



**Management's  
Discussion  
and Analysis**

## Management's Discussion and Analysis



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This discussion and analysis should be read in conjunction with the audited consolidated financial statements of the Company and the accompanying notes. The consolidated results of the Company and its subsidiaries for the year ended December 31, 2006 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).

### 1. BUSINESS OVERVIEW

In 2006, the demand for railway transportation services has been strong due to the continuous and rapid growth in China's economy. The Company captured market opportunities, strengthened marketing efforts, adjusted transportation organization, endeavored to increase transportation efficiency and addressed cost control, resulting in a stable growth in the profitability and operating results. In 2006, the total revenues of the Company were RMB3,594.5 million, representing an increase of 9.7% from RMB3,276.9 million in 2005. Among which, revenues from passenger transportation service, freight transportation service and other businesses were RMB2,841 million, RMB624.8 million and RMB128.6 million respectively, accounting for 79.0%, 17.4% and 3.6% of the total revenues of the Company, respectively. In 2006, profit attributable to equity holders of the Company was RMB771.5 million, representing an increase of 19.2% from RMB647 million in 2005.

### 2. BUSINESS ANALYSIS

#### (1) Passenger Transportation

Passenger transportation business is the most important business of the Company. As of December 31, 2006, the Company operated 123 pairs of passenger trains in accordance with its daily train schedule, representing an increase of one pair from the number in operation at the end of 2005. There were 67 pairs of high-speed passenger trains between Guangzhou and Shenzhen; two pairs of regular-speed passenger trains between Guangzhou and Shenzhen; 13 pairs of Hong Kong Through Trains and 41 pairs of long-distance passenger trains, an increase of one pair.

*\*Note:* 67 pairs of high-speed trains between Guangzhou and Shenzhen included 10 standby pairs; 13 pairs of Hong Kong Through Trains included 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 counted as one pair of Through Trains as they operate on alternate days).

## Management's Discussion and Analysis

In 2006, the Company's total number of passengers was 51.923 million, representing an increase of 5.8% from 49.058 million in 2005. Its revenue from passenger transportation was RMB2,841 million, representing an increase of 13.1% from RMB2,511.2 million in 2005, among which:

- ***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 3.3% from 21.529 million in 2005 to 22.243 million in 2006. The number of passengers travelling on the high-speed passenger trains between Guangzhou and Shenzhen increased by 5.4% from 21.084 million in 2005 to 22,226 million in 2006; while the number of passengers travelling on the regular-speed passenger trains between Guangzhou and Shenzhen decreased by 96.2% from 0.445 million in 2005 to 0.017 million in 2006. The revenues from Guangzhou-Shenzhen trains increased by 10.0% from RMB1,219.8 million in 2005 to RMB1,341.7 million in 2006. The increase in business volume of Guangzhou-Shenzhen trains was mainly due to: (1) the strong economic growth in the Pearl River Delta, which resulted in the upward flows of business persons, tourists and workers; (2) the vigorous optimization of transportation organization, the increase in the frequency of trains and the introduction of IC Card Ticketing System for the convenience of passengers; (3) the gradual improvement of the metro systems in Guangzhou and Shenzhen, which boosted the railway passenger volume; (4) the promotion of our passenger transportation service, enhancement of service level and the improvement of boarding environment for passengers.

- ***Hong Kong Through Trains***

The number of passengers travelling on the Hong Kong Through Trains of the Company increased by 4.6% from 3.065 million in 2005 to 3.207 million in 2006. Revenues from Hong Kong Through Trains decreased by 0.8% from RMB457.7 million in 2005 to RMB454.2 million in



## Management's Discussion and Analysis

2006. The decrease in revenue of Hong Kong Through Trains was mainly due to the ticket price of Hong Kong Through Trains is set out in HKD and the exchange rate of HKD to RMB continues to decrease.

- ***Long-distance trains***

The number of passengers travelling on the long-distance trains of the Company increased by 8.2% from 24.463 million in 2005 to 26.473 million in 2006. The revenue from long-distance trains increased by 25.4% from RMB833.7 million in 2005 to RMB1,045.2 million in 2006. The increase in business volume of the long-distance trains was mainly due to: (1) the continuing increase in the number of business persons and workers from inland as a result of the continuous and rapid economic growth in the Pearl River Delta; (2) in addition to the large-scale operation of temporary passenger trains during the Spring Festival season, long-distance trains from Shenzhen to Shanghai had been in operation since January 2006 and the operation of Shenzhen-Shaoguan trains was handed over to the Company in May 2006; (3) the Shenzhen-Jian trains and Shenzhen-Taizhou trains that commenced operation in July 2005 were in full operation throughout 2006.



## Management's Discussion and Analysis

The table below illustrates the revenues from passenger transportation business and the volume of passengers for the year ended December 31, 2006 as compared to those of the same period in 2005:

	For the year ended December 31,		Increase (Decrease)
	2006	2005	
Revenues from passenger transportation (RMB thousands)	<b>2,841,045</b>	2,511,156	13.1%
— Guangzhou-Shenzhen trains	<b>1,341,685</b>	1,219,758	10.0%
— Hong Kong Through Trains	<b>454,150</b>	457,728	(0.8%)
— Long-distance trains	<b>1,045,210</b>	833,670	25.4%
Total number of passengers (thousand persons)	<b>51,923</b>	49,058	5.8%
— Guangzhou-Shenzhen trains	<b>22,243</b>	21,529	3.3%
— Hong Kong Through Trains	<b>3,207</b>	3,065	4.6%
— Long-distance trains	<b>26,473</b>	24,463	8.2%
Revenue per passenger (RMB)	<b>54.72</b>	51.19	6.9%
— Guangzhou-Shenzhen trains	<b>60.32</b>	56.66	6.5%
— Hong Kong Through Trains	<b>141.61</b>	149.29	(5.1%)
— Long-distance trains	<b>39.48</b>	34.08	15.9%
Total passenger-kilometers (millions)	<b>4,842.7</b>	4,539.10	6.7%
Revenue per passenger-kilometer (RMB)	<b>0.59</b>	0.55	7.3%



## Management's Discussion and Analysis

### (2) Freight Transportation

Freight transportation is one important business of the Company. In 2006, benefited from tariff hikes, the operating results of freight transportation business of the Company grew despite the decrease in total freight tonnage. The total tonnage of freight transported by the Company in 2006 was 30.708 million tonnes, representing a decrease of 3.7% from 31.893 million tonnes in 2005. Revenues from freight transportation business were RMB624.8 million, representing an increase of 6.2% from RMB588.3 million in 2005, among which:

- **Outbound freight**

In 2006, the Company's outbound freight tonnage was 7.582 million tonnes, representing a decrease of 10.4% from 8.460 million tonnes in 2005. Outbound freight revenues were RMB144.8 million, representing an increase of 3.9% from RMB139.3 million in 2005.

- **Inbound and pass-through freight**

In 2006, the Company's inbound and pass-through freight tonnages were 23.125 million tonnes, representing a decrease of 1.3% from 23.433 million tonnes in 2005; its inbound and pass-through freight revenues were RMB331.5 million, representing an increase of 7.6% from RMB308.0 million in 2005.

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

In 2006, the Company's revenues from storage, loading and unloading and miscellaneous items were RMB148.5 million, representing an increase of 5.3% from RMB141.0 million in 2005.

Set out below are the Company's revenues from its freight transportation business and the freight volume for the year ended December 31, 2006 as compared with those of the same period in 2005:

	For the year ended December 31,		
	2006	2005	Increase/ (Decrease)
REVENUES FROM FREIGHT			
TRANSPORTATION ( <i>RMB thousands</i> )	<b>624,839</b>	588,310	6.2%
— Outbound freight transportation	<b>144,848</b>	139,340	3.9%
— Inbound and pass-through freight transportation	<b>331,477</b>	307,962	7.6%
— Storage, loading and unloading and miscellaneous items	<b>148,514</b>	141,008	5.3%
TOTAL TONNAGE ( <i>thousand tonnes</i> )	<b>30,708</b>	31,893	(3.7%)
— Outbound freight	<b>7,582</b>	8,460	(10.4%)
— Inbound and pass-through freight	<b>23,125</b>	23,433	(1.3%)
Revenue per tonne ( <i>RMB</i> )	<b>20.35</b>	18.45	10.3%
Total tonne-kilometres ( <i>millions</i> )	<b>2,276.3</b>	2,294.8	(0.8%)
Revenue per tonne-kilometre ( <i>RMB</i> )	<b>0.27</b>	0.26	3.8%

## Management's Discussion and Analysis

### (3) Other businesses

The Company's other businesses mainly consist of on-board and in-station sales of goods and food, advertising and tourism services. Revenues from other businesses of the Company in 2006 were RMB128.6 million, representing a decrease of 27.5% from RMB177.5 million in 2005. The substantial decrease in revenues from other businesses was due to the slash of part of the non-profitable businesses in the consolidation of other businesses.

The table below sets forth the revenues from other businesses of the Company for the year ended December 31, 2006 compared with those of the same period in 2005:

*Unit: RMB thousands*

Category of Businesses	For the year ended December 31,		
	2006	2005	Increase/ (Decrease)
On-board and in-station sales of goods	33,846	29,172	16.0%
Station services	29,814	39,430	(24.4%)
Others	64,930	108,860	(40.1%)
Total	<b>128,590</b>	<b>177,462</b>	<b>(27.5%)</b>

### 3. COST ANALYSIS

In 2006, the total operating expenses of the Company were RMB2,693.9 million, representing an increase of 6.5% from RMB2,529.7 million in 2005, among which, the railway operating expenses were RMB2,527.9 million, representing an increase of 8.1% from RMB2,339.4 million in 2005. Expenses of other businesses were RMB166 million, representing a decrease of 12.8% from RMB190.3 million in 2005.

For the year ended December 31, 2006, the railway operating expenses of the Company mainly include:

- **Business tax**

The business tax for 2006 was RMB98.57 million, representing an increase of 13.9% from RMB86.57 million in 2005. Such increase was due to the increase in the revenues of the Company.

- **Labor and benefits**

In 2006, labor and benefits expenses amounted to RMB718 million, representing an increase of 20.2% from RMB597.3 million in 2005. The increase was mainly due to: (1) the additional operation of long-distance passenger trains during the year, which led to the increase in the workload of related operation staff; (2) the implementation of the performance based salary policy; steady increase of operating results in 2006 resulted in the overall increase in employees' salaries and benefits.

## Management's Discussion and Analysis

- **Equipment leases and services**

In 2006, expenses on equipment leases and services of the Company amounted to RMB633 million, representing an increase of 24.7% from RMB507.6 million in 2005. This was mainly due to: (1) the additional operation of long-distance passenger trains, which led to the corresponding increase in railway usage fees; and (2) the increase in the number of temporary passenger trains operated during the Spring Festival season in 2006, which led to the increase of related equipment leases and services fees.

- **Materials and supplies**

Materials and supplies include materials, fuel, water and electricity consumption. In 2006, the Company's materials and supplies expenses amounted to RMB268.3 million, representing a decrease of 5.5% from RMB283.9 million in 2005. The main reason for the decrease was the reduction of materials used in repairment.

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

Repair expenses (excluding materials and supplies) decreased by 19.2% from RMB263.0 million in 2005 to RMB212.4 million in 2006. The decrease was mainly due to the decrease in railway repair workload contracted out this year.

- **Depreciation**

Depreciation expenses of fixed assets increased by 9.8% from RMB289.2 million in 2005 to RMB317.4 million in 2006, which was mainly due to the increase in the fixed assets of the Company.

- **Social services fees**

Social services fees of the Company in 2006 were RMB74.52 million, generally equal to RMB78.23 million of 2005.

- **Utility and Office expenses**

General and administration expenses of the Company in 2006 were RMB102.9 million, representing a decrease of 6.2% from RMB109.7 million in 2005. The decrease was mainly due to the decrease in the provision for impairment.



## Management's Discussion and Analysis

### 4. TAXATION

As the Company is a corporation incorporated in the Shenzhen Special Economic Zone, it is subject to an income tax at a rate of 15%. According to relevant taxation regulations, other businesses of the Company and its subsidiaries are subject to an income tax at the rate of 15% or 33%, depending on the location of incorporation. Income tax expenses of the Company and its subsidiaries were RMB149.2 million in 2006, implying an effective tax rate of 16.2%, increased by 35% from RMB110.2 million in 2005, which was mainly due to the increase in profit before tax of the Company.

### 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, 2006 compared with those as at December 31, 2005:

*Unit: RMB thousands*

	<b>December 31, 2006</b>	December 31, 2005 Restated	Increase/ Decrease
Current assets	<b>6,515,273</b>	2,473,931	163.4%
Non-current assets	<b>17,827,846</b>	9,382,539	90.0%
Total assets	<b>24,343,119</b>	11,856,470	105.3%
Current liabilities	<b>2,236,470</b>	2,006,807	11.4%
Non-current liabilities	<b>1,886,719</b>	4,830	38,962.5%
Total liabilities	<b>4,123,189</b>	2,011,637	105.0%
Minority interests	<b>50,922</b>	48,757	4.4%
Total shareholders' equity	<b>20,169,008</b>	9,796,076	105.9%
Share capital	<b>7,083,537</b>	4,335,550	63.4%
Reserves	<b>13,085,471</b>	5,460,526	139.6%
Total shareholders' equity	<b>20,219,930</b>	9,844,833	105.4%

As of December 31, 2006, total assets of the Company were RMB24,343.1 million, representing an increase of RMB12,486.6 million from RMB11,856.5 million as of December 31, 2005. The increase in the total assets was mainly due to the A Share offering and the construction of the Fourth Rail Line.

As of December 31, 2006, current assets of the Company were RMB6,515.3 million, representing an increase of RMB4,041.4 million from RMB2,473.9 million as of December 31, 2005. This was mainly due to the increase in cash and cash equivalents in a sum of RMB4,739.7 million, as a result of the completion of the A share offering of the Company.

## Management's Discussion and Analysis

As of December 31, 2006, non-current assets of the Company were RMB17,827.8 million, representing an increase of RMB8,445.3 million from RMB9,382.5 million as of December 31, 2005. This was primarily due to an increase in the amount of RMB8,152.4 million for construction-in-progress, prepayment and deferred acquisition costs relating to a business combination for acquiring certain railway assets from a related company.

As of December 31, 2006, the current liabilities of the Company were RMB2,236.5 million, representing an increase of RMB229.7 million from RMB2,006.8 million in 2005. This was mainly due to the increase in trade payables, payables for construction-in-progress, accrued expenses and other payables, tax payable and housing fund payable in a total sum of RMB1,183.3 million and the decrease in the amounts due to related parties in a sum of RMB953.2 million.

As of December 31, 2006, the shareholders' equity of the Company was RMB20,219.9 million, representing an increase of RMB10,375.1 million from RMB9,844.8 million as of December 31, 2005. This was mainly due to the increase in share capital and reserves in a sum of RMB10,372.9 million when compared with that of 2005, as a result of the A share offering.

As of December 31, 2006, the gearing ratio of the Company was 16.9%.

As of December 31, 2006, the Company had no charge on any of its assets and had not provided any guarantees.

### Liquidity and capital resources

In 2006, the principal source of capital of the Company were revenues generated from operations and A share issue. In 2006, the net cash flow from the Company's operations was RMB1,112 million, representing a decrease of RMB268.1 million from RMB1,380.1 million in 2005.

The Company's capital was mainly used for capital and operating expenses and payment of taxes and dividends. In 2006, the Company spent RMB3,202.7 million on purchase of fixed assets and construction-in-progress. It also paid RMB117.2 million for income tax and approximately RMB520.7 million for dividends.

The table below sets forth the comparisons of the major items in the consolidated cash flow statements of 2006 and 2005.

**Unit: RMB thousands**

	2006	2005	Increase/ (Decrease)
Net cash inflows from operating activities	1,112,004	1,380,147	(268,143)
Net cash from (used in) investment activities	(7,833,331)	(820,915)	(7,012,416)
Net cash from (used in) financing activities	11,461,030	(491,733)	11,953,036
Net cash and cash equivalents inflows	<u>4,739,703</u>	<u>67,499</u>	<u>4,672,204</u>

The Company believes it has sufficient working capital to meet its operation and development requirements.

## Management's Discussion and Analysis

### 6. COMMITMENTS

#### (1) Capital commitments (except for (2))

As of December 31, 2006, the Company had the following capital commitments which were authorized but not contracted for and contracted but not provided for:

*Unit: RMB thousands*

	2006	2005
Authorized but not contracted for	1,384,287	3,985,253
Contracted but not provided for	<u>3,137,581</u>	<u>3,331,311</u>

A substantial amount of these commitments is related to the construction of the Fourth Rail Line and purchase of new locomotives.

#### (2) Capital commitments relating to the acquisition of net assets of Yangcheng Railway

Please refer to Note 36 for details.

#### (3) Operating lease commitments

As of December 31, 2006, the total future minimum lease payments under non-cancellable operating leases were as follows:

*Unit: RMB thousands*

	2006	2005
Machinery and equipment	69,673	75,375
— not more than 1 year	69,673	75,375
— more than 1 year but not more than 5 years	<u>—</u>	<u>—</u>

### 7. FOREIGN EXCHANGE RISK AND HEDGING

The Company currently holds a certain amount of United States dollars ("USD") and Hong Kong dollars ("HKD") deposits. It also earns revenues in HKD from its railway transportation businesses. Dividends to the shareholders of H shares and ADSs are paid in foreign currencies. The Company also pays foreign currencies for the purchase of equipment from abroad and overseas agency services. If there are changes in our foreign currency deposits, the mode of payment or relatively strong fluctuations in the exchange rate of RMB to the relative foreign currencies, the operating results of the Company will be affected. In 2006, the fluctuations in the exchange rate led to a book loss of foreign exchange of the Company in the amount of approximately RMB13.68 million due to the continuous revaluation of RMB against USD and HKD.

## Management's Discussion and Analysis

### 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 Center of the MOR. The Company does not hold any market risk-sensitive instruments for trading purposes. In order to finance the construction of infrastructure and large asset purchases, the Company has obtained loans with commercial banks. If there are relatively strong fluctuations in the rates of interest for the relevant deposits or loans, the operating results of the Company will be affected. Details of the loans of the Company in 2006 are set out in "Bank Borrowings" in the Report of Directors of this annual report.

### 9. POTENTIAL IMPAIRMENT LOSS IN INVESTMENT IN AN ASSOCIATE

As of December 31, 2006, the Company's investment interest in an associated company, Guangzhou Tiecheng Enterprise Company Limited ("Tiecheng"), amounted to approximately RMB140 million (at cost). 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 debts of Guangzhou Guancheng Real Estate Company Limited ("Guangzhou Guancheng") to an independent third party. Guangzhou Guantian, Guangzhou Guanhua, Guangzhou Guanyi and Guangzhou Guancheng were related companies with a common chairman. As Guangzhou Guancheng failed to repay the debts, according to a court judgment 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 together with any accrued interest. As such, if Guangzhou Guantian was held responsible for the guarantee, the Company may need to make provision for impairment on its interest in Tiecheng.

On December 15, 2003, the Higher People's Court of Guangdong Province ("the Court") accepted Guangzhou Guantian's re-trial application for discharging the aforesaid guarantee. In December 2003, the Court delivered a civil case judgement in which it was ruled that proceedings regarding this case shall be terminated. As a necessary procedure for the Court to decide whether to grant a re-trial, a hearing was held on March 18, 2004. In December 2005, the Court commenced procedures for re-trial. The Court reheard the case on November 14, 2006 and December 25, 2006, respectively. Up to the date of this report, the Court has not yet delivered any judgment as the necessary procedures have not been completed. However, having consulted an independent lawyer, the Directors are of the opinion that the guarantee arrangement would be determined invalid according to the relevant PRC rules and regulations. Accordingly, the Directors consider that as of the date of this report, the likelihood of Guangzhou Guantian, a subsidiary of Tiecheng, having to settle the above claim is remote and no impairment 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. It undertook to resolve the issue or to take up the liabilities so that the investment interest of the Company in Tiecheng will not be affected by the litigation.

## Management's Discussion and Analysis

### 10. EMPLOYEES, SALARY DISTRIBUTION POLICY AND TRAINING PLANS

#### (1) Employees

As of December 31, 2006, the Company had in total 9,411 employees, representing an increase of 529 compared to that at the end of 2005. This was mainly due to the additional operation of long-distance trains, which required more hands.

#### *The professional composition of the employees*

Category of profession	Number
Administrative personnel	591
Technical personnel	780
Ordinary operation personnel	8,040
Total	9,411

#### *Education level of employees*

Category of education level	Number
Postgraduate or above	22
Undergraduate	475
College for professional training	886
Others (Secondary vocational school, high school and vocational technical school, etc)	8,028
Total	9,411

#### (2) Salary and benefits

The Company's salary policy is closely linked with economic efficiency, labour efficiency and individual performance. The total amount of employees' salaries is closely related to the operating results of the Company and the distribution of employees' salaries is based on their post score and performance reviews. The basic salary of an employee is determined on the basis of the evaluation of basic labor factors such as labor skills, labor responsibilities, labor intensity and labor conditions, etc, and the actual labor remuneration is calculated on the basis of technical competence and vocational level of the employee and the evaluation of the quantity and quality of the actual labor input. In 2006, the Company paid approximately RMB718 million for salaries and benefits.

## Management's Discussion and Analysis

Pursuant to applicable state policies and regulations, the Company provides the employees with a set of statutory welfare funds and benefits as listed below:

### As a Percentage of the Aggregate Salaries of the Employees in 2005

Employees' benefits	Employees residing in Guangzhou area of along the Guangzhou- Shenzhen line	Employees residing in Shenzhen
Housing fund	7%	13%
Retirement pension	18%	18%
Supplemental retirement pension	5%	5%
Basic medical insurance	8%	6%
Supplemental medical insurance	1%	0.5%
Maternity medical insurance	0.4%	0.5%
Other welfare fund	6%	8%

### (3) Training

During 2006, the Company provided 8,352 units of training on post standardization and adaptability for its employees including standardized operation, passenger and freight transportation marketing, safety education, training on speed raising and adjustment of railway traffic diagram, training on new technology and new equipment and handling of emergency, etc. The total expenses for these training programmes in 2006 was approximately RMB3.04 million.