou, Chongqing and Sichuan. On 18 February 2005, the said acquisition was approved at the extraordinary general meeting of the Company.

In 2004, the Company made substantial progress in its investments outside Shenzhen with breakthroughs in its expansion to Guangdong Province and the Pearl River Delta region. Aside from providing solid foundations for expanding the Company's income base in future, these collaborative projects would also enable the Company to increase its market share and strengthen its position and influence in the industry by channelling strategic partnerships with GD Communications Group.

Entering 2005, the Company continued to make major strides in external investments. On 3 February 2005, the Company, Mei Wah Company, Mr. Chung Chi Fai (a natural person), Spring Sun International Limited, Guangdong Yingjun Investment Holdings Co. Ltd., Maxprofit Gain Limited and Zhuhai New Chang Jiang Construction Investment Co. Ltd. entered into agreements with an aim to acquire a total of 56.28% equity interest in and related shareholders' loans of Qinglian Company for an aggregate consideration of RMB1,839.2 million. Qinglian Class I Highway, owned by Qinglian Company, is a 215.85km arterial highway in Guangdong Province, connecting the northern and the southern highway framework in the province and enhancing the trading and economic activities from the Pearl River Delta region to the Mainland. It connects with the proposed Tai-ao (Taiyuan - Macau) Expressway in Lian Zhou. In the south, it connects with Guangqing (Guangzhou-Qingyuan) Expressway, thereby linking up the transportation network of the Pearl River Delta region. In the north, it further extends to Yizhang of Hunan Province where it connects with Beijing-Zhuhai Expressway. In addition, it intersects with the Shantou-Kunming Expressway, a major government-planned highway trunk connecting China's East and West, and is an essential corridor to link up the Pearl River Delta region and the central and northern parts of Guangdong Province with Hunan Province and other mainland provinces. With a view to increasing the traffic capacity of highway networks by enhancing the efficiency of existing lines and bringing the capacity of major trunk highways into full play, plans are underway to re-construct Qinglian Class I Highway into an expressway for a total investment of approximately RMB3.9 billion. The reconstructed Qinglian Class I Highway will be an important transportation infrastructure for the development of the Pan Pearl River Delta Economic Zone as a key passage for the transportation between mainland provinces and the Pearl River Delta and Hong Kong/Macau regions. The Company will ensure sound project construction and management and prudent operation of this asset upon completion of the acquisition on the back of its strengths in highway investment and construction, with a view to enhancing the Company's overall profitability.

### Entrusted Construction Management

Entrusted construction management refers to government selection and appointment of private companies specialised in project management to organise, implement and manage government-invested projects. During the entrustment period, the entrusted administrator assumes certain duties of the investor according to the contract. Such duties normally include reporting, environmental assessment, engineering work tendering, management and coordination of construction works and during the warranty period, cost control as well as supervision of construction standards and progress, while the commissioning and assessment of project designs, land requisitioning and demolition of buildings, inspection and acceptance upon completion, management and maintenance after acceptance and duties in respect of organisation, coordination and approvals among relevant government authorities are excluded. The administrator is also not liable to advance or provide any funding for the project on behalf of the investor.

The entrusted construction management system represents an effective measure in the government's reform of the investment financing system. It is aimed to effectively separate the functions of investment, construction, operation and supervision in government projects, in order to avoid excessive investment, over-sized construction or excess above stipulated standards. While modifying and defining the role of the government, this system has also opened up new business opportunities for companies in relevant sectors. Under the entrusted construction management system, the entrusted administrator provides construction management services to the government for a management fee. Generally, the management fee is charged on a balance-of-cost basis, and the administrator is responsible for any breach of contract in respect of construction costs, construction schedules and standards within the scope of entrustment as agreed in the contract. Therefore, on top of reliable quality and credibility, it requires strong expertise in budget and work schedule controls for a project management company to succeed in this emerging business.

The Company boasts proven experience in project construction management, having been engaged in this sector for over 10 years with a track record in controlling construction quality, schedules and costs. It has been widely recognised by the government and the industry as a "model of quality and effectiveness" in highway construction. Therefore, the Company is well-positioned to capitalise on this unique opportunity to develop the business of construction management in connection with government-invested highways by "exporting" its construction management skills and experience. This will further broaden the Company's scope of business and create a new income base for the Company.

*Nanping Project*

On 11 February 2004, the Company entered into an entrusted construction management agreement with the Shenzhen Communications Bureau (on behalf of the Shenzhen Government) to manage the Nanping Project. The Company was appointed as the project administrator of the Nanping Project. According to the agreement, the Company's management income was to be determined by the project costs balance. The construction budget of the project was estimated at approximately RMB2,268 million. If the final balance of project costs or any deficit was to fall within 2.5% of the construction budget, then the balance or the deficit amount would be credited to or borne by the Company. If the balance or the deficit was greater than 2.5% of the construction budget, the portion of balance or deficit that exceeded 2.5% would be equally shared or borne by the Company and the Shenzhen Communications Bureau. Cost projections were made by the Company and approved by the Shenzhen Audit Bureau.

During the Year, 15 contract sections of the Nanping Project commenced construction and an investment amount of RMB471.92 million had been utilised. The project is expected to be completed in line with schedules specified under the terms and conditions of the agreement, with partial completion scheduled for the first half of 2005 and full completion by the end of 2005.

The project is expected to be completed on time in accordance with the terms and conditions of the agreement. Based on the tendering status of various contract sections, the accepted tender prices were generally within budget. As at the end of the reporting period, the Company had received RMB400 million from the Shenzhen Government as project funding, of which an aggregate of RMB355.567 million had been paid as project costs.

*Hengping Project*

On 12 March 2004, the Company entered into an entrusted construction management agreement with Longgang Highway Bureau (on behalf of the Shenzhen Longgang People's Government) to manage the Hengping Project. The Company was appointed as the project administrator of the Hengping Project. The construction budget of the project was estimated at approximately RMB450 million. The Company's management income is to be determined by the project costs balance. Any balance or deficit amount of the final construction costs would be credited to or borne by the Company.

As at the end of the reporting period, Hengping Project incurred project costs of RMB14.09 million. The Company received RMB30 million from the Shenzhen Longgang District Government as project funds and an aggregate of RMB18.445 million had been advanced or paid as project costs. At present, the land requisitioning and demolition work relating to the Hengping Project is falling behind schedule and the completion date will be delayed. The whole project is expected to be completed in the first half of 2006. As the Company is not required by the agreement to be responsible for land requisitioning and demolition, the Company's performance in accordance with the construction schedules as stipulated in the agreement will not be affected.

### Other Businesses and Matters

The Company invests in an advertising company which is engaged in the businesses of billboard leasing, advertising agency, design production and related services, utilising land-use rights alongside the Company's toll highways and toll stations. The advertising company recorded a profit of RMB1.324 million in 2004.

The Company has established a consultancy company together with certain engineering and technical personnel as primary shareholders to develop businesses such as project management consultancy, information technology consultancy, engineering consultancy, construction costs consultancy and tendering agent. The purpose of establishing this company is to leverage the Company's experience and human resources in highway project management while providing motivations to such engineering and technical personnel. To date, some initial progress have been made on the market development of the businesses concerned.

In a move to resolve problems associated with the Shenzhen Wutongling Ropeway project, the Company acquired the 55% equity interest in Ropeway Company held by Zhongmin Investment Services Limited (深圳市中民投資服務公司) in August 2004 by way of auction for a price of RMB945,000. The Company now holds a total of 95% in the equity interest of Ropeway Company. As at the end of the Year, the Wutongling Ropeway project, which Ropeway Company is responsible for constructing and managing, remained suspended. The Company is actively seeking appropriate solutions. In the event that the project is abrogated by the government, the Company will strive to claim damages for losses from the government.

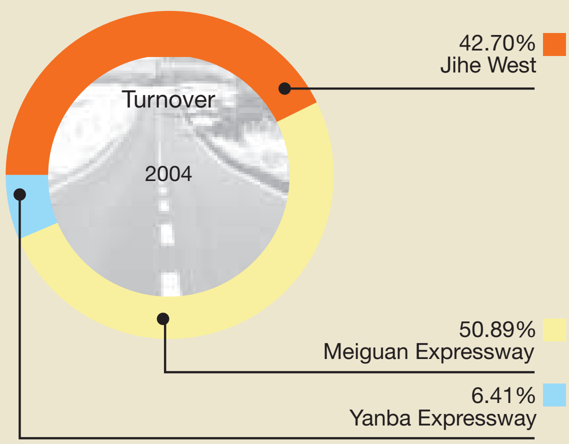
## Financial Review

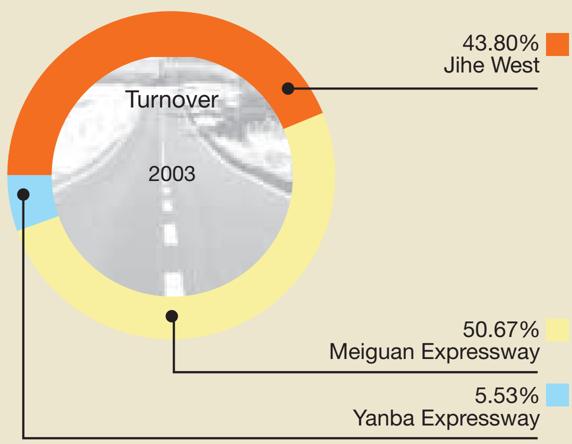
### Profit Analysis

The Group's profit attributable to shareholders for 2004 amounted to RMB418,870,000, representing an increase of 33.78% as compared to profit attributable to shareholders generated from "ordinary activities" in the previous year. The decrease of 53.43% in total profit over the previous year was attributable to the disposal of two Class 1 highways by the Group in March 2003, which resulted in non-recurring "gain on disposal of assets". The Group's toll roads continued to enjoy rising profitability during the Year and as a result, profit generated from its ordinary activities quickly returned to the same level before the disposal of the two Class 1 highways.

***Turnover***

The Group recorded a turnover of RMB482,540,000 in 2004, representing an increase of 14.47% when compared to the previous year. Discounting the turnover from the two Class I highways for the three months prior to their disposal in 2003 (amounting to RMB38,793,000), turnover of the Group's existing highway operations registered a year-on-year growth of 26.08%. For the three toll roads owned by the Group, turnover of Meiguan Expressway increased from RMB193,936,000 in the previous year to RMB245,553,000, representing an increase of 26.62%; turnover of Jihe West Expressway increased from RMB167,635,000 in the previous year to RMB206,049,000, representing an increase of 22.92%; turnover of Yanba A and B increased from RMB21,166,000 in the previous year to RMB30,938,000, representing an increase of 46.17%, as Yanba B was completed and opened to traffic in June 2003.




Growth in the Group's turnover during the Year was mainly attributable to the increase in traffic flow on each of the toll roads as they benefited from the robust growth of China's economy and the substantial increase in the number of vehicles. Given an unchanged toll rates this year with the previous year, the increasing number of small vehicles among total vehicle ownership in the region caused the Group's average toll revenue per vehicle a slight decrease of 5.19%. As a result, turnover growth lagged slightly behind the growth in traffic flow.

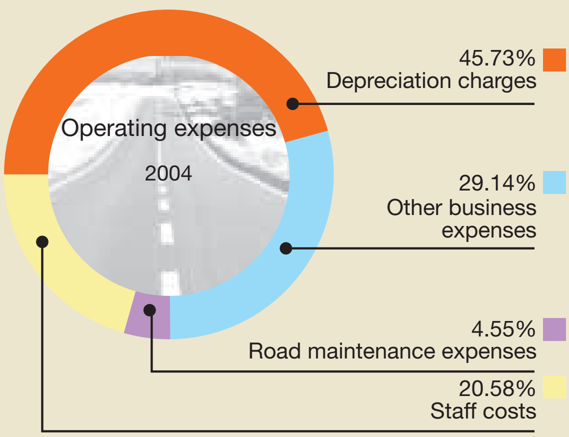
| Toll Road | Average Toll Per Vehicle 2004 (RMB) | Average Toll Per Vehicle 2003 (RMB) | Growth Rate | Growth Rate of Mixed Traffic Volume | Growth Rate of Turnover |
|---|---|---|---|---|---|
| Meiguan Expressway | 11.024 | 12.080 | -8.74% | 38.37% | 26.62% |
| Jihe West | 16.844 | 17.129 | -1.66% | 24.65% | 22.92% |
| Yanba Expressway | 9.458 | 8.241 | 14.77% | 27.00% | 46.17% |
| **Total** | **12.773** | **13.472** | **-5.19%** | **32.62%** | **26.08%** |

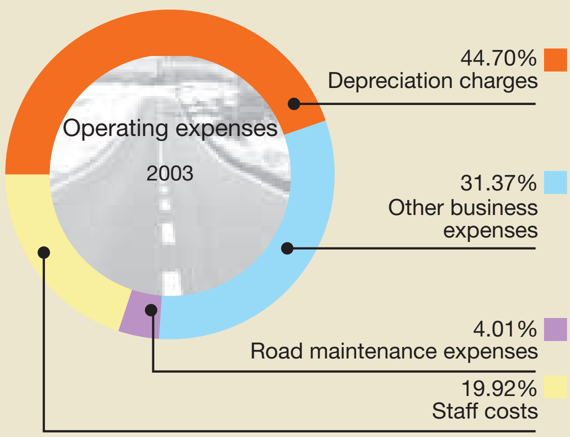
***Operating Expenses***

The Group's operating expenses remained under effective control. Despite a larger volume of business relating to new projects, the Group's operating expenses before depreciation increased by only 4.59%.

Staff costs amounted to RMB40,337,000, representing an increase of 10.1% as compared to the previous year, attributable mainly to a longer period of operation of six more months for Yanba B as compared to the previous year, as well as additional headcount required by business expansion. Road maintenance expenses amounted to RMB8,912,000, representing an increase of 20.94% as compared to the previous year, which was attributable to increased investment in road maintenance and repair to ensure sound road conditions in response to increased traffic flow and longer operating life of roads. Other operating costs decreased by 0.98% to RMB57,114,000, primarily due to provision for impairment loss amounting to RMB28,311,000 made in respect of the Wutongling Ropeway project in the previous year, as well as a write-off of RMB6,104,000 for the replacement and disposal of toll collection systems in connection with the inter-road network toll collection project and the increase in new business development expenses during the Year.

During the Year, the Group reviewed the use of traffic flow estimates as the basis for calculating depreciation, and decided to maintain the existing accounting estimates. Depreciation charge for the Year increased to RMB89,651,000 as traffic flow increased, representing an increase of 9.08% as compared to the previous year.




***Other Revenues***

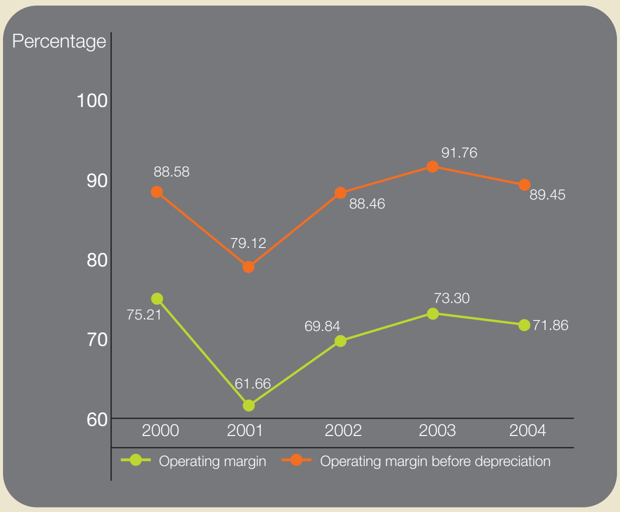
In 2004, the Group's other revenues increased by 39.11% to RMB110,609,000. Such increase was mainly attributable to:

- A deferred income of RMB35,708,000 recognised for the Year in respect of government subsidies for Yanba Expressway;
- A discounted interest income of RMB35,779,000 recognised for the Year in respect of long-term account receivable in connection with the disposal of two Class 1 highways;
- A total income of RMB17,351,000 received in respect of the entrusted construction management service provided for the Yanba linkage project and the Nanping Project. As no reliable estimates could be made in respect of the management results for the project during the Year but future reimbursement of administration expenses incurred relating to this project were probable, the Company recognised income and expenditure for the Nanping Project on the basis of administration expenses of RMB6,333,000 incurred during the Year. No profit was accounted for during the Year; and
- Bank deposit interest income of RMB11,938,000.

***Operating Profit***

As a result of the increase in turnover and other revenues, the Group recorded an operating profit of RMB397,135,000 in 2004, representing an increase of 25.22% as compared with that generated from "ordinary activities" in the previous year. Total operating profit for the Year decreased by 60.62% over the previous year, due to the non-recurring profit derived from "gain on disposal of assets" in 2003. Operating margin from toll roads for the Year was 71.86%, as compared to 73.30% in 2003. Such decrease was mainly attributable to the increase in write-off relating to obsolete toll collection systems.

**Operating Margin of Toll Roads**




* Operating margin of toll roads does not include government subsidies for Yanba Expressway.

***Share of Profit of Jointly Controlled Entities***

The Group's share of profit of jointly controlled entities was RMB120,032,000, representing an increase of 103.12% as compared with that of the previous year. This was mainly attributable to the increase in traffic volume on toll roads operated by all jointly controlled entities.

In particular, the Group's share of profit of Jihe East Company (operator of Jihe East) increased by 23.42% to RMB94,907,000 and its share of profit of Qinglong Company (operator of Shuiguan Expressway) increased substantially by 82.92% to RMB22,444,000. In respect of Qinglong Company, in addition to increased traffic flow, the growth was attributable to a decrease of RMB1,720,000 in interest expense as a result of reduction in borrowing costs for the company. The Group's share of loss of Shenchang Company (operator of Changsha Ring Road) amounting to RMB28,346,000 in 2003 was reversed to a profit of RMB333,000 for the Year under review (Please refer to Note** under a paragraph entitled Earnings Before Interest and Taxation ("EBIT") on page 42 for detailed explanations). The Group's share of profit of Yungang Company (operator of Geputan Bridge), the results of which were included in the Group's accounts since November 2003, amounted to RMB2,349,000 for the Year under review.

***Share of Profit of Associated Companies***

The Group registered six new associated companies during 2004 and its share of loss of associated companies amounted to RMB706,000, comprising share of profit of a consulting company that was formerly a subsidiary amounting to RMB1,420,000 and share of loss of Yangmao Company (operator of Yangmao Expressway which was opened to traffic in late November 2004) amounting to RMB581,000. Other associated companies were in the stage of construction. The Group's share of loss of associated companies was mainly attributable to amortisation of goodwill on acquisition for the Year amounting to RMB1,545,000.

***Earnings Before Interest and Taxation ("EBIT")***

Contributions of the Group's principal activities to EBIT were as follows:

| Principal Operation | 2004 (RMB'000) | 2003 (RMB'000) | change (%) |
|---|---|---|---|
| Meiguan Expressway | 184,105 | 154,298 | 19.32 |
| Jihe West | 166,480 | 142,326 | 16.97 |
| Jihe East | 94,907 | 76,896 | 23.42 |
| Yanba Expressway | 31,948 | 30,226 | 5.69 |
| Shuiguan Expressway | 22,443 | 12,348 | 81.76 |
| Other highways** | 2,645 | (28,150)** | N/A |
| Highway related businesses*** | 71,897 | 2,441*** | 2,846.59 |
| **Sub-total** | **574,425** | **390,385** | **47.14** |
| Two Class 1 highways: NH107 and NH205 | – | 25,931 | -100.00 |
| Unallocated expenses of the Group | (57,964 ) | (40,062 ) | 44.69 |
| **Total** | **516,461** | **376,254** | **37.26** |

* "Gain on disposal of assets" was not included in the figures for 2003.

** Other highways included Changsha Ring Road, Geputan Bridge and highways operated by associated companies. EBIT from other highways in 2003 comprised the Group's share of loss of Shenchang Company amounting to RMB28,346,000 (comprising provision for impairment loss of fixed assets amounting to RMB77,000,000, interest income on entrusted project loans amounting to RMB50,026,000, operating losses of Shenchang Company amounting to RMB1,372,000, and operating profit of Geputan Bridge amounting to RMB196,000.

*** Highway-related businesses consisted of project management fee income from entrusted construction management services, the Ropeway Company, the advertising company and interest income. A provision of RMB30,311,000 was made for impairment loss of the Ropeway Company in 2003.

Finance costs in 2004 amounted to RMB12,922,000, representing a decrease of 1.66% as compared with that of the previous year.

The Group's profit attributable to shareholders for 2004 amounted to RMB418,870,000. Earnings per share amounted to RMB0.192. The Board recommended a final dividend of RMB0.11 per share.

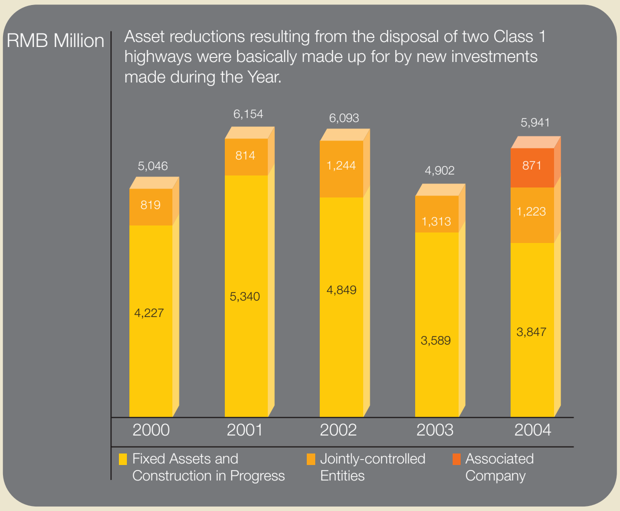
## Financial Position

***Non-current Assets***

The Group is principally engaged in the operation of toll roads and its non-current assets comprise mainly fixed asset investments and equity investments in high-grade toll roads. As at the year end date, the original costs of the Group's non-current assets amounted to RMB5,941,749,000, representing an increase of 21.20% over the previous year. The net book value of the Group's non-current assets at the end of the Year amounted to RMB5,676,056,000. The Group's capital expenditure during the Year amounted to RMB1,164,413,000 (2003: RMB395,622,000). As at 31 December 2004, the Group's capital commitment for the future five years was estimated at RMB7,147,356,000. Asset reductions resulting from the disposal of two Class 1 highways were basically made up for by new investments made during the Year, which will become a new source of revenue growth for the Group in the future.

Details of the new investments are set out in the section headed "Business Review". Details of future capital expenditure are set out in the section below headed "Financing/Capital".

**Long-term Asset Growth (at Cost)**




***Current Assets and Liabilities***

As at 31 December 2004, the Group's current assets amounted to RMB1,669,430,000 (2003: RMB1,944,490,000), including cash and cash equivalents of RMB1,203,239,000 (RMB1,133,014,000 and HK$64,165,000), restricted cash of RMB55,988,000 and account receivable of RMB403,268,000. The cash and cash equivalents at the end of the Year were mainly cash received from the disposal of two Class 1 highways in the previous year. Such cash amounts will be used as investments for new projects.

The Group's cash is generally held in current account deposits or short-term fixed deposits with commercial banks in China and Hong Kong. No cash is deposited with non-bank institutions or is employed in any securities investments.

As at 31 December 2004, the Group's current liabilities amounted to RMB642,756,000 (2003: RMB357,133,000), including RMB156,538,000 as project costs payables and deposits, RMB55,988,000 as government funds for entrusted construction management projects and RMB360,000,000 as short-term bank loans. Increase in the Group's current liabilities was mainly attributable to the increase in short-term borrowings. In view of the current cash flow position and future cash flow requirements of the Group, it is expected that the Group will have sufficient funds for the repayment of these borrowings.

***Shareholders' Equity***

As at 31 December 2004, shareholders' equity of the Group amounted to RMB6,086,606,000, an increase of RMB4,537,000 from 2003. The increase reflected mainly profit attributable to shareholders and retained earnings after dividend payment during the Year.

***Deferred Tax Liabilities***

As at 31 December 2004, the Group's net deferred tax liabilities amounted to RMB50,383,000, comprising mainly deferred tax liabilities of RMB52,261,000 on timing difference arising from differences between the carrying amounts of assets and liabilities and their tax bases in respect of toll road depreciation and amortisation of land use rights, and deferred tax assets of RMB1,878,000 in respect of the provision for impairment loss for investment in the Wutongling Ropeway project.

***Deferred Income and Government Subsidies***

As at 31 December 2004, the balance of the Group's deferred income amounted to RMB318,764,000. This deferred income represented the amount paid by the Shenzhen Government to subsidise insufficient traffic flow owing to the early completion of six driveways on the Group's Yanba Expressway. Income recognised by the Group amounted to RMB35,708,000. As at 31 December 2004, the Group's long-term liabilities included other long-term advance amounted to RMB54,000,000 which is an interest-free advances by the Ministry of Communications for the Yanba Expressway with no fixed repayment date.

***Borrowings and Solvency***

As at 31 December 2004, the Group's total borrowings in respect of bank loans and government loans amounted to RMB493,901,000, an increase of RMB417,725,000 from 2003. The loans were mainly used for investment in new projects. Details of the Group's borrowings and capital are set out in the section below headed "Financing/Capital".

## Financing/Capital

***Financing activities***

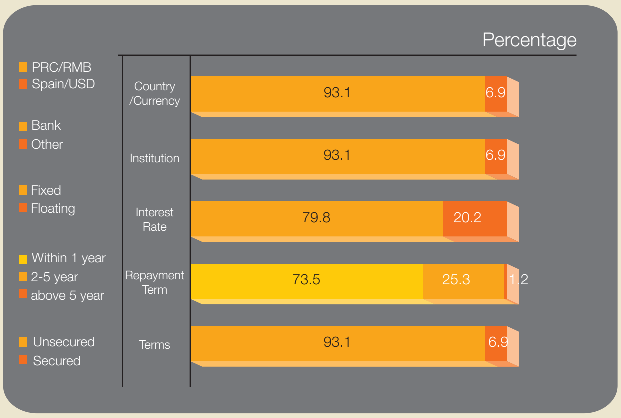
While the Chinese government implemented macro-economic control measures during the Year, highway investments remained an encouraged industry and continued to enjoy enormous support from the capital market such as banks. At present, bank loans generally finance 65% of the total investment for highway projects in China. The repayment period is generally over 10 years and this provides adequate financial resources for highway projects. The Renminbi interest rate remained at historic lows despite a small upward adjustment in the second half of 2004 due to inflation and US interest rate hikes.

On the back of steady growth in cash flow, sound credit record and fine industry reputation, the Company was assigned an AAA credit rating in 2004 by an institution recognised by the People's Bank of China. Good credit rating is beneficial to the Company's financing activities and allows the Company to continue to qualify for prime rates under the interest rate policy of the People's Bank of China.

Due to a low borrowing level in 2004, the Group's bank loans were mainly short-term nature with maturity period of one to two years. The combined lending rate for the Year under review was 4.778%, slightly higher than 4.582% for the previous year, mainly as a result of the larger proportion of two-year loans compared to the previous year.

During the Year, the Company made proactive moves to capitalise on favourable conditions, both internal and external, to negotiate new financing facilities and agreements with banks. As of the date of this report, credit facilities granted to the Company amounted to RMB4,890,000,000, with an unutilised balance of RMB4,400,000,000. The Company also has plans to adjust its borrowing structure to increase the variety of loan types employed and to extend its maturity profiles, with a view to satisfying the capital expenditure requirements in future.

**Borrowing Structure (as at 31 December 2004):**

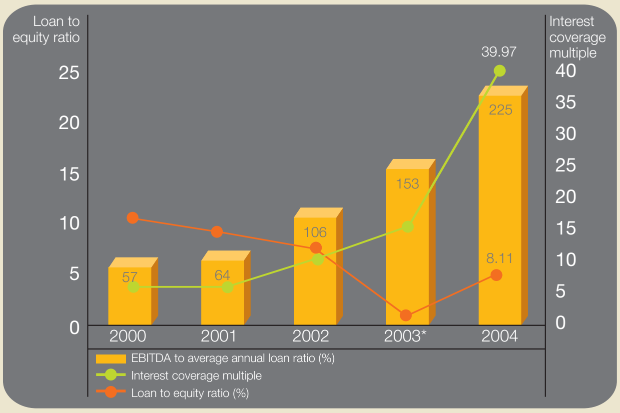



***Capital Structure***

As at 31 December 2004, the Group's total debt to equity ratio was 19.86% (2003: 14.09%) and its loan to equity ratio was 8.11% (2003: 1.25%). Interest coverage for the Year was 39.97 times (2003: 28.63, excluding "gain on disposal of assets").

With steady growth of net operating cash flow and funds generated from the disposal of two Class 1 highways, the Group currently enjoys a high level of solvency that ensures greater flexibility for raising loans in the future.

**Debt Repayment Abilities (as at 31 December 2004):**




* Gain on disposal of assets was excluded from the 2003 net profit

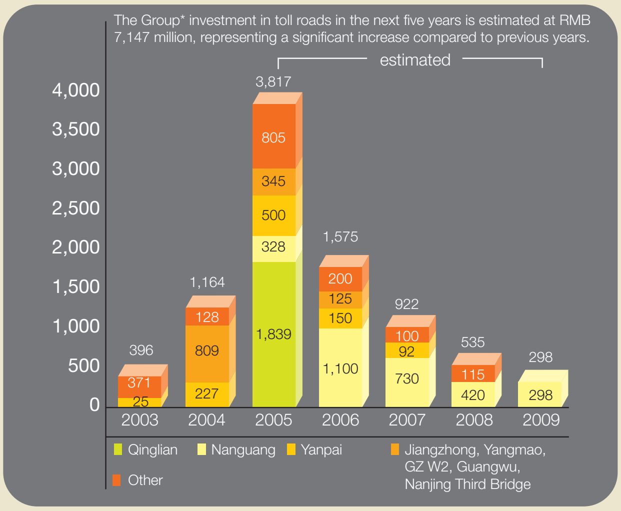
***Capital Commitment***

As at 31 December 2004, the Group's capital expenditure projects mainly included the construction of Yanpai Expressway, Nanguang Expressway and Yanba C and investments in Qinglian Class I Highway, GZ W2 Expressway, Guangwu Expressway and Jiangzhong Expressway. Capital expenditure for the next five years is estimated at RMB7,147,356,000, representing a substantial increase compared to previous years.

The Company plans to fund the aforesaid amounts by internal resources and external borrowings and would be able to fulfill such capital expenditure given the Company's enriched financial resources and sound financing capabilities. Apart from the aforesaid capital expenditure of the Company, funds for the reconstruction of Qinglian Class I Highway into an expressway amounting to RMB3,900,000,000 is expected to be satisfied by external borrowings by Qinglian Company.

The Company believes that the aforesaid new projects will significantly enhance the Group's profitability. The Company is fully aware of the financial and other risks associated with large-scale investments and effective measures will be adopted to control such risks. Please refer to the section headed "Risk Management" for details.

**Capital Expenditure Plans (RMB million)**




***Cash flow of the Group***

The growth in traffic volume and toll revenue ensures steady growth in the Group's operating cash flow. During the Year, net operating cash flow of the Group was RMB351,317,000 (2003: RMB295,006,000). Dividends and loan repayments received from jointly controlled entities amounted to RMB159,459,000 (2003: RMB168,255,000). Aggregate net cash flow resulted from the above two items amounted to RMB510,776,000 (2003: RMB463,261,000).

The installment payment and the tax-equivalent compensation payment in respect of the disposal of two Class 1 highways received during the Year amounted to RMB579,000,000 and RMB105,204,000, respectively. A cumulative amount of RMB1,649,204,000 has been received as at the year end date. According to the agreement, the balance of RMB386,000,000 is receivable in 2005.

Net increase in loans amounted to RMB417,725,000 during the Year.

During the Year, cash outflow comprised mainly capital expenditure for Yanpai Expressway, Yanba Expressway, Yangmao Expressway, Jiangzhong Expressway, Nangjing Third Bridge, Shuiguan Extension and GZ W2 Expressway and amounted to RMB1,164,413,000 in aggregate; payment of income tax amounting to RMB105,204,000 in respect of income received for the disposal of two Class 1 highways; and dividend payments amounting to RMB414,333,000.

As at 31 December 2004, the Group's cash and cash equivalents decreased by RMB1,579,000 as compared to the previous year.

### Use of Proceeds

The Company raised RMB604 million from the issue of A Shares in 2001. During the reporting period, the Company applied such proceeds in the construction of Yanba B in strict compliance with representations made in the Prospectus. The construction of Yanba B began in June 2001 and the section was opened to traffic for toll collection in June 2003.

An amount of RMB30.5 million was applied during the reporting period and the cumulative amount of proceeds applied was RMB414 million. As at 31 December 2004, proceeds in the amount of RMB190 million remained unutilised and were mainly held as short-term fixed deposits with banks in China to be used for the settlement of remaining project payments for Yanba B. After the commissioning of Yanba B, traffic flow and toll revenue of Yanba Expressway had been significantly enhanced with the formation of a local traffic network with Yanba A, details of which are set out in the section headed "Profit Analysis".

## Risk Management

It has always been a high priority for the Board and the management of the Company to deal with various risks facing the Group. Proactive reviews are conducted on an ongoing basis and relevant preventive measures have been adopted to procure effective implementation and realisation of the Group's strategies and goals.

### Financial Risks

***Cashflow risk***

The highway business is a capital-intensive industry characterised by a relatively long period for investment return. For this reason, the Group has consistently adopted a prudent approach in financial management to prevent risks associated with cashflow problems, which is particularly important in the current stage of the Company's business development, underpinned by capital expenditure growth in a macro-economic environment threatened by inflationary pressure.

Over the years, the Company has developed an exacting model for financial forecasts and estimates to evaluate investments in new projects in light of the Company's financial resources. All investments of the Company are stringently evaluated and prioritised on the basis of intended levels of return on capital, turnover of cashflow and capital costs. Essential sensitivity analysis is conducted in respect of all important assumptions and parameters. Such principal assumptions of the model are reviewed in detail and updated as necessary on an annual basis.

Meanwhile, the Company has employed different types of financing tools and maintained a balanced debt portfolio, taking into account the repayment term, fixed/floating interest rates and foreign exchange risks, with a view to diversifying debt risks, maintaining sufficient financial facilities and lowering capital costs.

***Risk of dependence on a single source of profit***

The Group's major operations are based in Shenzhen since its establishment. Given the limited geographical size of Shenzhen and the limited number of vehicles the city can accommodate, the Group will be exposed to risks associated with the coverage of a single market if it relies solely on toll roads in Shenzhen as its source of profit. Such risks include the adverse effects of falling demand for new projects, economic slowdown and policy changes.

Therefore, the Group is seeking to explore new toll road projects in other areas in Guangdong Province and the rest of China to increase profit contribution from markets beyond Shenzhen. Meanwhile, the Company has also identified "entrusted construction management" as a new source of income besides toll road operations by providing this service to government-owned infrastructure, fully leveraging our core capabilities and strengths in highway construction and management.

***Interest rate risk***

The Group maintains a reasonable debt portfolio mainly based on a combination of fixed and floating interest rates. Interest rate swap contracts are also executed as appropriate, according to changes in the market, to control the risk of interest rate hikes. As at the end of 2004, the Group had no outstanding interest rate swap option contracts.

***Foreign exchange risk***

All major operations of the Group are located in China and the operating income and expenses as well as capital expenditure of the Company, with the exception of dividend payment in respect of its H-Shares, are denominated in RMB. Therefore, the Group's loans are principally denominated in RMB. As at the end of 2004, the Group only recorded a minimal amount of foreign exchange loans and deposits and as a result, fluctuations in exchange rates did not have any material impact on the Company's results.

***Contingent liabilities***

For details of the Group's contingent liabilities, please refer to Note 29 in the accounts.

**Market and Policy Risks**

***Fluctuation in toll rates***

In November 2004, the National Development and Reform Commission ("NDRC") and the Ministry of Communications recommended to provincial governments the reduction of toll rates for Category 4 and Category 5 vehicles as a means to alleviate the issue of vehicle overloading. In the event of implementation of this policy by the Guangdong Government, there will be a slight decrease in the Group's toll revenue. On the other hand, continued inflation in China in future will affect investment in and operating costs for highway operations, while corresponding adjustments to toll rates are subject to approval by local provincial governments.

Measures adopted by the Company: the application of more prudent assumptions for toll rate adjustments in the analysis of new project investments to build in stronger risk resilience; the ongoing adoption of cost reduction measures (including construction costs and operating costs) to ensure that profit for shareholders will grow even if toll rates remain at the same level; maintaining good working relationships and proactive communications with government authorities and fellow highway operators to foster accurate and pragmatic understanding of the business among parties concerned, so that more desirable toll rates will be determined.

***Variations in traffic flow***

The growth of traffic flow on China's highways is assured by China's continued economic growth coupled with potential vehicle growth. However, situations vary with different projects and all toll roads are subject to a limited term of operation. The Company's profit might be adversely affected if the vehicle flow for a highway investment project fails to reach the projected level during the term of operation, or if existing highways are subject to significant diversions as a result of changes in the layout of China's highway network.

Measures adopted by the Company: the application of more prudent assumptions for the growth of vehicle flow at the stage of evaluation to increase the risk resilience of projects; the adoption of a more prudent approach in the evaluation of new projects to rule out investments in unfamiliar regions; acquiring timely knowledge of the distribution and flow of peripheral networks and making timely, appropriate investment decisions; maintaining good working relationships with government authorities and fellow highway operators to help realise optimal distribution and connection of regional highway networks in the region; and offering premium services to roadsters and strengthening the promotion and marketing of new highways to enhance the Company's market competitiveness.

***Increasing market competition***

The highway sector saw increasing investments from non-specialised companies, private companies and foreign investors during the Year. Some of them were encouraged by incentives offered by the Chinese Government, while others were attracted by the steady cashflow available to this sector. This has resulted in more intense competition and may push up acquisition costs.

Measures adopted by the Company: direct acquisition of development projects for new toll roads in Shenzhen by virtue of the concession rights granted to the Company; developing and maintaining sound working relationships with the Guangdong Communications Bureau and GD Communications Group to build up confidence and trust; enhancing the Company's management and service standards and actively exploring innovative and value-added services so as to upgrade the Company's non-price related competitiveness.

***Tax rates***

The Group's assets are principally located in Shenzhen and the Group is currently entitled to preferential corporate income tax rates applicable in Shenzhen Special Economic Zone. The Company's profitability will be affected if preferential tax rates for Shenzhen are abolished in future. The Company has fully taken into account the effect of higher tax rates in its evaluation of new projects in Shenzhen. As for investment projects outside Shenzhen, the convergence of varying tax rates is not expected to bring any adverse impact.

### Operational Risks

***Construction Management***

The Group expects to take on large-scale highway construction projects in future, including new toll roads invested by the Company and highways to be constructed and managed on behalf of the government. These projects might face the risks of rising construction costs, delayed completion and compromised quality because of rising costs of raw materials, increasing difficulties in land requisitioning and resettlement of residents, changing construction plans, etc.

As most of these construction projects will be managed by the Company, its core expertise and extensive experience in highway construction and management will be an important cornerstone for managing such risks. By entering into construction outsource agreements with contractors, the Company has substantially transferred such risks to its contractors.

***Reliability of toll collection systems in operation***

For investors and general users of toll roads, risks associated with an unreliable or malfunctioning toll collection system that might cause traffic congestion, insecurity of revenue and inaccuracy of data relating to vehicle flow and toll revenue would be a major concern.

Ongoing improvement of the operating toll collection system has always been a matter of top priority for the Group, who has adopted a series of preventive measures such as multiple review and supervision at key junctions, emergency back-up plans, on-site simulation tests on a regular basis, ongoing research to improve system reliability and parallel testing prior to the implementation of new systems to ensure the reliability of system operation.

***Repair and maintenance of highways***

While the Group's highways are maintained in sound conditions at present and repair costs are relatively low as a percentage of operating costs, the scale and costs of repair works may rise as road surfaces are being subjected to more significant wear-and-tear with increasing vehicle flow, and traffic flow will also be affected while repair works are underway.

Measures adopted by the Company: arranging practicable work plans, such as road repair on a section-by-section or lane-by-lane basis or during night time, so as to maintain smooth traffic flow and keep the impact on peak-hour traffic to a minimum.

## Outlook

As discussed above, the Pearl River Delta region stands out with robust economic growth, against the backdrop of the rapid, stable and healthy development of the Chinese economy. Economic growth is set to create demand for transportation as individual travelling and business commuting become more frequent. Transportation is, in a certain sense, a decisive factor for development, and as such, the building of transportation infrastructure should be anticipatory of development. The State and local governments have formulated forward-looking plans for China's transportation network to meet the needs of economic development, and it has been separately confirmed by the Ministry of Communications and NDRC that highway construction will continue to be funded through a variety of sources including national tax income, treasury bonds, bank loans, domestic investments and foreign investments, and toll revenue shall remain a rightful source from which investors generate returns.

- The State Council: China will add around 3,000 km each year to its highway network until 2010, translating into annual investments of approximately RMB140 billion.
- Guangdong Province: Intra-provincial expressways to reach 4,000 km by 2008.
- Shenzhen: Investment of RMB20 billion by 2013 to add 270 km to its expressway network.

Robust economic growth coupled with effective policy support has provided highway operators with a golden opportunity for development. Meanwhile, the Board and the management of the Company are fully aware of the risks confronting the Group in the financial, marketing and operational aspects. Proactive reviews are conducted on an ongoing basis and relevant preventive measures have been adopted in this regard. The Board and the management are confident that by constantly fostering and building upon its core competitive strengths, the Company will be able to reward its shareholders with better returns as it continues to identify new growth drivers and enhance its profitability as well as its ability to withstand risks.