Vice Chairman's Report

Navigating through turbulent times is a challenge COSCO Pacific met well in 2009. We have a sound long-term strategy for port and terminal development, with a global portfolio and a strong presence in China, and an "asset light" container leasing business. This, combined with successful risk mitigation and a prudent financial policy, form a resilient business model that will enable us to achieve higher growth once the container market recovers.

According to Drewry, global container shipping volume saw a substantial 11.7% year-on-year decline to 131,500,000 TEUs in 2009 from 148,900,000 TEUs in 2008. During the year, major carriers reduced the operating capacity of their shipping fleets, and the situation only began to stabilise in the fourth quarter as the global economy improved.

Navigating through turbulent times

The contraction of container traffic put pressure on our operational and financial performance in 2009, as the container terminal, leasing and manufacturing industries faced an unprecedented downturn in demand.

Against this background of adverse market change, we managed our business during the year by constraining capital expenditure, strengthening cost control and mitigating risk factors. Despite difficult market conditions, we are pleased at having achieved impressive revenue growth, while at the same time delivering a profit. This is a testament to our strengthened business model and strong customer base.

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Terminal revenue grew by 40.1%

The Group's revenue rose 3.4% to US$349,424,000 (2008: US$337,973,000) in 2009. Our container leasing division accounted for US$229,831,000 (2008: US$252,620,000), or 65.8% (2008: 74.7%) of the Group's total revenue, while our terminal division generated the remaining 34.2% (2008: 25.3%), which amounted to US$119,593,000 (2008: US$85,353,000).

Thanks to the solid performance and expansion of the Group's five terminal subsidiaries, our terminal division achieved a strong 40.1% revenue growth in 2009. Quan Zhou Pacific Terminal and Yangzhou Yuanyang Terminal delivered stable revenue growth. Jinjiang Pacific Terminal made its first full year contribution. Furthermore, Piraeus Terminal has contributed three months of revenue since the Group took over this terminal in October 2009.

Terminals continued as the largest profit contributor

Profit attributable to equity holders of the Company decreased by 37.2% to US$172,526,000 for the year 2009 and the terminal division remained the largest profit contributor. All of our three major business divisions experienced profit declines.

- The overall 5.1% drop in terminal throughput caused terminal divisional profit to fall by 30.7% year-on-year to US$83,554,000. (This terminal divisional profit includes profit contribution from the Group's subsidiaries, jointly controlled entities, associates and available-for-sale financial assets of terminal investments.)
- Impacted by a 4 percentage points drop in the average utilisation rate of its leasing fleet, which also shrank by 2.4%, profit contribution from the container leasing division decreased by 37.9% to US$71,375,000.
- Profit contribution from the container manufacturing division decreased by 21.5% to US$30,876,000, as CIMC's profit contribution fell by 35.1% to US$25,360,000 because of the halt in dry container production since the fourth quarter of 2008.

Long-term strategy for port and terminal development

During the year, COSCO Pacific further strengthened its terminal portfolio to provide comprehensive terminal services to its customers. In September 2009, Drewry released its annual review for global container terminal operators for the year 2008. COSCO Pacific continued to rank as the fifth largest operator, with our global market share increasing to 6.1% (2007: 5.5%).

The Group's total container throughput declined by 5.1% year-on-year to 43,549,810 TEUs as a result of the decline in global container trade. However, our total container throughput in China, excluding Hong Kong, decreased by 4.0%, better than the 6.0% overall drop recorded by China ports, and easily outperforming the 11.6% decline in global container port throughput.

This achievement of an even stronger position in the market reflects the Group's continuing efforts to transform its business model by becoming a leading global terminal operator and by focusing on terminals as the principal earnings driver. We have continued to pursue this long-term strategy based on four key elements of control, globalisation, diversification and enhancement of enterprise value.

Increasing controlling rights in terminals

The Group has placed increasing emphasis on obtaining controlling stakes in new terminal investments, and now holds such investments in six terminals: Piraeus Terminal (100%), Zhangjiagang Win Hanverky Terminal (51%), Yangzhou Yuanyang Terminal (55.59%), Quan Zhou Pacific Terminal (71.43%), Jinjiang Pacific Terminal (80%) and Xiamen Ocean Gate Terminal (70%). This strategy has successfully expanded the Group's revenue, which reached US$119,593,000 in 2009 (2008: US$85,353,000), representing a growth of 40.1% year-on-year.

Expanding worldwide terminal network with primary focus on China

Since its first overseas terminal investment in Singapore in 2003, COSCO Pacific has adjusted its investment strategy from solely focusing on China to become a global player with China as its primary market. As at 31st December 2009, the total number of berths reached 146 (2008: 146), including 134 (2008: 134) container berths, 10 (2008: 10) break-bulk cargo berths and 2 (2008: 2) automobile berths.

During the year, another major milestone was achieved with the takeover of our first wholly owned terminal, Piraeus Terminal, which has added 1,600,000 TEUs of handling capacity to the portfolio. Upon completion of the upgrading of Pier 2 and the construction of Pier 3, this terminal will have a total capacity of 3,700,000 TEUs. The Group is confident that Piraeus Terminal can be developed as a major transshipment centre in the Mediterranean region and as a gateway to Southern Europe.

Our terminal portfolio provides ample room for volume growth because only 96 (2008: 89) of the 134 container berths are currently operating. Most of the remaining 38 (2008: 45) container berths will be brought into operation once the utilisation of their respective terminals reaches an appropriate level. This strategy ensures that we manage our capacity effectively so as to enhance the profitability of the terminal portfolio while maintaining sustainable growth.

The existing annual capacity of the 96 (2008: 89) operating container berths is 52,050,000 TEUs (2008: 48,150,000 TEUs). Despite a difficult year in 2009, these berths handled 43,549,810 TEUs (2008: 45,878,875 TEUs).

Diversifying the terminal portfolio

The Group has diversified its terminal portfolio from investing solely in container berths to one that includes investments in break-bulk cargo and multi-purpose berths. This diversification serves to expand our sources of income.

We have invested in 10 break-bulk cargo berths, among which 8 berths are in operation, located in Quan Zhou Pacific Terminal, Jinjiang Pacific Terminal and Yangzhou Yuanyang Terminal. These achieved a strong 24.3% year-on-year throughput growth to 16,973,421 tons of cargo in 2009.

We continually study investment opportunities in new ports and terminals, seeking to identify those that offer significant potential to enhance the profitability of our terminal divisional through having a more diversified portfolio.

Enhancing enterprise value

Aiming to create value over the medium to long term, the Group deferred new terminal investments in response to the adverse market change in 2009. We nonetheless continued to undertake a substantial review of our terminal investment plans to ensure we are able to seize good investment opportunities at the right time that can enhance the value of our terminal assets, and hence create enterprise value for COSCO Pacific.

Successful container leasing business model mitigates risk factors

The container leasing, management and sale businesses provide another core profit contribution for COSCO Pacific. We own the world's second largest container leasing company, with a fleet size of 1,582,614 TEUs as at 31st December 2009 (2008: 1,621,222 TEUs), accounting for approximately 14.3% (2008: approximately 13.6%) of the global container leasing market.

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During the year, the Group's leasing fleet capacity shrank by 2.4% to 1,582,614 TEUs. Despite its average utilisation rate dropping by 4 percentage points to 90.6%, the fleet continued to perform well above the industry average, which at 86% experienced eight percentage points decrease in 2009.

To mitigate risks, we implement a comprehensive set of risk management principles to evaluate customer credit. The Group focuses its customer targeting on well-established container shipping companies, especially those among the world's top ten. During the year, the container leasing rental revenue from these shipping companies accounted for 77.7% (2008: 80.7%) of our total container leasing revenue.

We limit risks by providing more long-term leasing services, which enable us to maintain a higher utilisation rate and reduce cyclical market risks. In 2009, 93.2% (2008: 92.2%) of the Group's total leasing revenue was generated from long-term leases.

We have built a resilient container leasing business model since we first began to offer leasing services to international customers in 1997. Since 2006, we have developed our leasing business as an asset light model through sale-and-manage-back and sale-and-lease-back container contracts. The complementary advantages of the leasing, management and sale of containers lower the Group's investment risks while consolidating its leading industry position.

Prudent financial policy

COSCO Pacific has a policy of exercising prudence in relation to financial planning, and senior management closely monitors the Group's gearing ratio, interest coverage ratio, debt structure, dividend policy and financing strategy, to ensure the Group maintains a strong financial position that allows it to continue to invest in future development.

The Group's financial position remains healthy. As at 31st December 2009, total loans outstanding amounted to US$1,604,285,000 (2008: US$1,424,335,000), with an average loan tenure of 3.8 years (2008: 4.4 years). Loans to be repaid in the coming two years amounted to US$336,667,000 (2008: US$156,975,000) representing 21.0% (2008: 11.0%) of total outstanding loans.

In August 2009, the Company signed a Euro 215,000,000 credit agreement with a 21-year term to 2030. This facility is solely for the development of Piraeus Terminal. As at 31st December 2009, the total cash balance of the Company was US$405,754,000 (2008: US$429,041,000). Net debt to equity ratio increased slightly to 41.9% (2008: 37.6%) but remained at a relatively healthy level. The interest coverage ratio was 5.8 times (2008: 6.2 times).

Core capital expenditures of the Group decreased to US$465,516,000 in 2009 (2008: US$893,381,000). Among these, US$374,192,000 in 2009 (2008: US$281,383,000) was applied in the terminal division, mainly for committed terminal projects, upgrading of existing terminal operations to enhance operating efficiency, expansion of facilities, and the purchase of machinery.

During the year, the Group incurred US$61,871,000 (2008: US$348,008,000) to acquire 15,000 TEUs (2008: 152,752 TEUs) of new containers, including 6,000 TEUs (2008: 5,512 TEUs) of refrigerated and specialised containers, and 9,000 TEUs (2008: 147,240 TEUs) of dry containers.

Given the uncertainties in the global economy, COSCO Pacific will maintain its prudent financial policy and manage risk carefully, while prudently investing in future growth. The Group has carefully assessed how market conditions may affect its businesses and funding requirements, and is fine tuning operations and investment planning accordingly.

Well positioned to capture growth opportunities

As to international trade, it is generally believed that the worst of the contraction is over and that imports and exports may return to sustainable growth. COSCO Pacific believes that its two core businesses of container terminals and container leasing are well positioned to take advantage of these positive trends and expects their performances to improve further in 2010.

On the container terminal side, with a strong presence in China, COSCO Pacific has already achieved a stronger than expected over 20% year-on-year growth in container throughput volume in the first two months of 2010. The Group notes the persistently high unemployment rate and weak consumer confidence around the world, two critical factors that are likely to restrain the growth of international trade, including that with China. Notwithstanding this, COSCO Pacific believes further improvement of its terminal division performance for the full year in 2010 is achievable as long as the recent improvement in global containerised trade volumes is sustained.

The operating efficiency of the Group's container leasing division has improved further in the first two months of 2010. During this period, the average utilisation rate increased to 93.1%, representing a 2.5 percentage points rise from the full year average recorded in 2009. The on-going slow steaming operations of shipping lines and the strong upturn in cargo volume are likely to translate into stronger container leasing demand, and hence higher utilisation and profitability for the Group in 2010.

As long as significant vulnerabilities in the global economy remain, in particular financial vulnerabilities that can magnify business risks, COSCO Pacific will continue to maintain its prudent financial policy and tighten cost control in 2010. Provided global containerised trade continues to recover, COSCO Pacific will re-activate its capital expenditure programme so as to seize the opportunity for business growth. COSCO Pacific strongly believes that its long range planning will allow the Group to deliver profitability and long term stability to its shareholders.

XU Minjie
Vice Chairman and Managing Director
30th March 2010

Long range planning will allow the Group to deliver profitability and long term stability to shareholders