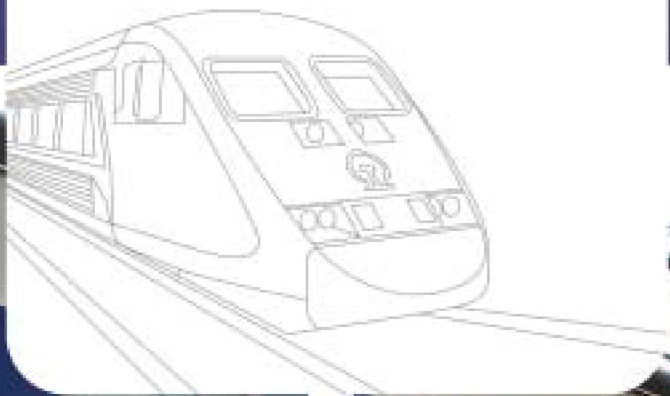
Management's Discussion and Analysis



Management's Discussion and Analysis

Mr. Li Kelie *Director and General Manager*

This discussion and analysis should be read in conjunction with the audited consolidated financial statements of the Company and the accompanying notes appearing in the 2004 annual report. The consolidated results of the Company and its subsidiaries for the year ended December 31, 2004 were prepared in accordance with International Financial Reporting Standards (IFRS), which differ in certain material respects from PRC generally accepted accounting principles and United States generally accepted accounting principles (see "Supplementary Financial Information" for a discussion of these differences).

In order to better conform to "International Accounting Standards (IAS) 18 — Revenue", the "Revenues" in this annual report (including the management's Discussion and Analysis) are set out before the deduction of business tax, while the "Revenues" in the annual reports of previous years were set out after the deduction of business tax.

1. BUSINESS OVERVIEW

In 2004, with continuous and rapid growth in the economy of the PRC, the expansion of regional economic cooperation in the Great Pearl River Delta and Pan Pearl River Delta, the gradual implementation of CEPA and the implementation of the "Relaxed Individual Travel" program to Hong Kong and Macau, the Company had excellent development opportunities as there was strong demand for passenger and freight transportation services in the Company's service region. The Company aggressively captured market opportunities, strengthened passenger and freight transportation marketing and took advantage of its the transportation capacity. Good operating results were achieved with the joint effort of the management and the employees.

In 2004, the total revenues of the Company were RMB3,038.1 million, representing an increase of 23.1% from RMB2,468.2 million in 2003. The revenues of the Company from passenger transportation service, freight transportation service and other businesses were RMB2,259.7 million, RMB611.8 million and RMB166.7 million, accounting for approximately 74.4%, 20.1% and 5.5% of the total revenues of the Company in 2004, respectively. In 2004, profit attributable to shareholders of the Company was RMB567.5 million, representing an increase of 10.9% from RMB511.8 million in 2003.

2. RESULTS ANALYSIS

(1) Passenger Transportation

The passenger transportation business was the most important business of the Company. As of December 31, 2004, the Company operated 117 pairs of passenger trains according to its train schedule everyday, representing an increase of five pairs from the number in operation as of December 31, 2003. There were 64 pairs of high-speed passenger trains between Guangzhou and Shenzhen, an increase of one pair; two pairs of regular-speed passenger trains between Guangzhou and Shenzhen, a decrease of one pair; 13 pairs of Hong Kong Through Trains, an increase of two pairs and 38 pairs of long-distance passenger trains, an increase of three pairs.

**Note:* 64 pairs of high-speed passenger trains between Guangzhou and Shenzhen include eight standby trains; 13 pairs of Hong Kong Through Trains include 11 pairs of Canton-Kowloon through trains, one pair of Through Trains between Zhaoqing and Kowloon and one pair of Through Trains between Beijing and Kowloon or between Shanghai and Kowloon. (The Hong Kong Through Trains between Beijing and Kowloon and the Through Trains between Shanghai and Kowloon are accounted for as one pair of Through Trains due to their operations on alternate day).

In 2004, the Company's total number of passengers was 46.0 million, representing an increase of 21.5% from 37.861 million in 2003. Its revenue from passenger transportation was RMB2,259.7 million, representing an increase of 26.2% from RMB1,790.2 million in 2003. In particular:

- ***Guangzhou-Shenzhen trains***

  The Company's Guangzhou-Shenzhen trains consist of high-speed passenger trains and regular-speed passenger trains between Guangzhou and Shenzhen. The number of passengers travelling on the Company's Guangzhou-Shenzhen trains increased by 26.5% from 16.027 million in 2003 to 20.270 million in 2004. The number of passengers travelling on the high-speed passenger trains between Guangzhou and Shenzhen increased by 29.4% from 15.170 million in 2003 to 19.630 million in 2004 while the number of passengers travelling on the regular-speed passenger trains between Guangzhou and Shenzhen decreased by 25.4% from 0.857 million in 2003 to 0.640 million in 2004. The revenues from Guangzhou-Shenzhen trains increased by 26.2% from RMB913.4 million in 2003 to RMB1,152.5 million in 2004. The increase in business volume of Guangzhou-Shenzhen trains was mainly due to: (1) the official implementation of CEPA as well as the gradual expansion of scope of the "Relaxed Individual Travel" program to Hong Kong and Macau in more mainland cities resulted in an increase in the number of business persons and tourists traveling via Luohu; (2) the disappearance of the impact of the Severe Acute Respiratory Syndrome ("SARS") epidemic, which had caused significant decrease in the number of passengers in the first half of 2003; (3) the further improvement of the "As-frequent-as-buses" Train Project of the Guangzhou-Shenzhen high-speed passenger trains: the Company increased the frequency of the trains and added stops at the intermediary stations to meet the market demand; (4) the overall refurbishment of passenger stations, which led to further improvement in passenger boarding and disembarking.

- ***Hong Kong Through Trains***

  The number of passengers traveling on the Hong Kong Through Trains of the Company increased by 43.4% from 2.015 million in 2003 to 2.890 million in 2004. Revenues from Hong Kong Through Trains increased by 35.6% from RMB322.3 million in 2003 to RMB436.9 million. The substantial increase in business volume of Through Trains was mainly due to: (1) the official implementation of CEPA as well as the gradual implementation of the "Relaxed Individual Travel" program to Hong Kong and Macau, which led to evident increase in the number of business travellers and tourists traveling between Hong Kong and the Mainland; (2) the operation of two additional pairs of Canton-Kowloon Through Trains in April 2004, the extension of service hours of Through Trains and the promotion of ticketing on-line, which made traveling more convenient; (3) the disappearance of the impact of the SARS epidemic, which had caused significant decrease in the number of passengers in the first half of 2003.

- ***Long-distance trains***

  The number of passengers traveling on long-distance trains of the Company increased by 15.3% from 19.819 million in 2003 to 22.852 million in 2004. The revenues from long-distance trains increased by 20.9% from RMB554.4 million in 2003 to RMB670.2 million. The significant increase in passenger volume of the long-distance train business was mainly due to: (1) the gradual advancement of regional economic cooperation within the Pearl River Delta and the Pan Pearl River Delta as well as the continuous and rapid economic growth in the Pearl River Delta, which led to substantial increase in the number of business travellers, tourists and labourers traveling between Guangzhou and Shenzhen and other provinces; (2) the operation of another three pairs of long-distance trains from Shenzhen to Guilin, Hankou and Shenyang North in April and December 2004, respectively and the large-scale operation of temporary passenger trains during the Spring Festival; (3) the elimination of impact of the SARS epidemic, which caused significant decrease in the number of passengers in the first half of 2003; hence the Company operated all the trains in full schedules and configuration during 2004.

The table below illustrates the revenues from passenger transportation business and the volume of passengers for the year ended December 31, 2004 as compared to those of the same period last year:

	For the year ended December 31,		Change in 2004 compared to 2003
	2004	2003	Increase/(Decrease)
Revenues from passenger transportation *(RMB thousands)*	**2,259,671**	1,790,204	26.2%
— Guangzhou-Shenzhen trains	**1,152,529**	913,444	26.2%
— Hong Kong Through Trains	**436,918**	322,316	35.6%
— Long-distance trains	**670,224**	554,444	20.9%
Total number of passengers *(thousand persons)*	**46,012**	37,861	21.5%
— Guangzhou-Shenzhen trains	**20,270**	16,027	26.5%
— Hong Kong Through Trains	**2,890**	2,015	43.4%
— Long-distance trains	**22,852**	19,819	15.3%
Revenue per passenger *(RMB)*	**49.11**	47.28	3.9%
— Guangzhou-Shenzhen trains	**56.86**	56.99	(0.2%)
— Hong Kong Through Trains	**151.18**	159.96	(5.5%)
— Long-distance trains	**29.33**	27.98	4.8%
Total passenger-kilometres *(millions)*	**4,200.2**	3,295.5	27.5%
Revenue per passenger-kilometre *(RMB)*	**0.54**	0.54	—

Management's Discussion and Analysis

(2) Freight Transportation

Freight transportation is the core business of the Company. The total tonnage of freight transported by the Company in 2004 was 34.199 million tonnes, representing an increase of 24.0% from 27.584 million tonnes in 2003. Revenues from freight transportation business were RMB611.8 million, representing an increase of 16.2% from RMB526.4 million in 2003. In particular:

- ***Outbound freight***

  In 2004, the Company's outbound freight tonnage was 8.241 million tonnes, representing an increase of 27.5% from 6.466 million tonnes in 2003. Outbound freight revenues were RMB113.4 million, representing an increase of 28.8% from RMB88.04 million in 2003. The main reasons for the increase in outbound freight tonnages in 2004 were: (1) the economic growth in the Mainland China created increasing demands for energy and raw materials, such as coal, ore and petroleum imports, etc, which led to greater demand for freight transportation service; (2) the severe crackdown on oversize and overloaded trucks on highways and the implementation of the Road Traffic Safety Law led to increase in price of road transport, as a result, part of the freight shifted to railway transportation; (3) the additional operation of the special container trains from Dongguan to Kowloon and the "5 fixed" (fixed locations, fixed line, fixed time, fixed price and fixed schedule) freight trains, namely from Pinghu South to Chengdu East, etc. led to the significant increase in the transportation of containers; and (4) the end of the SARS epidemic, which and affected the freight transportation business last year.

- ***Inbound and pass-through freight***

  In 2004, the Company's inbound and pass-through freight tonnages were 25.958 million tonnes, representing an increase of 22.9% from 21.118 million tonnes in 2003. Its inbound and pass-through freight revenues were RMB323.1 million, representing an increase of 20.6% from RMB267.8 million in 2003. The increase in inbound and pass-through freight tonnages was mainly due to: (1) the rapid economic growth in the PRC, especially in the Pearl River Delta, which created great demand for raw materials like steel, cement, etc.; (2) the recovery of the global economy, including that of Hong Kong, and the increase of Chinese export volume, led to large increase in the demand of freight transportation; (3) the Chinese government's crackdown on oversize and overloaded trucks on highways, which led to a shift of part of truck freight to railway transportation.

- ***Storage, loading and unloading and other miscellaneous items***

  In 2004, the Company's revenues from storage, loading and unloading and other miscellaneous items were RMB175.3 million, representing an increase of 2.8% from RMB170.5 million in 2003. The increase was mainly due to the relatively large increase in the total tonnage of freight, while the downward adjustments of fares for certain customers and some categories of freight to attract source of freight partly offset the increase in revenues brought about by the increase in freight volume.

Set out below are the Company's revenues from its freight transportation business and the freight volume for the year ended December 31, 2004 as compared with that of the same period in the previous year:

	For the year ended December 31, 2004	2003	Change in 2004 compared to 2003 Increase/(Decrease)
REVENUES FROM FREIGHT TRANSPORTATION *(RMB thousand)*	**611,807**	526,382	16.2%
— Revenues from outbound freight transportation	**113,421**	88,042	28.8%
— Revenues from inbound and pass-through transportation	**323,108**	267,844	20.6%
— Revenues from storage, loading and unloading and other miscellaneous items	**175,278**	170,496	2.8%
TOTAL TONNAGE *(thousand tonnes)*	**34,199**	27,584	24.0%
— Outbound freight tonnage	**8,241**	6,466	27.5%
— Inbound and pass-through freight tonnage	**25,958**	21,118	22.9%
Revenue per tonne *(RMB)*	**17.89**	19.08	(6.2%)
Total tonne-kilometres *(millions)*	**2,489.5**	1,978.9	25.8%
Revenue per tonne-kilometre *(RMB)*	**0.25**	0.27	(7.4%)

(3) Other Businesses

The Company's other businesses mainly consist of sales of goods and food, advertising and tourism services on board and in stations. Revenues from other businesses of the Company in 2004 were RMB166.7 million, representing an increase of 9.9% from RMB151.6 million in 2003. Such increase was mainly due to the increase in passenger volume, which led to the rise of revenues from sales of goods, food and beverages in stations and on board.

The table below sets forth the revenues of other businesses of the Company for the year ended December 31, 2004 compared with that of the same period in the previous year:

	For the year ended December 31,		Change in 2004 compared to 2003
Category of Businesses	**2004**	2003	Increase/(Decrease)
	(RMB thousand)	*(RMB thousand)*	
On-board and station good sales	**48,496**	39,217	23.7%
Station services	**45,206**	41,610	8.6%
Others	**72,969**	70,769	3.1%
Total	**166,671**	151,596	9.9%

3. COST ANALYSIS

In 2004, the total operating expenses of the Company were RMB2,408.0 million, representing an increase of 26.4% from RMB1,905.5 million in 2003, among which the railway operating expenses were RMB2,241.8 million, representing an increase of 27.7% from RMB1,755.9 million in 2003. Other expenses were RMB166.2 million, representing an increase of 11.1% from RMB149.6 million in 2003.

As of December 31, 2004, the analysis of the railway operating expenses of the Company is as follows:

- **Business tax**

  The business tax of 2004 was RMB83.73 million, representing an increase of 76.0% from RMB47.57 million in 2003. The increase was mainly due to: (1) the substantial increase in revenues from passenger and freight transportation in 2004; (2) the exemption of the Company from business tax on its revenue from passenger transportation according to relevant government policies between May 1, 2003 and September 30, 2003 due to the impact of SARS was not available to the Company in 2004.

- **Labor and benefits**

  In 2004, labor and benefits expenses amounted to RMB492.6 million, representing an increase of 41.7% from RMB347.6 million in 2003. The increase was mainly due to: (1) the increase in passenger and freight volume, which led to the corresponding increase in average workload, salaries and welfare expenses; (2) the impact of the SARS epidemic had led to a significant decrease in salaries and welfare expenses in 2003; hence there was an increase in these expenses in 2004.

- **Material and supplies**

  Material and supplies included materials, fuel, water and electricity consumption. In 2004, the Company's material and supplies expenses amounted to RMB245.5 million, representing an increase of 13.2% from RMB217.0 million in 2003. The increase was mainly due to: (1) the increase in the prices of oil and electricity, which caused the increase in the expenses on fuels and electricity used by locomotives and vehicles; (2) the increased consumption of materials and supplies resulted from the additional operation of the high-speed passenger trains between Guangzhou and Shenzhen, Hong Kong Through Trains and temporary passenger trains during the Spring Festival.

- **Depreciation**

  Depreciation expenses of fixed assets increased by 15.3% from RMB290.0 million in 2003 to RMB334.5 million in 2004, which was mainly due to an increase in the Company's fixed assets; hence the depreciation correspondingly increased.

- **Repair expenses (excluding materials and supplies)**

  Repair expenses increased by 141.3% from RMB89.64 million in 2003 to RMB216.3 million in 2004. The main reasons were: (1) the substantial increase in the repair expenses as a result of the replacement of worn-out high-speed rails; (2) the increase in the number of trains, and vehicles that needed overhaul, leading to the increase in equipment repair expenses; (3) the further refurbishment of Guangzhou East Station, Shenzhen Station and passenger stations along the line, causing increase in the repair expenses on buildings.

- **Equipment leases and services**

  The expenses on equipment leases and services mainly consist of the railway line usage fees, train hauling fees and train leasing fees paid to other railway companies (administrations). In 2004, expenses on equipment leases and services of the Company amounted to RMB452.2 million, representing an increase of 3.3% from RMB437.7 million in 2003. This was mainly due to the operation of additional Guangshen high-speed passenger trains and Hong Kong Through Trains as well as the operation of several pairs of temporary long-distance passenger trains during the peak seasons of passenger transportation such as the Spring Festival holidays and Golden Week holidays, which resulted in an increase in the railway line usage fees and train hauling fees. Moreover, the leasing fees of trucks paid to the MOR increased due to the increase in freight transportation.

- **Social services fees**

  Social services fees of the Company in 2004 were RMB84.64 million, representing an increase of 35.3% from RMB62.58 million in 2003. The increase was mainly due to the implementation of segmentation of principal and subordinate businesses reform of railway industry. The hospitals and schools that used to provide medical and education services to the Company were transferred to local authorities, thus the Company had to pay certain amount of subsidy according to government policies.

- **General and administration expenses**

  General and administration expenses on the Company's railway businesses increased by 41.3% from RMB134.7 million in 2003 to RMB190.3 million in 2004. This was mainly due to: (1) the payment of supplemental medical insurance fees and maternity medical premium for all of its employees and the one-off payment of medical insurance premium for retired employees of the Company in accordance with government policies as a result of reform of the medical insurance system; and (2) the increase in provision for bad debt in respect of the deposit with Zengcheng Licheng Urban Credit Cooperative, which was overdue and not recovered.

- **Other expenses**

  The other expenses of the Company in 2004 were RMB126.3 million, representing an increase of 11.4% from RMB113.4 million in 2003. This was mainly due to the increase in other relevant expenses, such as communication services fees and various surcharges for production, as a result of the significant increase in railway passenger and freight volume.

4. TAXATION

As the Company is a corporation incorporated in Shenzhen Special Economic Zone, it is subject to income tax at a rate of 15%. According to relevant tax regulations, other businesses of the Company and its subsidiaries are subject to income tax at the rate of 15% or 33%, depending on the location of incorporation. Income tax expense of the Company and its subsidiaries were RMB98.42 million in 2004, implying an actual tax rate of 14.8%. Income tax expense in 2004 increased by RMB4.98 million from RMB93.44 million in 2003, mainly due to the increase in the Company's profits before tax.

5. ANALYSIS OF FINANCIAL POSITION

Assets, Liabilities and Shareholders' Equity

Set out below are the assets, liabilities and shareholders' equity of the Company and its subsidiaries as at December 31, 2004 compared with that as at December 31, 2003:

	2004 *(RMB thousand)*	2003 *(RMB thousand)*	Increase/(Decrease)
Current assets	**2,988,455**	2,597,986	390,469
Non-current assets	**8,420,596**	8,475,967	(55,371)
Total assets	**11,409,051**	11,073,953	335,098
Current liabilities	**936,865**	699,237	237,628
Non-current liabilities	**—**	—	—
Total liabilities	**936,865**	699,237	237,628
Minority interests	**51,612**	52,358	(746)
Net assets	**10,420,574**	10,322,358	98,216
Share capital	**4,335,550**	4,335,550	—
Reserves	**6,085,024**	5,986,808	98,216
Total shareholders' equity	**10,420,574**	10,322,358	98,216

As of December 31, 2004, total assets of the Company were RMB11,409.1 million, representing an increase of RMB335.1 million from RMB11,074.0 million as of December 31, 2003.

As of December 31, 2004, current assets of the Company were RMB2,988.5 million, representing an increase of RMB390.5 million from RMB2,598.0 million as of December 31, 2003. This was mainly due to the increase in temporary cash investment, trade receivables and materials and supplies in the sum of RMB799.8 million; however, the decline in cash and cash equivalent, trade receivables from connected companies, prepayments and other trade receivables in the amount of RMB409.3 million partly offset the increase in current assets.

As of December 31, 2004, non-current assets of the Company were RMB8,420.6 million, representing a decrease of RMB55.37 million from RMB8,476.0 million as of December 31, 2003. This was primarily due to a decrease in construction-in-progress in the amount of RMB45.08 million and the amortization in land use right fees and the deferred staff costs in the amount of RMB15.70 million and RMB15.09 million, respectively, in 2004.

As of December 31, 2004, all the liabilities of the Company were current liabilities and the total amount was RMB936.9 million, representing an increase of RMB237.6 million from RMB699.2 million in 2003. This was mainly due to the increase in pre-payment and other payables, tax, payments due to related parties, trade payables and payment on constructions in the amount of RMB250.0 million.

As of December 31, 2004, the shareholders' equity of the Company were RMB10,420.6 million, representing an increase of RMB98.22 million from RMB10,322.4 million as of December 31, 2003. This was mainly due to the increase in reserves of RMB98.22 million when compared with that of 2003, which was the balance of net profits of RMB567.5 million in 2004 after deducting dividends of RMB455.2 million declared for 2003 and the expenses in relation to the proposed A share issue and the plan for acquisition of railway business of Yangcheng Railway Company and the related assets and liabilities in the amount of RMB14.04 million in 2004.

As of December 31, 2004, the gearing ratio of the Company was 8.2%.

As of December 31, 2004, the Company had no charge on any of its assets and had not provided any guarantees.

Liquidity and Capital Resources

The principal source of capital of the Company was revenues generated from operations. In 2004, the net cash inflow from the Company's operations were RMB1,236.6 million, representing an increase of RMB438.1 million from RMB798.4 million in 2003. The increase in net cash inflow from the Company's operations was mainly due to the substantial increase in the Company's total revenues.

The Company's capital was mainly used for temporary cash investments, capital and operating expenses and payment of taxes and dividends. In 2004, the Company increased the temporary cash investments in the amount of RMB751.9 million, expended RMB310.2 million on the purchase of fixed assets and construction-in-progress. It also paid RMB84.24 million for income tax and approximately RMB455.0 million for dividends.

The table below sets forth the major items in the consolidated cash flow statements of 2004 and 2003.

	2004 *(RMB thousand)*	2003 *(RMB thousand)*	Increase/(Decrease) *(RMB thousand)*
Net cash inflows from operating activities	**1,236,579**	798,449	438,130
Net cash used in investing activities	**(1,000,639)**	(375,469)	(625,170)
Net cash used in financing activities	**(469,044)**	(433,666)	(35,378)
Net cash and cash equivalents (outflows) inflows	**(233,104)**	(10,686)	(222,418)

The Company has sufficient cash flow and has no commercial loans. The Company has a credit facility of RMB3 billion from China Development Bank, which has not been utilized so far. The Company believes it has sufficient working capital to meet its operation and development requirements.

6. COMMITMENTS

(1) Capital commitments

As of December 31, 2004, the Company had the following capital commitments which were authorized but not contracted for and contracted but not provided for:

	2004 *(RMB thousand)*	2003 *(RMB thousand)*
Authorized but not contracted for	**451,500**	—
Contracted but not provided for	**693,828**	—

(2) Operating lease commitments

Total future minimum lease payments under non-cancellable operating leases were as follows:

	2004 *(RMB thousand)*	2003 *(RMB thousand)*
Machinery and equipment		
— not more than 1 year	**108,000**	108,000
— more than 1 year but not more than 5 years	**75,375**	183,375
	183,375	291,375

The above said operating lease commitments were for leasing eight AC-driving electric passenger trains ("Blue Arrow") with a speed of up to 200 kilometres per hour.

7. FOREIGN EXCHANGE RISK AND HEDGING

The Company currently hold certain amounts of United States dollars and Hong Kong dollars deposits. It also earns revenues in HK dollars from its railway transportation businesses. Dividends to the shareholders of H shares and the holders of ADSs are paid in foreign currencies. Some of the Company's contracts, particularly with respect to the high-speed passenger train projects, are payable by the Company in foreign currencies. If the exchange rate of RMB to the relative foreign currencies fluctuates, the operating results of the Company will be affected. The Company has not entered into any contract for the purpose of hedging.

8. INTEREST RATE RISK

Funds that are not needed for immediate use are placed as temporary cash deposits or time deposits in commercial banks and in the Railway Deposit-taking Centre of the Ministry of Railways (the "MOR"). The Company does not hold any market risk-sensitive instruments for trading purposes. As of December 31, 2004, the Company had no commercial bank loans outstanding. Accordingly, the Company is not exposed to any material interest rate risks.

9. CONTINGENCY

As of December 31, 2004, the Company's interest in an associated company, Guangzhou Tiecheng Enterprise Company Limited ("Tiecheng"), amounted to approximately RMB140 million. In 1996, Tiecheng and a Hong Kong incorporated company jointly established Guangzhou Guantian Real Estate Company Limited ("Guangzhou Guantian"), a sino-foreign cooperative joint venture to develop certain properties near a railway station operated by the Company.

On October 27, 2000, Guangzhou Guantian together with Guangzhou Guanhua Real Estate Company Limited ("Guangzhou Guanhua") and Guangzhou Guanyi Real Estate Company Limited ("Guangzhou Guanyi") agreed to act as joint guarantors of certain payables of Guangdong Guangcheng Real Estate Company Limited ("Guangdong Guancheng") to an independent third party. Guangzhou Guanhua, Guangzhou Guanyi, Guangdong Guancheng and Guangzhou Guantian were related companies with a common chairman. As Guangdong Guancheng failed to repay the payables, according to a court verdict on November 4, 2001, Guangzhou Guantian, Guangzhou Guanhua and Guangzhou Guanyi were liable to the independent third party for an amount of approximately RMB257 million plus interest from Guangdong Guancheng. As such, if Guangzhou Guantian were held responsible for the guarantee, the Company may need to make provision for impairment on its interest in Tiecheng.

On December 15, 2003, the High People's Court of Guangdong Province ("the Court") received Guangzhou Guantian's application for discharging the aforesaid guarantee. As a necessary procedure for the Court to decide whether to grant a re-trial, a hearing was held on March 18, 2004. In this respect, Guangzhou Guantian appointed an independent lawyer to represent its to attend the hearing. Up to the date of this report, the Court has not yet determined whether to grant a re-trial as the necessary procedures have not been completed. However, having consulted that independent lawyer, the directors are of the opinion that the guarantee arrangement should be invalid according to the relevant PRC rules and regulations. Accordingly, the directors consider that as of the date of this report, the chance of Guangzhou Guantian to settle the above claim is remote and no provision for the interest in Tiecheng was made in the accounts. To avoid the possible loss resulting from the litigation, the Company has obtained a letter of undertaking issued by Guangzhou Railway (Group) Company (the parent company of the Company). The Parent Company undertook to resolve through relevant channels or to take up the responsibilities so that the equity interest of the Company in Tiecheng will not be affected by the litigation.

10. OVERDUE TIME DEPOSITS

As of December 31, 2004 the Company had an overdue time deposit in the amount of approximately RMB31.365 million placed with Zengcheng Licheng Urban Credit Cooperative. The Company had initiated legal proceedings and obtained a judgment in its favour regarding the unpaid time deposits. However, as the debtor was undergoing restructuring, the court ordered a stay of execution of the judgment obtained by the Company. The said overdue time deposit accounts for approximately 0.3% of the net assets and 1.05% of the total current assets of the Company and has no material impact on the capital usage and operations of the Company. For prudence, the Company has reclassified such amount to other receivables and made full provision in its financial statements for impairment.

Except for such overdue time deposit, the Company has no other overdue time deposit that has not been repaid. The Company has not encountered any difficulty in withdrawing deposits. The Company has placed its deposits with other commercial banks in the PRC and the Railway Deposit-taking Centre.

11. EMPLOYEES, SALARY DISTRIBUTION POLICY AND TRAINING PLANS

As of December 31, 2004, the Company had in total 8,964 employees, representing a decrease of 65 compared to that of December 31, 2003.

The Company's a salary policy is closely linked to operating results, labour efficiency and individual performance. Employees' salaries distribution is subject to macro-economic control and is based on their post scores and performance reviews. The Company paid approximately RMB492.6 million in salaries and benefits for its railroad businesses in 2004.

Pursuant to applicable state policies and regulations, the employees of the Company enjoy the following benefits: (1) retirement pension — the Company is required to set aside a sum equivalent to 18% of the aggregate amount of the salaries of all of its employees for the year and 5% of the aggregate amount of the salaries of all of its employees for the year as employees' retirement pension and supplemental retirement pension, respectively; (2) basic medical insurance — the Company is required to set aside 8% (for residents in Guangzhou area or along the Guangzhou-Shenzhen route) and 6% (for Shenzhen residents) of the aggregate amount of salaries of all of its employees for the year as employees' basic medical insurance fees; and (3) housing fund — both the Company and its employees are required to deposit 7% (for residents in Guangzhou area or along the Guangzhou-Shenzhen route), or 13% (for Shenzhen residents) of the employee's monthly salary into the employee's personal housing fund account; (4) supplemental medical insurance and maternity medical insurance — the Company is required to set aside 1% and 0.4% (for residents in Guangzhou area or along the Guangzhou-Shenzhen route) and 0.5% and 0.5% (for Shenzhen residents) of the aggregate amount of salaries of all of its employees for supplemental medical insurance and maternity medical insurance, respectively; (5) other welfare fund — the Company is required to set aside 6% (for residents in Guangzhou area or along the Guangzhou-Shenzhen route) and 8% (for Shenzhen residents) of the aggregate amount of salaries of all of its employees for the year as employees' other welfare expenses.

During 2004, the Company provided 338 employees with training on post standardization and 5,799 employees with training on adaptability. Training included the Fifth Great Speed Up Projects in China railways, office automation, etiquette for passenger transportation, safety code of operation, handling of emergency and further education of professionals and technicians. The training plan of 2004 was fully implemented and the total expenses for these training programmes in 2004 were approximately RMB3.36 million.

12. SIGNIFICANT DIFFERENCE FROM NYSE CORPORATE GOVERNANCE STANDARDS

As a foreign private issuer under the U.S. Securities Exchange Act (the "Exchange Act"), the Company is permitted to follow the corporate governance practice of its home country, which the Company considers to be the PRC, in lieu of the provisions of Section 303A of the Listed Company Manual of the New York Stock Exchange (the "NYSE"), except that the Company is required to comply with the requirements of Sections 303A.06, 303A.11 and 303A.12(b) and (c). The Company is currently in compliance with Section 303A.06 of the Listed Company Manual, which requires the Company to have an audit committee that satisfies the requirements of Rule 10A-3 under the Exchange Act. The Company expects to comply with the certification requirements of Sections 303A.12(b) and (c) shortly after it files its annual report on Form 20-F with the Securities and Exchange Commission and, in any event, prior to the deadlines specified by the NYSE.

In accordance with Rule 303A.11 of the Listed Company Manual of the New York Stock Exchange (the "NYSE"), the following is a summary of the significant ways in which the corporate governance practices of the Company differ from those followed by a U.S. domestic company in compliance with applicable corporate governance rules of the NYSE.

1. According to the Audit Committee Charter, the members of the audit committee, who are all non-management directors, shall meet at lease four times a year pursuant to the schedule determined by the audit committee.

2. the Company does not have a nominating committee or a corporate governance committee similar to that required for U.S. domestic companies under Section 303A.04 of the Listed Company Manual;

3. the Company does not have a compensation committee similar to that required for U.S. domestic companies under Section 303A.05 of the Listed Company Manual. Under the Corporate Governance Code implemented by the HKSE in January 2005, there is mandatory requirement for a company listed on the HKSE to have a remuneration committee composed of a majority of independent non-executive directors.

4. the Company does not have formal corporate governance guidelines similar to those required for U.S. domestic companies under Section 303A.09 of the Listed Company Manual. However, in accordance with applicable PRC laws and regulations and the HKSE Listing Rules, the Company has adopted its Articles of Association, the General Meeting System, the Working Ordinance for the Board of Directors, the Working Ordinance for the Board of Supervisors, the Working Ordinance for the General Manager, the Capital Management Measures, the Investment Management Measures, the Code of Ethics for Senior Officers and the Audit Committee Charter that contain provisions which address the following subjects:

   - director qualification standards and responsibilities;
   - key board committee responsibilities;
   - director access to management and, as necessary and appropriate, independent advisors;
   - director compensation;
   - management succession; and
   - director orientation and continuing education;

   In addition, as a company listed on the HKSE, the Company is required to comply with applicable corporate governance and other related requirements of the HKSE Listing Rules, including the Corporate Governance Code, unless an exemption is available.

5. The Company has not adopted a code of business conduct and ethics for its directors, officers and employees similar to that required for U.S. domestic companies under Section 303A.10 of the Listed Company Manual. The Company has implemented code of business conduct and ethics for senior management, including its General Manager, Deputy General Manager, Chief Accountant, Chief Engineer and Company Secretary. A translation of the Company's Code of Ethics for Senior Officers has been filed as an exhibit to its annual report on Form 20-F for the fiscal year ended December 31, 2003. In addition, the directors of the Company are required to comply with the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") set out in the HKSE Listing Rules, which sets out standards with which directors are required to comply with respect to transactions involving securities of the Company.