Management discussion and analysis

Overall Analysis of Results

Driven by the economic recovery in the PRC and overseas, COSCO Pacific regained momentum in the overall operation of its terminal and container leasing businesses. Profit attributable to equity holders of the Company for the year of 2010 was US$361,307,000 (2009: US$172,526,000), a 109.4% increase compared with last year. Excluding the non-recurring items , profit attributable to equity holders of the Company increased by 92.7% to US$269,577,000 (2009: US$139,890,000). Non-recurring items include profit on disposal of COSCO Logistics of US$84,710,000 in 2010; profit on disposal of Dalian Port Container of US$7,020,000 in 2010; share of profit of COSCO Logistics of US$25,627,000 in 2009; dividend income from Dalian Port Container of US$1,493,000 in 2009 and profit on disposal of Shanghai CIMC Reefer of US$5,516,000 in 2009.

In 2010, with the gradual recovery of the global economy, container throughput of the terminals also restored its growth. During the year, throughput of the container terminals reached 48,523,870 TEUs (2009: 40,643,042 TEUs), a 19.4% increase compared with last year. In addition, the Group completed the acquisition of approximately 10% additional equity interest in Yantian terminal on 11th June 2010, leading to an increase in the profit of Yantian terminal attributable to COSCO Pacific. Meanwhile, COSCO Pacific completed the disposal of its stake in Dalian Port Container in January 2010 and recorded a profit of US$7,020,000. The overall profit of the terminal business therefore increased to US$119,882,000 (2009: US$83,554,000), an increase of 43.5% compared with last year.

Container leasing, management and sale businesses yielded a profit of US$96,366,000 (2009: US$71,375,000), a 35.0% increase compared with last year. As at 31st December 2010, the total container fleet of the container leasing business of the Group increased by 3.1% to 1,631,783 TEUs (31st December 2009: 1,582,614 TEUs), among which 813,625 TEUs (31st December 2009: 742,388 TEUs) were owned containers, 118,094 TEUs (31st December 2009: 118,094 TEUs) were sale-and-leaseback containers and 700,064 TEUs (31st December 2009: 722,132 TEUs) were managed containers.

With regard to the container manufacturing business, due to the increase in demand and the price of containers in 2010, CIMC saw marked improvement in its dry container manufacturing business with an increase in operating profit. During the year, profit from container manufacturing business rose significantly to US$91,871,000 (2009: US$30,876,000), an increase of 197.5% compared with last year. Profit from container manufacturing business in 2009 included profit attributable from CIMC, as well as profit of US$5,516,000 from the disposal of 20% stake in Shanghai CIMC Reefer in 2009.

With regard to the logistics business, the Group completed the disposal of its 49% stake in COSCO Logistics on 30th March 2010, realising a profit (net of tax and direct expenses) of US$84,710,000. In 2009, the Group's share of profit of COSCO Logistics was US$25,627,000. No relevant profit was attributable in 2010.

Financial Analysis

Revenue

Revenue of the Group in 2010 was US$446,492,000, a 27.8% increase from US$349,424,000 in 2009. Revenue was mainly derived from container leasing, management and sale businesses and terminal business of US$250,898,000 (2009: US$229,831,000) and US$195,594,000 (2009: US$119,593,000) respectively. Revenue from container leasing, management and sale businesses primarily included container leasing income and revenue from disposal of returned containers. For container leasing income, as the fleet capacity of owned containers and sale-and-leaseback containers reached 813,625 TEUs and 118,094 TEUs respectively at the end of 2010 (2009: 742,388 TEUs and 118,094 TEUs respectively), revenue from container leasing therefore increased to US$207,245,000 in the year (2009: US$198,069,000), an increase of 4.6% over last year. On the other hand, as the sale of returned containers increased to 28,674 TEUs (2009: 22,863 TEUs), revenue from sale of returned containers rose to US$33,895,000 (2009: US$22,844,000), an increase of 48.4% year-on-year. Revenue from container management was US$7,416,000, an increase of 14.6% over US$6,470,000 of 2009. Revenue from leasing of reefer-container generator sets was US$2,135,000, a slight decrease of 3.5% from US$2,213,000 recorded last year.

For the terminal and related businesses with controlling stakes, revenue amounted to US$195,594,000 in 2010 (2009: US$119,593,000), a significant increase of 63.5% as compared with last year. The increase was primarily contributed from Piraeus Terminal. In October 2009, COSCO Pacific took over the operation of Pier 2 of the Piraeus Port in Greece. Piraeus Terminal achieved a throughput of 684,881 TEUs (2009: 166,062 TEUs) in 2010, contributing revenue of US$83,303,000 (2009: US$23,159,000) to the Group during the year, representing an increase of approximately 2.6 times year-on-year. The throughput of Quan Zhou Pacific Terminal was 1,050,710 TEUs and 1,698,693 tons of break-bulk cargo (2009: 936,136 TEUs and 1,473,156 tons of break-bulk cargo) and its revenue increased to US$44,783,000 in the year (2009: US$37,203,000), representing a rise of 20.4% year-on-year.

Cost of sales

Cost of sales mainly comprised depreciation charges on owned containers, net carrying amounts of returned containers disposed of, container rental expense and operating expenses of the terminal companies with controlling stakes. Cost of sales in 2010 was US$279,768,000 (2009: US$200,174,000), an increase of 39.8% over last year. The increase was mainly from the consolidation of the cost of sales incurred by Piraeus Terminal into the accounts of the Group starting from 1st October 2009. In addition, a rise in the container and break-bulk cargo throughput of terminals with controlling stakes also led to the rise in the related cost of sales. The total operating expenses of the terminal business increased to US$154,408,000 in 2010 (2009: US$84,155,000). For container leasing, the depreciation charges for containers were US$84,665,000 (2009: US$77,241,000) in the year. The number of returned containers sold increased to 28,674 TEUs (2009: 22,863 TEUs) and the net carrying amount of disposed returned containers rose to US$25,347,000 (2009: US$19,734,000).

Investment income

Investment income, comprising mainly dividend income, was US$1,612,000 (2009: US$22,339,000), a significant drop of 92.8% over last year. The decrease was mainly due to the completion of the disposal of the Group's stake in Dalian Port Container in January 2010 and, following the completion of the Group's acquisition of approximately 10% additional equity interest in Yantian terminal in June 2010, Yantian terminal being reclassified from an available-for-sale financial asset to an associate and accounted for using the equity method. Yantian terminal did not declare an interim dividend in the first half of 2010. Accordingly, no relevant dividend income from Yantian terminal and Dalian Port Container were recorded in the year (2009: dividend income of US$18,727,000 and US$1,493,000 respectively). Tianjin Five Continents Terminal declared dividends of US$1,485,000 in 2010 (2009: US$2,034,000) to the Group.

Administrative expenses

Administrative expenses in the year were US$59,823,000 (2009: US$62,949,000), a decrease of 5.0% as compared with last year. Though the administrative expenses increased due to the commencement of new terminals in the year, the pre-operating expenses of Piraeus Terminal had been taken into account in the administrative expenses in 2009 and the over-provision of the professional services fee accrued for the project regarding the disposal of COSCO Logistics was reversed in 2010. As a result, the overall administrative expenses decreased in 2010 as compared with last year.

Other operating income/expense, net

Net other operating income in 2010 was US$4,754,000 (2009: an expense of US$8,722,000). In January 2010, the Group completed the disposal of equity interest in Dalian Port Container and recognised a profit of US$7,020,000. On the other hand, owing to the improved economic environment, provision for the year decreased significantly as compared with 2009. In 2010, provision for impairment loss on trade receivables of US$292,000 was reversed (2009: provision for trade receivables: US$3,791,000); provision for inventories of US$1,495,000 (2009: US$7,028,000) was made; and provision for asset impairment of US$1,167,000 (2009: US$3,607,000) was recognised. All the abovementioned factors led to the significant increase of the overall net other operating income in 2010.

Finance costs

The Group's finance costs in 2010 were US$29,439,000 (2009: US$39,805,000), a decrease of 26.0% from last year. The average balance of borrowings increased to US$1,579,766,000 during the year (2009: US$1,485,567,000), an increase of 6.3% as compared with last year. However, the increase was offset by the decrease in London Interbank Offer Rate ("LIBOR"). Average cost of borrowings during the year, including the amortisation of transaction costs over bank loans and notes, was an average 6-month LIBOR of approximately 0.51% plus 135 basis points (i.e. 1.86%). The average cost of borrowings for 2009 was an average 6-month LIBOR of approximately 1.13% plus 155 basis points (i.e. 2.68%).

Share of profits less losses of jointly controlled entities and associates

Net profit contribution from jointly controlled entities amounted to US$74,654,000 in 2010, an increase of 26.1% from US$59,183,000 of last year. Among them, the throughput of COSCO-HIT Terminal and Shanghai Pudong Terminal increased by 12.9% and 6.9% respectively during the year and their profits increased to US$21,244,000 and US$22,945,000 respectively (2009: US$17,080,000 and US$20,118,000 respectively), representing increases of 24.4% and 14.1% respectively. The throughput of Guangzhou South China Oceangate Terminal also increased markedly, up 41.8% to 3,060,591 TEUs (2009: 2,158,291 TEUs). Its loss in the year narrowed down to US$5,088,000 (2009: a loss of US$10,327,000), representing a decrease in loss of 50.7%. In 2010, Ningbo Yuan Dong Terminal successfully introduced new routes, leading to an increase in throughput by 52.6% to 1,704,588 TEUs (2009: 1,117,169 TEUs). Its profit also increased by 103.7% to US$6,534,000 (2009: US$3,207,000). During the year, COSCO-PSA Terminal also saw an increase in its throughput, and turned around from loss-making to profitable, recording a profit of US$1,263,000 (2009: a loss of US$1,516,000). Qingdao Qianwan Terminal achieved a throughput of 10,568,065 TEUs (2009: 8,961,785 TEUs), representing a 17.9% increase. However, the gradual certification and commencement of production of terminal equipment of Qingdao Qianwan United Terminal, a jointly controlled entity of Qingdao Qianwan Terminal, led to an increase in depreciation and interest charges of Qingdao Qianwan Terminal. The overall profit of Qingdao Qianwan Terminal fell to US$25,563,000 (2009: US$ 26,649,000), representing a decrease of 4.1% year-on-year.

During the year, share of net profit from associates increased significantly to US$132,120,000 (2009: US$32,890,000), an increase of 301.7% year-on-year. After the completion of acquisition of further interest in Yantian terminal in June 2010, the Group's investment in Yantian terminal was reclassified from an available-for-sale financial asset to an associate and is accounted for using the equity method. The share of profit from Yantian terminal to the Group using the equity method was US$30,216,000 (2009: Nil) in 2010. With regard to the container manufacturing business, due to the increase in demand and the price of containers in 2010, CIMC saw marked improvement in its dry container manufacturing business with an increase in operating profit. Its profit contribution to the Group rose by 262.3% to US$91,871,000 (2009: US$25,360,000) in 2010 as compared with last year.

Profit on disposal of a jointly controlled entity

In order to simplify the shareholding structure of the container manufacturing business of the Group and concentrate on the development of the core businesses such as terminal business and container leasing business, the Group completed the disposal of its 20% equity interest in Shanghai CIMC Reefer in 2009, which generated a profit of US$5,516,000. No relevant profit was recognised in 2010.

Income tax expenses

During the year, income tax expenses amounted to US$15,653,000 (2009: US$13,286,000). This included a provision of US$12,900,000 (2009: US$11,317,000) for withholding income tax in respect of the profit distribution by certain investments of the Group in the PRC.

Profit from discontinued operation

Profit from discontinued operation represents the profit generated from the disposal of COSCO Logistics. In March 2010, the Group completed the disposal of COSCO Logistics which resulted in a profit (net of direct expenses and tax) of US$84,710,000. Profit of US$25,627,000 attributed from COSCO Logistics was recognised in 2009 and no profit was recorded in this regard in 2010.

Financial Position

Cash flow

Cash inflow of the Group remained steady in 2010. During the year, net cash from operating activities amounted to US$255,702,000 (2009: US$174,896,000). The Group drew bank loans of US$202,401,000 (2009: US$285,783,000) and repaid US$265,153,000 (2009: US$100,749,000) in 2010. On the other hand, the net proceeds from the placing of the Company's 449,000,000 new shares amounted to approximately US$584,000,000, after deduction of placing commission and expenses.

In 2010, the total cash outflow for investments of the Group amounted to US$570,871,000, mainly comprising US$520,000,000 used for the acquisition of an approximate 10% equity interest in Yantian terminal, US$27,996,000 used for reinvestment of dividend of Yantian terminal, US$9,052,000 used for capital injection in Nanjing Longtan Terminal, US$7,030,000 used for capital injection in Dalian Automobile Terminal and US$3,352,000 used for provision of shareholders' loan to Antwerp Terminal. In 2009, the total cash outflow for investments of the Group amounted to US$39,027,000, comprising US$13,560,000 used for Nanjing Longtan Terminal, US$18,727,000 used for reinvestment of dividend of Yantian terminal and US$6,740,000 for Antwerp Terminal. In 2010, an amount of US$375,342,000 (2009: US$364,716,000) was paid in cash for the expansion of berths and purchase of property, plant and equipment, of which US$239,607,000 (2009: US$47,222,000) was for the purchase of new containers.

Financing and credit facilities

On 12th May 2010, COSCO Pacific completed the placing of 449,000,000 new shares at HK$10.4 per share. After deduction of commission and expenses of the placing, the net proceeds of approximately US$584,000,000 were raised, which were mainly for the acquisition of approximately 10% equity interest in Yantian terminal. After the placing, the number of issued shares of the Company increased from 2,262,525,573 shares to 2,711,525,573 shares.

As at 31st December 2010, cash balance of the Group was US$524,274,000 (2009: US$405,754,000) and banking facilities available but unused amounted to US$1,099,127,000 (2009: US$673,000,000).

Assets and liabilities

As at 31st December 2010, the Group's total assets and total liabilities amounted to US$5,251,917,000 (2009: US$4,635,312,000) and US$1,758,055,000 (2009: US$1,776,961,000) respectively. Net assets in 2010 increased to US$3,493,862,000 (2009: US$2,858,351,000) and the increase was primarily from the placing and the net profit of 2010. Net asset value per share was US$1.29 (2009: US$1.26), an increase of 2.4% over last year.

As at 31st December 2010, the cash balance of the Group was US$524,274,000 (2009: US$405,754,000). Total outstanding borrowings amounted to US$1,558,755,000 (2009: US$1,604,285,000). Net debt-to-equity ratio decreased to 29.6% from 41.9% of last year. Excluding profit from the discontinued logistics business, the interest coverage was 11.1 times compared with 5.1 times of last year. As at 31st December 2010, certain of the Group's property, plant and equipment with an aggregate net book value of US$20,896,000 (2009: Nil) were pledged as securities against bank borrowings of US$64,180,000 (2009: Nil).

Debt analysis

	As at 31st December 2010		As at 31st December 2009	
	US$	%	US$	%
By repayment term				
Within the first year	**169,109,000**	**10.8**	193,614,000	12.1
Within the second year	**297,490,000**	**19.1**	143,053,000	8.9
Within the third year	**668,458,000**	**42.9**	290,219,000	18.1
Within the fourth year	**173,001,000**	**11.1**	662,174,000	41.3
Within the fifth year and after	**250,697,000**	**16.1**	315,225,000	19.6
	1,558,755,000*	**100.0**	1,604,285,000*	100.0
By category				
Secured borrowings	**64,180,000**	**4.1**	–	–
Unsecured borrowings	**1,494,575,000**	**95.9**	1,604,285,000	100.0
	1,558,755,000*	**100.0**	1,604,285,000*	100.0
By denominated currency				
US dollar borrowings	**1,165,404,000**	**74.8**	1,226,587,000	76.5
RMB borrowings	**329,171,000**	**21.1**	377,698,000	23.5
Euro borrowings	**64,180,000**	**4.1**	–	–
	1,558,755,000*	**100.0**	1,604,285,000*	100.0

** Net of unamortised discount on notes and transaction costs on borrowings and notes.*

Financial guarantee contracts

As at 31st December 2010, the Group had provided guarantees on a loan facility granted to an associate of US$29,505,000 (2009: US$31,788,000).

Contingent liabilities

A statement of claim was issued on 19th October 2009 by ADK against the Company and Piraeus Terminal, a wholly-owned subsidiary of the Company, in a civil claim at the Court of First Instance of Athens in Greece alleging non-payment of fees for design services and project management services. The plaintiff has claimed approximately Euro 5,800,000 (equivalent to approximately US$7,700,000) in total. The Company and Piraeus Terminal have defended all material claims at the trial hearing held on 30th November 2010.

The Court of First Instance of Athens has issued (pronounced) judgment on the case and has dismissed the aforementioned statement of claim in its entirety both as regards the Company and as regards Piraeus Terminal. According to Greek procedural law, the plaintiff (ADK) has the right to file an appeal against the aforesaid judgment of the Court of First Instance of Athens before the Court of Appeals of Athens. The directors and management of the Company, having taken legal advice, are of the view that the Company and Piraeus Terminal have good defences to all material claims and that the dismissal of the aforementioned statement of claim in its entirety by the Court of First Instance of Athens has further strengthened the Company's position on this case. However, and as long as ADK maintains the right to file an appeal against the judgment of the Court of First Instance in accordance with Greek procedural law, it is still not possible to predict the final outcome of this litigation with certainty. Hence, no provision has been made for the claims.

Treasury policy

The Group manages its foreign exchange risk by matching the currencies of its loans with the Group's functional currency of major cash receipts and underlying assets as far as possible. Borrowings for the container leasing business are mainly denominated in US dollars, which is the same currency as the majority of its revenue and expenses so as to minimise potential foreign exchange exposure.

The financing activities of jointly controlled entities and associates were denominated in their respective functional currencies so as to minimise foreign exchange exposure in investments.

The Group continues to exercise stringent control over the use of financial derivatives to hedge against its interest rates exposure. As at 31st December 2010, outstanding interest rate swap contracts comprised nominal principal amounting to US$200,000,000 (31st December 2009: US$200,000,000) in total whereby the Group agreed to pay the banks interest at floating rates ranging from 105 basis points to 116 basis points (2009: 105 basis points to 116 basis points) above 6-month LIBOR in return for receiving interests from the banks at a fixed interest rate of 5.875% per annum (2009: 5.875%).

As at 31st December 2010, after adjustment of the fixed rate borrowings for the interest rate swap contracts, 6.4% (31st December 2009: 6.2%) of the Group's total borrowings were in fixed rate. The Group continues to monitor and regulate its fixed and floating rate debt portfolio from time to time in light of the market conditions, with a view to minimising its potential interest rate exposure.

Event after the balance sheet date

CP Nansha was a jointly controlled entity of the Group. By virtue of the clause in an agreement entered into by the Group and the other shareholder of CP Nansha, the joint control of CP Nansha expired on 31st December 2010 and the Group has the power to govern the financial and operating policies of CP Nansha and its subsidiary, Guangzhou South China Oceangate Terminal, from then onwards. Accordingly, the Group has accounted for CP Nansha as a subsidiary from 1st January 2011.