



Management Discussion and Analysis

BUSINESS REVIEW

For the year ended 31 December, 2006, the Group recorded a turnover of RMB30,502,378,000, representing an increase of 7.5% as compared to the previous year; profit before income tax was RMB1,142,561,000, representing a decrease of 73.5% as compared to the last year; profit attributable to equity holders amounted to RMB859,210,000, representing a decrease of 76.0% as compared to the last year; loaded cargo volume for the whole year amounted to 5,657,955 TEU, representing an increase of 23.1% as compared to the last year. For the year ended 31 December, 2006, the average freight rate per TEU of the Group amounted to RMB5,295, representing a decrease of 12.5% as compared to the previous year.

As at 31 December, 2006, the total shipping capacity of the Group reached 398,974 TEU. The shipping capacity for the year increased 14.7% as compared to the last year.

FINANCIAL REVIEW

TURNOVER

The Group's turnover increased by RMB2,127,698,000 or 7.5% from RMB28,374,680,000 for the year ended 31 December, 2005 to RMB30,502,378,000 for the year ended 31 December, 2006. The increase in turnover was primarily due to:

- *Increased volume of loaded cargoes*

The volume of loaded cargoes for the year ended 31 December, 2006 amounted to 5,657,955 TEU, representing an increase of 23.1% as compared to year 2005 as a result of the increased cargo volume in several main trade lanes including the American trade lane, the Middle East trade lane and domestic trade lanes as well as the enhanced shipping capacity on major trade lanes and the improving of the overall structure of the global trade lanes through the deployment of new and large container vessels.

ANALYSIS OF LOADED CONTAINER VOLUME BY TRADE LANES

Principal Market	2006 (TEU)	2005 (TEU)	Change
North America	1,356,657	1,092,118	24.2%
South America	75,908	32,723	132.0%
Europe/Mediterranean	1,351,670	1,219,384	10.8%
Australia	181,526	194,216	-6.5%
East Asia/Southeast Asia	604,164	572,215	5.6%
China domestic	1,712,679	1,402,272	22.1%
Middle East	236,204	9,905	2284.7%
Others	139,147	74,562	86.6%
	5,657,955	4,597,395	23.1%

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- *Freight rate:*

The Group's average freight rate per TEU for the year 2006 amounted to RMB5,295, representing a decrease of 12.5% as compared to year 2005. In particular, the average freight rate per TEU for international trade lanes recorded a decrease of about 13.8% as compared to year 2005 to RMB6,980.



The main reason for the decrease in international trade lanes was that in 2006, the great decrease of freight rates for Europe/Mediterranean trade lanes dragged down the average freight rate for the whole year. The average freight rate per TEU for domestic trade lanes increased by RMB30 as compared to the same period last year to RMB1,413 mainly due to the inauguration of quality trade lanes for domestic trade by the Group, which in turn resulted in an increase in freight rates for domestic trade lanes.

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OPERATING COSTS

For the year ended 31 December, 2006, total operating costs amounted to RMB28,391,606,000, representing an increase of 21.7% as compared to year 2005. However, operating costs, on a per TEU basis, decreased by 1.1% as compared to year 2005 to RMB5,018. The increase in the total operating costs was mainly due to:

- Container and cargo costs increased by 22.1% from RMB10,473,989,000 in 2005 to RMB12,789,231,000 mainly due to the increase in the volume of loaded cargoes. Port charges amounted to RMB2,256,495,000, representing an increase of 21.5% as a result of extended services, higher voyage frequencies and increase in port calling and canal passing frequency. The stevedore charges for loaded and empty containers amounted to RMB7,980,690,000, representing an increase of 22.7%, principally due to the increase in the volume of loaded cargoes in the international and domestic trade lanes and repositioning of empty containers.
- Vessel and voyage costs amounted to RMB10,280,565,000 for the year ended 31 December, 2006, representing an increase of 32.6% as compared to year 2005. To a certain extent, vessel and voyage costs per TEU decreased with the deployment of large vessels which were ordered by the Group at low costs during the down cycle of the shipping industry. However, with the continuously high rise in fuel price in 2006, the annual average closing price of crude oil in the New York commodity exchange was USD66.2 per barrel, representing an increase of 16.9% as

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compared to year 2005. Moreover, there were additional vessels deployed and put into operation. Accordingly fuel and oil costs amounted to RMB6,311,076,000, representing an increase of 44.0% as compared with the year 2005. As a result, the Group's vessel and voyage costs per TEU increased by RMB130.6 or 7.7% from RMB1,686.4 in 2005 to RMB1,817.0 in 2006.

- Sub-route and other costs amounted to RMB5,321,810,000, representing an increase of 4.3% as compared to year 2005. The increase was mainly due to an increase in volume of sub-route services and expense in employee welfare.

GROSS PROFIT

Due to the above reasons, the Group recorded a gross profit of RMB2,110,772,000 in 2006, representing a decrease of RMB2,932,776,000 or 58.1% as compared to year 2005.

INCOME TAX EXPENSE

The Company is a joint stock limited company under the Company Law of the PRC and was registered in the Pudong New District, Shanghai, the EIT rate applicable to the Company is 15%. The Company's subsidiaries incorporated in the PRC are subject to EIT at a rate ranging from 0% to 33% for the year ended 31 December, 2006. The profits derived by the Company's overseas subsidiaries are subject to EIT at a fixed rate of 16.5%, as approved by the tax bureau, on the profits of the overseas subsidiaries for EIT purpose.

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ADMINISTRATIVE AND GENERAL EXPENSES

For the year ended 31 December, 2006, the Group's administrative and general expenses were RMB573,912,000, representing an increase of 4.1% as compared to year 2005. This was mainly due to an increase in employee costs.

PROFIT ATTRIBUTABLE TO EQUITY HOLDERS

Due to the above reasons, the profit attributable to the equity holders of the Company decreased by RMB2,723,572,000 or 76.0% from RMB3,582,782,000 in 2005 to RMB859,210,000 in 2006.

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LIQUIDITY AND FINANCIAL RESOURCES

The Group's principal sources of working capital have been the cash flow from operations and bank borrowings. Cash is mainly used in financing operating costs, new vessels, purchase of containers, payment of dividends and the repayment of principal and interest for bank borrowings and finance leases.

As at 31 December, 2006, the Group's total bank loans were RMB6,645,760,000. The maturity profile is spread over a period between 2007 and 2019, with RMB1,107,608,000 repayable within one year, RMB707,608,000 in the second year, RMB4,079,808,000 in the third to fifth year, and RMB750,736,000 after the fifth year. The Group's long-term bank loans are mainly used for the purchase of new vessels and containers.

As at 31 December, 2006, the long-term bank loans were secured by mortgages over several container vessels, vessels under construction and containers with a net book value of RMB7,009,915,000 (31 December, 2005: RMB6,727,496,000), charges over shipbuilding contracts and shares of certain vessel owning subsidiaries.

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As at 31 December, 2006, the Group had RMB loans at fixed interest rates in the amount of RMB4,283,940,000 and USD loans at floating interest rates in the amount of RMB2,361,820,000. The Group's loans are primarily denominated in RMB and US dollars while cash and cash equivalents are also denominated in these two currencies.

As at 31 December, 2006, the Group's obligations under finance leases amounted to RMB3,894,973,000 (as compared with RMB2,863,655,000 as at 31 December, 2005). The maturity profile is spread as follows: the amount repayable within one year is RMB695,724,000, the amount repayable in the second year is RMB664,694,000, the amount repayable in the third to fifth year is RMB1,731,693,000 and the amount repayable after the fifth year is RMB802,862,000. All the finance lease obligations payable are arranged for the lease of containers.

NET CURRENT ASSETS

As at 31 December, 2006, the Group's net current assets amounted to RMB2,546,463,000.

Current assets mainly comprised bunkers of RMB635,735,000, trade and notes receivables of RMB3,490,403,000, prepayments and other receivables of RMB97,984,000 and cash and cash equivalents of RMB2,915,542,000.

Current liabilities mainly comprised trade and notes payables of RMB2,205,055,000, accrual and other payables of RMB515,189,000, income tax payable of RMB69,625,000, long-term bank loans-current portion of RMB707,608,000, finance lease obligations-current portion of RMB695,724,000 and short-term borrowing of RMB400,000,000.

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CASH FLOWS

For the year ended 31 December, 2006, the Group's net cash generated from operating activities was RMB2,765,663,000, denominated principally in RMB, US dollars and Hong Kong dollars, and which represented a decrease of RMB2,375,485,000 from year 2005. Cash and cash equivalent balances at the end of year 2006 decreased by RMB507,831,000 as compared to the same period last year, mainly reflecting the net cash used in financing activities and investing activities in construction of vessels and containers, payment of dividends, repayment of principal and interest for bank borrowings and repayment of finance leases obligations exceeded the net cash generated from operating activities. Net cash generated from operations, when not needed for working capital requirements, is principally held as short-term and demand deposits.

The following table provides information regarding the Group's cash flows for the reporting periods.

	For the year ended	
	31 December,	
	2006	2005
	RMB	RMB
Net cash generated from operating activities	2,765,663,000	5,141,148,000
Net cash used in investing activities	(3,686,690,000)	(4,997,605,000)
Net cash generated from/(used in) financing activities	413,196,000	(2,583,661,000)
Net decrease in cash and cash equivalents	(507,831,000)	(2,440,118,000)

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NET CASH GENERATED FROM OPERATING ACTIVITIES

For the year ended 31 December, 2006, the net cash generated from operating activities was RMB2,765,663,000, representing a decrease of RMB2,375,485,000 from RMB5,141,148,000 in 2005. The decrease was mainly due to the increase in operating costs and decrease in the gross profit. The net cash generated from operations for 2006 was RMB2,975,706,000, representing a decrease of 43.9% as compared with RMB5,304,218,000 in 2005. Whereas, the payment of income tax within the stipulated period increased by RMB46,973,000 or 28.8% as compared to the last year.

NET CASH USED IN INVESTING ACTIVITIES

For the year ended 31 December, 2006, net cash used in investing activities was RMB3,686,690,000, representing a decrease of RMB1,310,915,000 from RMB4,997,605,000 in 2005. The decrease was mainly due to the decrease in the Group's capital expenditure on vessels and other construction in progress of RMB3,671,894,000 (2005: RMB5,088,539,000).

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NET CASH GENERATED FROM FINANCING ACTIVITIES

For the year ended 31 December, 2006, net cash generated from financing activities was RMB413,196,000, representing a net increase of RMB2,996,857,000 as compared to the net cash used in financing activities of RMB2,583,661,000 in 2005.

AVERAGE DEBTOR TURNOVER

The Group's average debtor turnover days were similar to last year, mainly due to management's effort to strengthen credit control over settlement from customers.

GEARING RATIO

As at 31 December, 2006, the Group's gearing ratio (i.e. the ratio of net debt over shareholder's equity) was 46.0%, which is higher than the 30.4% as at 31 December, 2005. The main reason for the higher level of the gearing was capital expenditure on construction of vessels and containers and payment of dividends exceeded net cash inflow from operating activities.

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FOREIGN EXCHANGE RISK AND HEDGING

Most of the revenue of the Group are settled or denominated in US dollars and most of the operating expenses are also settled or denominated in US dollars. As a result, the negative impact on the operating income due to the continuous appreciation of RMB can be offset by each other to a certain extent. With the RMB appreciation, monetary net assets including cash and cash equivalents in US dollars and HK dollars continued to depreciate. During the year, the Group devoted much effort to improve the currency structure of such assets, as a result, the exchange losses of the Group was controlled to RMB19,034,000 and the exchange difference attributable to equity holders amounted to RMB194,233,000. The Group continues to monitor the exchange rate fluctuation of RMB, convert net cash inflow from operating activities into RMB in a timely manner so as to minimise foreign currency risk. The Group will continue to implement the policy of timely conversion of foreign currency assets into RMB, reducing the net currency assets denominated in foreign currency and consider appropriate measures including making hedging arrangements (e.g. forward exchange contracts), based on its operating needs to mitigate the Group's currency exposure. However, as at 31 December, 2006, the Group had not entered into any hedging arrangement including any forward exchange contracts.

CAPITAL EXPENDITURE

During the year ended 31 December, 2006, capital expenditure excluding capitalised interest on vessels and vessels under construction amounted to RMB2,114,654,000, improvement on vessels under operating leases RMB3,855,000, development of information system RMB31,697,000, containers RMB1,504,630,000, motor vehicles RMB2,513,000 and office equipment RMB14,545,000.

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CAPITAL COMMITMENTS

As at 31 December, 2006, the Group had contracted but not provided for capital commitments of approximately RMB4,100,999,000 for vessels under construction. It is expected that part of the commitments will be financed by cash generated from operating activities, with the remaining portion by bank borrowings.



CONTINGENT LIABILITIES

As at 31 December, 2006, the Group did not have any material contingent liabilities.

EMPLOYEES, TRAINING AND BENEFITS

As at 31 December, 2006, the Group had 3,526 employees, representing an increase of 79 employees compared to year 2005. Staff cost was approximately RMB739,498,000 (including a provision for the year of RMB1,432,000 in relation to the H share share appreciation rights (the "Rights") granted to the Company's directors and employees). In addition, the Group entered into contracts with a number of subsidiaries of China Shipping, pursuant to which those companies provided the Group with approximately 3,370 crew members in aggregate who mainly worked on the Group's self-owned or bare-boat chartered vessels.

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Remuneration of the Group's employees includes basic salaries, other allowances and performance bonuses. The Group also adopts a performance discretionary incentive scheme for its staff. The scheme links up the financial benefits of the Group's staff with certain business performance indicators. Such indicators may include but not limited to the profit target of the Group.

Details of the performance discretionary incentive scheme vary among the members of the Group. The Group sets out certain performance indicators for each of its subsidiaries to achieve. Each subsidiary has the discretion to formulate its own detailed performance related remuneration policies according to its local circumstances.

The Group has adopted a compensation scheme, which is to be satisfied by cash payments and is share-based, known as the H Share Share Appreciation Rights Scheme (the "Scheme"). The fair value of services provided by the employees of the Company who are granted Rights is recognised as an expense of the Company. Employees might in the future be entitled to a compensation in the form of a cash payment, which is calculated based on the appreciation in the price of the Company's share from the date of grant to the date of exercise.