

Management Discussion and Analysis of Results of Operations and Financial Position

REVIEW OF OPERATING RESULTS

In the first six months of 2004, the Group made vigorous efforts in restructuring business resources and new product development to leverage on opportunities presented by China's fast-growing logistics and transportation market, as it faced the increasing pressure of competition in the further opening of the market. Process restructuring projects for the sea freight forwarding and shipping agency businesses commenced during the period, while novel services and products, such as Lianyungang to Alma-Ata international block train transportation and warehouse financing were also introduced, in a move to further enrich and improve the Group's business structure and product mix. Continued efforts in centralised marketing were underpinned by the solicitation of a number of major customers in different sectors, including Coca Cola and others. An overseas agency network covering East Asia, Europe and North America has initially come into shape following the Group's efforts in overseas expansion, and significant moves were made in the development of the NVOCC business on this basis. More information systems were built to enhance business management. The Group was also actively involved in the process of the consolidation of China's logistics and transportation market.

These efforts enabled the Group to maintain steady growth in operating results. For the six months ended 30 June 2004, the Group achieved turnover of approximately RMB9,909.2 million, representing a 28.8% increase compared with the same period in 2003. Profit for the period amounted to RMB374.3 million, representing a growth of 8.3% when compared with the same period in 2003. Earnings per share were RMB0.09 (corresponding period in 2003: RMB0.09).

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OPERATING STATISTICS

The table below sets forth certain Group's operating statistics by business segments for the periods indicated:

	For the six months ended 30 June	
	2004	2003
Freight forwarding		
Sea freight forwarding		
Bulk cargo (in millions of tonnes)	2.0	1.6
Container cargo (in millions of TEUs)	1.63	1.32
Air freight forwarding (in tonnes)	118,400	77,200
Rail freight forwarding (in millions of tonnes)		
Bulk Cargo	1.6	1.4
Container cargo	0.4	0.2
Road freight forwarding (in millions of tonnes)		
Bulk cargo	0.3	0.2
Container cargo	1.6	0.5
Express services		
Packages (in millions of units)	6.45	5.60
Shipping agency		
Net registered tonnes (in millions of tonnes)	130.6	96.2
Vessel calls (number of times)	30,550	24,791
Containers (in millions of TEUs)	3.45	2.74
Storage and terminal services		
Warehouses (in millions of tonnes)	13.7	11.2
Terminals bulk cargo (in millions of tonnes)	1.2	1.2
Terminal containers (in TEUs)	496,000	372,000
Marine transportation		
TEUs (number of units)	542,773	481,385
Other services		
Trucking (in millions of tonnes)	1.9	1.8

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FINANCIAL STATISTICS

The table below presents the Group's selected financial information for the periods indicated:

	For the six months ended 30 June (unaudited)	
	2004	2003
	(RMB in millions, except for earnings per share and number of shares data)	(RMB in millions, except for earnings per share and number of shares data)
Turnover	9,909.2	7,692.1
Other revenues	29.3	26.5
Total revenues	9,938.5	7,718.6
Transportation and related charges	(7,440.2)	(5,565.6)
Depreciation and amortisation	(115.8)	(103.1)
Operating costs (Excluding depreciation and amortisation):		
— Staff costs	(655.2)	(549.4)
— Repairs and maintenance	(42.5)	(40.4)
— Fuel	(208.2)	(217.1)
— Travel and promotional expenses	(109.7)	(77.0)
— Office and communications expenses	(79.0)	(78.0)
— Rental expenses	(546.6)	(398.6)
— Other operating expenses	(160.6)	(144.2)
Operating profit	580.7	545.2
Finance income, net	26.2	31.0
Share of results of associates before taxation	9.3	3.7
Profit before taxation	616.2	579.9
Taxation	(167.8)	(157.7)
Profit after taxation	448.4	422.2
Minority interests	(74.1)	(76.6)
Profit for the period	374.3	345.6
Declared/proposed interim dividend	(127.5)	(110.5)
Earnings per share, basic and diluted ⁽¹⁾	RMB0.09	RMB0.09
Weighted average number of shares for the period (in millions) ⁽¹⁾	4,249.0	3,852.6
Number of shares at the end of the period (in millions)	4,249.0	4,249.0

- (1) Basic and diluted earnings per share for the six months ended 30 June 2004 and 2003 were arrived at by dividing the profit for the respective periods by the weighted average number of the ordinary shares in issue for the six months ended 30 June 2004 totalling 4,249,002,200 shares and the weighted average number of the ordinary shares in issue for the six months ended 30 June 2003 totalling 3,852,585,771 shares. There is no difference between basic and diluted earnings per share as no potential dilutive shares existed.

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The table below sets forth the Group's unaudited turnover by key business segments and their respective percentage of total turnover before inter-segment elimination for the periods indicated:

	For the six months ended 30 June (unaudited)			
	2004		2003	
	(RMB in millions)		(RMB in millions)	
Freight forwarding	7,158.5	70.7%	5,502.8	69.1%
Express services	973.7	9.6%	732.9	9.2%
Shipping agency	231.6	2.3%	222.6	2.8%
Marine transportation	1,380.9	13.7%	1,175.5	14.8%
Storage and terminal services	304.6	3.0%	258.8	3.3%
Other services	66.6	0.7%	66.9	0.8%

The table below sets forth the Group's segment results (RMB in millions), as compared with the same period in 2003. Segment results are defined as the turnover for that segment less direct operating expenses but before deducting unallocated costs.

	For the six months ended 30 June (unaudited)	
	2004	2003
Freight forwarding	155.3	179.3
Express services	216.0	209.6
Shipping agency	110.9	124.3
Marine transportation	87.5	39.9
Storage and terminal services	59.4	50.8
Other services	(0.7)	(2.3)

COMPARISON AND ANALYSIS OF OPERATING RESULTS AND FINANCIAL POSITION

Turnover

For the six months ended 30 June 2004, the Group's turnover amounted to RMB9,909.2 million, up 28.8% from RMB7,692.1 million for the same period in 2003. The increase was primarily attributable to the Group's vigorous efforts in restructuring business resources and developing new products, centralising marketing activities and enhancing service networks, as well as to economies of scale achieved through proactive market development strategies. Moreover, rising international marine freight rates also contributed to the growth in the Group's turnover.

Freight forwarding

For the six months ended 30 June 2004, turnover from our freight forwarding services grew 30.1% to RMB7,158.5 million, from RMB5,502.8 million for the same period in 2003.

Turnover from freight forwarding mainly comprised of revenue from containers sea freight forwarding services and air freight forwarding services. The number of containers handled in sea freight forwarding services increased 23.5% to 1.63 million TEUs in the first half of 2004 from 1.32

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million TEUs for the corresponding period in 2003; while the amount of cargo handled in air freight forwarding services rose 53.4% to 118,400 tonnes in the first half of 2004 from 77,200 tonnes in the first half of 2003.

Revenue growth in freight forwarding for the period under review was driven by the Group's ability to maintain a relatively fast business development pace. While inroads were made in expanding the market for air freight forwarding, the strong growth rate was also due to a low comparative base following the outbreak of SARS in the first half of the previous year. The rise in international marine freight rates also contributed to the growth in the turnover for the sea freight forwarding business. According to the China Export Container Freight Rate Index published by Shanghai Shipping Exchange, there was an approximately 7.7% growth in the average freight rate index of international containers sea freight transportation for the first half of 2004 over the same period in 2003.

Express services

For the six months ended 2004, the Group's express services achieved a turnover of RMB973.7 million, representing an increase of 32.9% from RMB732.9 million for the same period in 2003.

The number of documents and packages handled in the first half of 2004 were 6.45 million pieces, an increase of 15.2% compared with 5.6 million pieces for the same period in 2003.

The growth was mainly attributable to enhanced marketing efforts with additional domestic sales outlets. The turnover for express services grew by a larger margin than the business volume of this segment did mainly because of changes in the mix of cargo handled.

Shipping agency

For the six months ended 30 June 2004, turnover from our shipping agency services reached RMB231.6 million, representing an increase of 4.0% from RMB222.6 million for the same period in 2003.

For the first half of 2004, the number of containers handled was 3.45 million TEUs, an increase of 25.9% from 2.74 million TEUs in 2003. Net registered tonnage of vessels handled by the Group's shipping agency services reached 130.6 million tonnes, a 35.8% increase from 96.2 million tonnes for the same period in 2003. The number of vessel calls managed also grew 23.2% to 30,550 compared with 24,791 for the same period in 2003.

The Group continued to record turnover and volume growth for shipping agency services as fast growth in business volume was maintained with the support of enhanced customer service and marketing efforts. However, revenue grew by a smaller margin than business volume owing to lower shipping agency rates in the first half of the year.

Storage and terminal services

For the six months ended 30 June 2004, the aggregate turnover from storage and terminal services amounted to RMB304.6 million, representing a 17.7% growth from RMB258.8 million for the same period in 2003.

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For the first half of 2004, the Group's warehouses handled 13.7 million tonnes of cargo, representing a 22.3% increase from 11.2 million tonnes for the same period in 2003; cargo tonnage handled in terminals grew to 496,000 TEUs from 372,000 TEUs for the same period in 2003, an increase of 33.3%. The volume of bulk cargo handled at terminals compared flatly with the corresponding period last year.

Business volume growth of the Group's terminal services segment was largely driven by enhanced cargo-handling capability with the installation of loading/unloading facilities. Meanwhile, the Group continued to focus on business integration and process standardisation and succeeded in improving its service standards with faster turnaround time in logistics. However, lower fees for handling domestic trade cargo coupled with growing business volume resulted in a smaller increment in turnover than that in business volume.

Marine transportation

For the six months ended 30 June 2004, turnover from the Group's marine transportation services grew 17.5% to RMB1,380.9 million from RMB1,175.5 million for the same period in 2003.

The number of containers shipped by the Group rose to 542,773 TEUs during the period, up 12.8% from 481,385 TEUs for the same period in 2003.

Such growth was primarily attributable to the steady growth in turnover and transport volume backed by the Group's efforts to enhance utilisation of its own vessel space while amending under-capacities for certain routes by entering into swap arrangements with shipping companies, in a move to capture favourable opportunities presented by the market. The rise in freight rates also contributed to turnover growth.

Other services

For the six months ended 30 June 2004, turnover from other services, mainly trucking services, fell 0.5% to RMB66.6 million from RMB66.9 million for the same period in 2003.

The Group shipped 1.9 million tonnes of cargo in the first half of 2004, an increase of 5.6% from 1.8 million tonnes of cargo for the same period in 2003.

TRANSPORTATION AND RELATED CHARGES

For the six months ended 30 June 2004, transportation and related charges grew 33.7% to RMB7,440.2 million, compared with RMB5,565.6 million for the same period in 2003.

The increase in transportation and related charges was mainly fuelled by fast-growing costs of the freight forwarding business. Aside from the growth in business volume of this segment, the increase in costs was also due to under-capacity for marine transportation, which undermined the Group's bargaining powers and ability to control transportation costs. Coupled with the squeeze in profit margin for sea freight forwarding business under increasing competition, there was an increase in costs while the profit margin declined. The rise in international marine freight rates also contributed to the growth in the Group's transportation costs. Meanwhile, transportation costs also increased as a result of chartered air freight spaces bought by Sinoair in exchange for guaranteed, stable supply of cabin space by airlines.

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DEPRECIATION AND AMORTISATION

Depreciation and amortisation expenses for the six months ended 30 June 2004 amounted to RMB115.8 million, representing an increase of 12.3% from RMB103.1 million for the same period in 2003, primarily as a result of an increase in the Group's fixed assets and intangible assets.

OPERATING COSTS, EXCLUDING DEPRECIATION AND AMORTISATION

For the six months ended 30 June 2004, the Group's operating costs, excluding depreciation and amortisation, were RMB1,801.8 million, a 19.7% increase from RMB1,504.7 million in 2003.

The increase in operating costs, excluding depreciation and amortisation, was primarily due to increased expenditure on lease payments, travel and promotional expenses and staff costs. The increase in lease payments was the result of higher rental fees for vessels and containers as well as increased containers leased by the marine transportation segment of the Group. Travel and promotional expenses increased in tandem with business expansion and enhanced marketing activities. In addition, the increase in staff costs was primarily due to salary adjustments in accordance with the Group's remuneration system and incentive schemes. Fuel costs decreased as certain owned vessels were berthed for repair and maintenance, while the transportation capacity otherwise available was provided by chartered cabin spaces in substitution.

OPERATING PROFIT

For the six months ended 30 June 2004, the Group's operating profit was RMB580.7 million, representing an increase of 6.5% from RMB545.2 million in the same period in 2003, mainly as a result of business volume growth. Operating profit as a percentage of total revenue decreased to 5.84% for the six months ended 30 June 2004 from 7.06% for the six months ended 30 June 2003 primarily as a result of the increase in the Group's transportation and related charges and various operating expenses.

The Group recorded growth in operating profit from its express services, marine transportation business and storage and terminal business. Such growth was, however, partially offset by decreases in operating profit recorded by the freight forwarding business and the shipping agency business.

TAXATION

Taxation of the Group for the six months ended 30 June 2004 amounted to RMB167.8 million, up 6.4% from RMB157.7 million for the same period in 2003, primarily as a result of the increase in taxable income. Taxation as a percentage of profit before tax remained level with 27.2% for the six months ended 30 June 2003.

MINORITY INTERESTS

Minority interests for the six months ended 30 June 2004 amounted to RMB74.1 million, down 3.3% from RMB76.6 million for the same period in 2003 and, primarily as a result of reduced profit contribution by the Group's subsidiary, Sinoair.

PROFIT FOR THE PERIOD

Profit of the Group for the six months ended 30 June 2004 amounted to RMB374.3 million, representing an increase of 8.3% from RMB345.6 million for the same period in 2003.

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LIQUIDITY AND CAPITAL RESOURCES

The following table summarises the Group's cash flows for the periods indicated:

	For the six months ended 30 June (unaudited)	
	2004	2003
	(RMB in millions)	(RMB in millions)
Net cash inflow from operating activities	295.6	344.3
Net cash inflow from (used in) investing activities	120.6	(1,518.2)
Net cash (used in) inflow from financing activities	(34.8)	3,023.7
Cash and cash equivalents at the end of the period	5,264.2	4,191.8

OPERATING ACTIVITIES

Net cash from operating activities for the six months ended 30 June 2004 amounted to RMB295.6 million, 14.1% less compared with RMB344.3 million for the corresponding period in 2003. The decrease in net cash from operating activities was mainly attributable to an increase of RMB591.7 million in trade receivables and other accounts receivable for the six months ended 30 June 2004, compared with an increase of RMB227.6 million for the corresponding period in 2003, which was partially offset by an increase of RMB235.3 million in trade payables (corresponding period in 2003: increase of RMB139.2 million) and an increase of RMB157.3 million in income tax and other tax liabilities (corresponding period in 2003: increase of RMB140.7 million).

The increase in trade receivables for the six months ended 30 June 2004 was primarily due to the growth in both business scale and revenue. The average turnover days of trade receivables for the six months ended 30 June 2004 and 2003 both were 69 days. The increase in trade payables for the six months ended 30 June 2004 was also primarily due to the growth in both business scale and revenue.

INVESTING ACTIVITIES

For the six months ended 30 June 2004, net cash from investing activities primarily comprised RMB268.7 million for the acquisition of fixed assets, RMB206.9 million for the acquisition of held-to-maturity investments, RMB82.91 million for the acquisition of land use rights and intangible assets, RMB42.5 million for the recoup of held-to-maturity investments and a reduction of RMB633.3 million in term deposits. For the six months ended 30 June 2003, net cash used in investing activities primarily comprised RMB173.7 million for the acquisition of fixed assets, RMB20.40 million for the acquisition of intangible assets, RMB19.4 million for the investment in and establishment of a new company and an increase of RMB1,376.6 million in term deposits with an initial term of maturity of over three months.

FINANCING ACTIVITIES

Net cash used in the Group's financing activities amounted to RMB34.80 million for the six months ended 30 June 2004, compared with net cash from financing activities of RMB3,023.7 million for the corresponding period in 2003. The decrease of net cash from financing activities was mainly attributable to the RMB3,533.4 million proceeds raised from the IPO in the same period last year. Bank loan repayments for the six months ended 30 June 2004 amounted to

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RMB110.6 million, compared to RMB56.4 million for the same period in 2003, which were offset by new bank loans secured during the six months ended 30 June 2004 amounting to RMB155.6 million (corresponding period in 2003: increase of RMB40.1 million).

CAPITAL EXPENDITURE

For the six months ended 30 June 2004, the Group's capital expenditure amounted to RMB351.6 million, consisting of RMB268.7 million for the acquisition of fixed assets and RMB82.91 million for the acquisition of intangible assets and land use rights, among which RMB220.8 million was used for the renovation and construction of docks, warehouses, logistics centres and piling areas, RMB65.95 million for the purchase of vehicles and equipment and RMB47.36 million for IT investment and refurbishment and purchase of office equipment.

CONTINGENCIES AND GUARANTEES

As at 30 June 2004, the contingent liabilities of the Group amounted to approximately RMB40.73 million, comprising mainly RMB31.24 million in relation to pending litigations, outstanding loan guarantees provided by the Group for the obligations of joint-controlled entities in the amount of RMB6.5 million and discounted bills with recourse amounting to approximately RMB2.99 million.

GEARING RATIO

As at 30 June 2004, the gearing ratio of the Group was 48.8% (as at 31 December 2003: 47.7%), which was arrived at by dividing the sum of liabilities and minority interests by total assets at 30 June 2004.

FOREIGN EXCHANGE RATE RISKS

A substantial portion of the Group's turnover and transportation and related charges are denominated in US dollars, therefore the Group is subject to foreign exchange risks mainly in connection with US dollars. The Group cannot give any assurance that any future movements in the exchange rate of the Renminbi against the US dollars and other foreign currencies will not adversely affect its results of operations and financial position (including the ability to pay dividends).

CREDIT RISK

The extent of our credit exposure is represented by an aggregated balance of trade receivables and other receivables, trading investments, held-to-maturity investments, pledged deposits and term deposits with an initial term of maturity of over three months. The maximum credit exposure in the event of counterparties' default on obligations under these financial instruments was approximately RMB4,827.7 million and RMB4,702.6 million as at 30 June 2004 and 31 December 2003, respectively. In addition, we provided certain prepayments, prepaid expenses and deposits on behalf of customers, the aggregate amounts of which were RMB228.7 million and RMB266.6 million as at 30 June 2004 and 31 December 2003, respectively.

EMPLOYEES

The Group had 13,310 employees as at 30 June 2004. The Group has made vigorous efforts in reforming its remuneration system with the introduction of long-term incentive programmes such as the Share Appreciation Rights Scheme and Long-term Performance Unit Scheme. We have also developed a unified performance management regime, which has been operating effectively to provide an effective mechanism for encouraging diligence and devotion through reward as well as supervision.

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With a strong concern for staff growth and development, the Group provides training in different aspects with a view to enhanced possibilities in career development.

OUTLOOK AND PROSPECTS

While the Group is expected to face increasing pressure from market competition in the second half of 2004, it should enjoy ongoing business growth driven by China's fast-growing logistics and transportation market.

We will further strengthen business integration and new product development, while seeking improvements to and innovations in traditional business models. Through incremental investments and proactive moves to integrate external logistic resources, an integrated, product-based service chain will be developed. Investments in information technology and the building of information systems will be enhanced to improve the standard of the Company's business management, business decision-making, customer management and service standards. We will gear up efforts to build a centralised marketing regime and a professional sales team with the provision of incentives, organisation and training, together with the appeal of quality products. Measures will be adopted to centralise cargo sources, procurement and the booking of shipment spaces, with a view to effective reduction of operating costs.

APPRECIATION

We consider our strong and professional team formed by qualified and proficient staff, which assures that customers are provided with the best possible services, to be the most valuable assets of the Group. I would like to express appreciation for our diligent staff, whose development and career opportunities will remain a prime concern for the Group.

Last but not least, my sincere gratitude goes to investors who have shown their concern and support to the Company and, may I add that we will continue with our endeavours to increase shareholders' return on the basis of sound growth for the Company.

Zhang Bin
Chairman

Beijing, 24 August 2004