

# Management Discussion and Analysis of Results of Operations and Financial Position



# management discussion and analysis of results of operations and financial position



**ZHANG JIANWEI**  
EXECUTIVE DIRECTOR PRESIDENT

You should read the following discussion and analysis in conjunction with the consolidated financial statements of the Company and its subsidiaries (collectively the "Group") and the accompanying notes thereto included elsewhere in this Annual Report.

## **BUSINESS OVERVIEW**

We are a leading provider of logistics services in China. Our core services include freight forwarding, express services and shipping agency, while our supporting services comprise storage and terminal services, marine transportation and other services, of which trucking is the primary service.

The sphere of operation of our business covers fast developing coastal areas and other strategic areas in China, such as Guangdong, Fujian, Shanghai, Zhejiang, Jiangsu, Hubei, Lianyungang, Shandong, Tianjin and Liaoning, with a comprehensive and full nationwide service network and overseas agency network.

Our well-established service networks as well as unified and integrated service strategy and competence enable us to provide integrated logistics services to our customers and to capture a leading position among market competition.

## **REVIEW OF OPERATIONS**

In 2004, the persistent growth of the demand for transportation and logistics services in the PRC, as driven by the strong economic development of the PRC over the years, had brought a golden opportunity for our business development. However, the liberalisation of the PRC market would intensify and complicate the market competition, causing customers to ask for a wider scope of services and higher efficiency.

In order to grasp the market opportunities and to proactively deal with the increasingly intensified competition, the Group adopted proactive development strategies in resources integration, establishment of standardised workflow, network coverage, new products development, perfection of the scope of services and enhancement of service efficiency and reinforcement of internal control. The Group has achieved substantial progress in those areas and such efforts had contributed a significant growth in the scale of operations and in economic efficiency:

- The better reallocation of corporate resources, the establishment of a standardised workflow and the centralisation of operations allow the Company to optimise its resource allocation and generate stronger synergies among its businesses.
- The development of an overseas network, comprising initially the overseas agency network established in the areas in which our business operates around the world, has achieved great progress. The mechanism of communications and operations of the overseas network has also been improved.
- The expansion and perfection of our services and the newly-developed services and products under our incessant efforts, such as warehouse financing and domestic express services (Sinoair "e"-Express) were launched to the market and has achieved satisfactory results.

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- The Group has enlarged the scope of the value-added services by launching new services, such as container consolidation, container tanker transportation, scheduled container railway transportation and auto parts and components transportation.
- With the substantial progress in logistics operations as shown in the successful bids on various logistics projects, the Group has created a more sophisticated and systematic RDC management model, trained up a professional logistics team and worked out a unique development roadmap for its logistics business.
- The strengthening of a centralised marketing strategy and the perfection of the client portfolio have resulted in the substantial increase in the turnover of major clients and the number of major clients has increased by 33% as compared to 2003.
- The thorough implementation and modification to the total budgetary control system has enabled the gradual transformation of our budgetary management from a financial focus to a strategic focus. With the implementation of the ORACLE financial management system, our financial management has been centralised and standardised. By establishing a settlement centre and implementing a mechanism of centralised operation of funds, we have reinforced our centralised management of funds and improved the utilisation efficiency of funds.



### OPERATING STATISTICS

The table below sets forth certain of the Group's operating statistics by activity for the years indicated:

	For the year ended 31 December	
	2004	2003
Freight forwarding		
Sea freight forwarding		
Bulk cargo (in millions of tonnes)	5.3	2.7
Container cargo (in 10 thousands of TEUs)	353.7	300.0
Air freight forwarding (in millions of kilograms)	282.6	183.7
Rail freight forwarding		
Bulk cargo (in millions of tonnes)	2.2	2.6
Container cargo (in 10 thousands of TEUs)	1.9	2.5
Road freight forwarding		
Bulk cargo (in millions of tonnes)	0.1	0.5
Container cargo (in 10 thousands of TEUs)	2.4	8.9
Express services		
Packages & documents (in millions of pieces)	14.3	12.2
Shipping agency		
Net registered tonnes (in millions of tonnes)	280.5	195.6
Vessel calls (number of times)	61,443	52,442
Storage and terminal services		
Warehouses (in millions of tonnes)	16.7	18.5
Terminals bulk cargo (in millions of tonnes)	2.4	2.3
Terminal containers (in 10 thousands of TEUs)	116.7	77.8
Marine transportation		
TEUs	1,128,364	1,016,229
Other services		
Trucking (in millions of tonnes)	2.8	2.8

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## Notes:

To better reflect the business operations of the Group, adjustments were made to the measurement unit of the following operating statistics of various businesses segments. Such adjustments do not affect the operating statistics for previous years:

1. The measurement unit for container cargo of sea freight forwarding under freight forwarding was changed from "in million tonnes" to "in 10 thousands of TEUs";
2. The measurement unit for container cargo of rail freight forwarding under freight forwarding was changed from "in million tonnes" to "in 10 thousands of TEUs";
3. The measurement unit for container cargo of road freight forwarding under freight forwarding was changed from "in million tonnes" to "in 10 thousands of TEUs";
4. The measurement unit for terminals containers under storage and terminal services was changed from "in million tonnes" to "in 10 thousands of TEUs".

## RESULTS OF OPERATIONS

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

	For the year ended 31 December 2004                  2003 (RMB in millions, except for data of per share and number of shares)	
Turnover	21,879.8	17,373.9
Other revenues	63.7	54.0
Total revenues	21,943.5	17,427.9
Transportation and related charges	(16,340.1)	(12,673.3)
Depreciation and amortisation	(245.9)	(218.4)
Operating costs (excluding transportation and related charges, depreciation and amortisation):		
— Staff costs	(1,477.3)	(1,262.6)
— Repairs and maintenance	(103.3)	(94.6)
— Fuel	(480.3)	(404.9)
— Travel and promotional expenses	(279.8)	(213.1)
— Office and communications expenses	(160.1)	(175.4)
— Rental expenses	(1,279.7)	(923.3)
— Other operating expenses	(339.8)	(343.6)
Operating profit	1,237.2	1,118.7
Finance income, net	68.3	72.5
	1,305.5	1,191.2

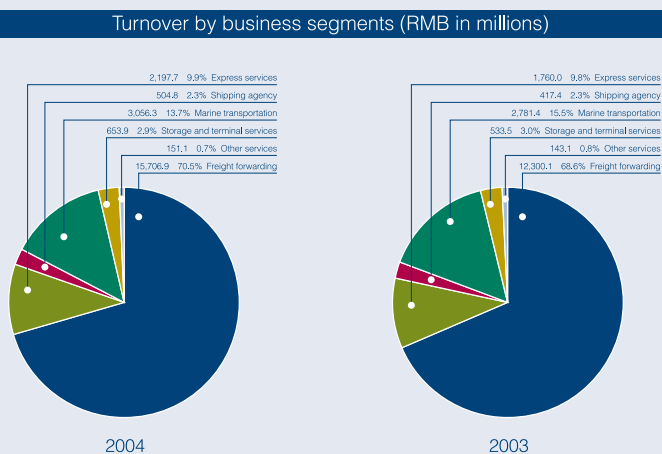
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	For the year ended 31 December	
	2004	2003
	(RMB in millions, except for data of per share and number of shares)	
Share of results of associates before taxation	13.9	9.6
Profit before taxation	1,319.4	1,200.8
Taxation	(338.7)	(339.6)
Profit after taxation	980.7	861.2
Minority interests	(177.9)	(156.2)
Profit for the year	802.8	705.0
Dividends	271.9	237.9
Earnings per share, basic and diluted <sup>(1)</sup>	RMB0.19	RMB0.17
Weighted average number of shares (in million) <sup>(1)</sup>	4,249.0	4,049.1
Number of shares at the end of the year (in millions) <sup>(1)</sup>	4,249.0	4,249.0

Note:

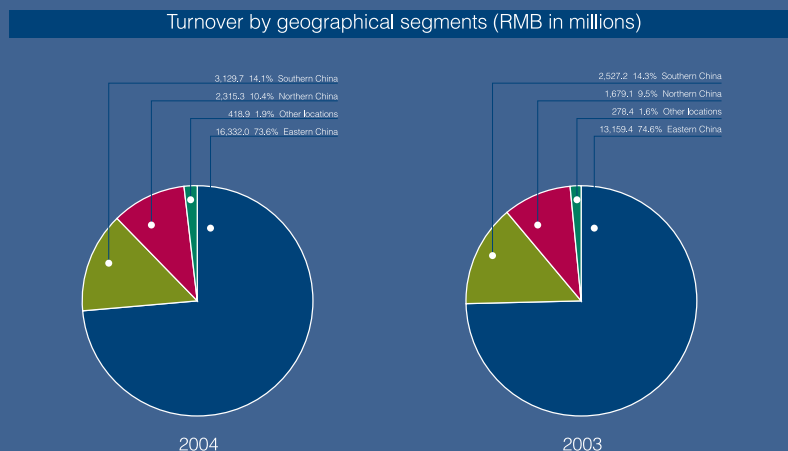
- (1) Basic and diluted earnings per share for the years ended 31 December 2004 and 2003 are computed by dividing the profit for the year by 4,249,002,200 shares and 4,049,057,340 shares, respectively, being the weighted average of number of ordinary shares in issue for the years. As there are no potentially dilutive securities, there is no difference between basic and diluted earnings per share.

The table below sets forth the Group's turnover by business segments and their respective percentages of total turnover before inter-segment eliminations for the years indicated:



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The table below sets forth the Group's turnover by geographical segments and their respective percentage of total turnover before inter-segment eliminations for the years indicated:



**Notes:**

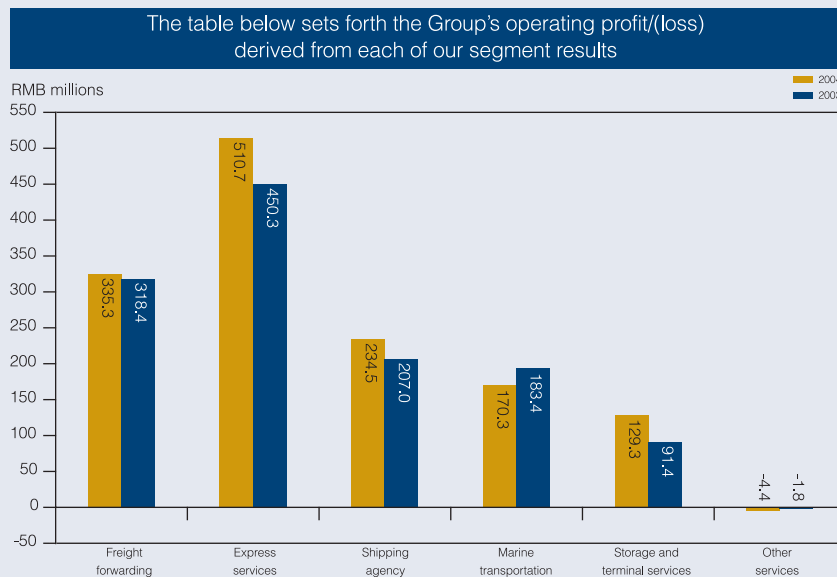
- (1) Eastern China includes core strategic locations in Jiangsu, Shanghai, Zhejiang, Fujian and Shandong and the operations of Sinoair (Sinotrans Air Transportation Development Co., Ltd., a listed company on the Shanghai Stock Exchange. Stock name: Sinoair; stock code: 600270) in Shanghai, Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi and Shandong.
- (2) Southern China includes core strategic locations in Guangdong and Hubei and the operations of Sinoair in Hubei, Hunan, Guangdong, Guangxi, Hainan, Guizhou and Yunnan.
- (3) Northern China includes core strategic locations in Liaoning, Tianjin and the operations of Sinoair in Beijing, Tianjin, Hebei, Shanxi, Inner Mongolia and Henan.
- (4) Other locations primarily includes air freight forwarding and express services operated by Sinoair and certain of our jointly controlled entities in locations other than the above.

Eastern China accounted for 73.6% of total turnover prior to inter-segment eliminations for the year ended 31 December 2004 primarily due to the fact that Eastern China comprises the most economically developed regions of China.



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The table below sets out the Group's operating profit/(loss) derived from the results of each segment which is defined as turnover for that segment less direct operating expenses but before deducting unallocated costs. Segment results are presented as amounts of the Group's combined segment results for the years indicated:



### COMPARISON AND ANALYSIS OF OPERATING RESULTS AND FINANCIAL POSITION FOR THE YEAR ENDED 31 DECEMBER 2004

#### Turnover

The Group's turnover increased by 25.9% from RMB17,373.9 million in 2003 to RMB21,879.8 million in 2004.

By integrating market resources, enhancing network coverage, strengthening development of standardised business processes, promoting unified sales and marketing, enhancing and perfecting business products and enlarging the scope of the value-added services, the Group's business activities sustained robust growth which has driven up the growth of the Group's turnover.

#### Freight forwarding

Turnover of the Group's freight forwarding services grew by 27.7% to RMB15,706.9 million in 2004, from RMB12,300.1 million in 2003.

Number of containers handled by sea freight forwarding services increased by 18.0% from 3.00 million TEUs in 2003 to 3.54 million TEUs in 2004, while the amount of cargo handled by air freight forwarding services increased by 53.8% from 183,700 tonnes in 2003 to 282,600 tonnes in 2004.

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Our freight forwarding business continued to achieve a steady growth, in particular, the increase in business volume of sea freight forwarding business and the higher rate charged for sea freight forwarding have both contributed to the increase in turnover. Leveraging on our extended efforts in marketing and the adoption of measures such as centralised purchase, the scale of operations of air freight forwarding was expanded, thereby providing a force that drives up the turnover of freight forwarding.

### **Express services**

Turnover of our express services rose by 24.9% to RMB2,197.7 million in 2004, from RMB1,760.0 million in 2003.

Number of documents and packages handled by the Group increased by 16.7% to 14.28 million pieces in 2004 from 12.24 million pieces in 2003.

The rapid growth in express services in the PRC has provided the Group with favourable opportunities to further improve its network coverage. Our marketing activities and new business products launched have also driven up our turnover.

### **Shipping agency**

Turnover of the Group's shipping agency services went up by 20.9% to RMB504.8 million in 2004 from RMB417.4 million in 2003.

Number of containers handled by our shipping agency services in 2004 was 7.38 million TEUs, an increase of 22.0% from 6.05 million TEUs in 2003. Net registered tonnage of vessels handled by our shipping agency services in 2004 reached 280.5 million tonnes, a 43.4% increase from 195.6 million tonnes in 2003. Number of vessel calls managed in 2004 grew by 17.2% to 61,443 compared with 52,442 for 2003.

The increasingly intensified market competition and the consistent lowering of agency fee have impelled the Group to expand its market in a proactive manner and to launch unified marketing activities, as well as to strengthen the strategic relationship with shipping companies, and such initiatives have propelled the rapid growth in the turnover and business volume of such business.

### **Storage and terminal services**

Turnover from storage and terminal services in 2004 aggregated RMB653.9 million, representing a 22.6% growth over RMB533.5 million in 2003.

Our warehouses handled 16.65 million tonnes of cargo in 2004, representing a 10.1% decrease over 18.51 million tonnes in 2003; containers handled in terminals in 2004 grew to 1.167 million TEUs from 0.778 million TEUs in 2003, an increase of 50.0%.



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By the increase in input of resources to the terminal business and the improvement in the work flow, our operation capacity and efficiency were enhanced, thus propelling the growth in the turnover and business volume of the storage and terminal business.

### **Marine transportation**

Turnover of the Group's marine transportation services increased by 9.9% from RMB2,781.4 million in 2003 to RMB3,056.3 million in 2004.

Number of containers shipped by the Group rose to 1.128 million TEUs in 2004, up 11.0% from 1.016 million TEUs in 2003.

Through the expansion of cargo-handling capacity for intra-Asia lines and increased marketing, the transportation volume of the Group's liner services rose. However, due to the drop in the average rate of intra-Asia lines, the increase in revenue lagged behind the growth in business volume.

### **Other services**

Turnover from other services, primarily from trucking services, rose by 5.6% from RMB143.1 million in 2003 to RMB151.1 million in 2004.

Our trucking services shipped 2.80 million tonnes of cargo in 2004, which is similar to that in 2003.

The Group's strategic measures such as expansion of our marketing activities, adjustment of business structure and reduction of vacancy rate, have helped achieve a growth of turnover, despite the reduction of our truck capacity and the transportation capacity being maintained at a similar level as compared to the previous year.

### **Transportation and related charges**

The relatively rapid increase in the cost of the freight forwarding business fuelled a 28.9% growth in transportation and related charges for 2004 to RMB16,340.1 million, compared with RMB12,673.3 million in 2003. This was not only caused by the rise of freight forwarding expenses, which resulted from an increase of business volume, but also the under-capacity of sea transportation which in turn undermined our bargaining power and our capability to control the transportation cost. Furthermore, the intensified market competition also squeezed the profit margin for the sea freight forwarding business, leading to an increase in cost and a decrease in profit margin. Rising rates of international marine transportation also contributed to the increase in our transportation cost.

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## **Depreciation and amortisation**

Depreciation and amortisation for 2004 amounted to RMB245.9 million, representing an increase of 12.6% from RMB218.4 million in 2003, primarily as a result of increases in the Group's property, plant and equipment and intangible assets.

## **Operating costs (excluding transportation and related charges, depreciation and amortisation)**

In 2004, the Group's operating costs (excluding transportation and related charges, depreciation and amortisation) went up by 20.6% from RMB3,417.5 million in 2003 to RMB4,120.3 million in 2004. Increases in operating costs (excluding transportation and related charges, depreciation and amortisation) were primarily due to increased costs in staff, leasing, travelling and promotion and fuel.

Rise in staff costs primarily was due to salary adjustments in accordance with the Group's new remuneration system and incentive schemes. Increase in leasing expenses was mainly driven by an increase in marine transportation capacity and vessel rentals. Increase in marine transportation capacity and rising global oil price also resulted in a 18.6% growth in fuel expenses. In addition, expenses like travelling and promotion also went up correspondingly in 2004.

## **Operating profit**

Operating profit for 2004 was RMB1,237.2 million, representing an increase of 10.6% from RMB1,118.7 million in 2003 primarily due to volume growth. Operating profit as a percentage of turnover decreased to 5.65% in 2004 from 6.44% in 2003, primarily as a result of the increases in transportation and related charges and all operating expenses.

## **Taxation**

Taxation amounted to RMB338.7 million in 2004, down 0.3% over RMB339.6 million in 2003. Taxation as a percentage of profit before taxation decreased to 25.7% for 2004 from 28.3% in 2003, primarily due to the relatively rapid increase in the profit before tax for certain companies enjoying low tax rates and the tax refund received by certain companies.

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## Minority interests

Minority interests in 2004 amounted to RMB177.9 million, up 13.9% from RMB156.2 million in 2003, primarily as a result of an increase in contributions from the Group's subsidiary, Sinoair.

## Profit for the year

Our profit for the year amounted to RMB802.8 million in 2004, up 13.9% over RMB705.0 million in 2003.

## Liquidity and capital resources

Our principal source of working capital is cash generated from our operations.

The following table summarises our cash flows for each of the two years ended 31 December 2004 and 2003:

	Year ended 31 December	
	2004	2003
	(RMB in millions)	
Net cash inflow from operating activities	665.6	719.3
Net cash used in investing activities	(582.3)	(1,074.6)
Net cash (used in)/generated from financing activities	(243.4)	2,896.1
Cash and cash equivalents at end of year	4,722.7	4,882.8

## Operating activities

Net cash from operating activities decreased from RMB719.3 million for 2003 to RMB665.6 million for 2004 by 7.5%, primarily as a result of an increase of RMB506.7 million in trade and other receivables (2003: increase of RMB794.3 million) and an increase of RMB112.5 million in prepayments, deposits and other current assets (2003: increase of RMB31.6 million), which was offset by an increase of RMB94.4 million in trade payables (2003: increase of RMB602.8 million), an increase of RMB77.6 million in receipts in advance from customers for 2004 (2003: increase of RMB126.7 million). Average aging of trade receivables for 2004 and 2003 were 63 days and 64 days respectively.

## Investing activities

Net cash used in investment activities in 2004 primarily comprised RMB621.8 million for purchase of property, plant and equipment, RMB15.7 million for purchase of intangible assets, RMB89.4 million for purchase of land use rights, RMB47.7 million for acquisition of subsidiaries, RMB101.6 million for investments in associates, RMB66.2 million for purchase of held-to-maturity investments, which was partially offset by

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RMB43.0 million from the proceeds of the disposal of held-to-maturity investments and RMB215.2 million with respect to the decrease of term deposits with initial term of over three months. In 2003, net cash used in investment activities primarily comprised RMB414.4 million for purchase of property, plant and machinery, RMB66.4 million for purchase of intangible assets and land use rights and RMB649.5 million with respect to the increase of term deposits with initial term of over three months.

## Financing activities

Net cash used in financing activities for 2004 amounted to RMB243.4 million, compared with net cash generated from financing activities of RMB2,896.1 million for 2003, which was primarily attributable to the net proceeds of RMB3,543.6 million, after deducting related expenses, raised from the IPO in 2003. Net cash used in financing activities for 2004 mainly comprised repayment of bank loans of RMB323.2 million, dividends paid of RMB254.9 million and dividends for minority shareholders in subsidiaries of RMB24.6 million, which was partially offset by newly raised bank borrowings of RMB364.1 million.

## Capital expenditures

The Group's capital expenditures for the year ended 31 December 2004 were RMB726.9 million, consisting mainly of RMB621.8 million for purchase and construction of property, plant and equipment, RMB15.7 million for purchase of intangible assets, RMB89.4 million for purchase of land use rights, among which RMB428.7 million was for construction of terminals, warehouses, logistics centres and depot areas, RMB179.8 million for purchase of vehicles and equipment, and RMB89.8 million for IT investment and refurbishment and purchase of office equipment.

## Contingent liabilities and guarantees

As at 31 December 2004, the Group's contingent liabilities amounted to approximately RMB59.2 million, arising primarily from outstanding guarantees of RMB29.1 million for the obligations of the jointly controlled entities of the Group, guarantees provided for the joint venture partner of RMB8.8 million and pending lawsuits of RMB21.3 million. In addition, in the ordinary course of business, Sinoair has issued various performance and liability guarantees of unspecified amounts to the General Administration of Civil Aviation of China for the benefit of certain jointly controlled entities to enable those entities to obtain the required air freight forwarding operating licenses.

## Gearing ratio

As at 31 December 2004, the Group's gearing ratio was 48.2% (2003: 47.7%), which was arrived at by dividing the sum of liabilities and minority interests by total assets as at 31 December 2004.

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### **Foreign exchange rate risk**

A substantial portion of our turnover and transportation and related charges are denominated in US dollars. The exchange rate of Renminbi is relatively stable at present and the Group expects that there would be no material foreign exchange exposure.

There is no assurance that any movements in the exchange rate of Renminbi against US dollars and other foreign currencies will not have any impact on our results and financial position (including ability to pay dividends).

### **Credit risk**

The extent of our credit exposure is represented by aggregated balances of trade receivables and other receivables, trading investments, held-to-maturity investments, pledged deposits and term deposits with an initial term of over three months. The maximum credit exposures in the event that other parties fail to perform their obligation under these financial instruments was approximately RMB5,162.6 million and RMB4,702.6 million as at 31 December 2004 and 2003 respectively. In addition, the Group made certain prepayments on behalf of customers, prepaid certain expenses and provided certain deposits, the aggregate of which was RMB381.1 million and RMB266.6 million as at 31 December 2004 and 2003 respectively.

### **Employees**

The Group (representing the Company and its subsidiaries) had 15,966 employees as at the end of 2004.

The Group established and implemented a standardised system for remuneration management, including Share Appreciation Rights Scheme and Long-term Performance Unit Scheme, which form an effective incentive control mechanism in motivating staff to work more diligently. It also reinforced its training to the staff, which further enhanced their personal development.

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The Company advocates a staff oriented philosophy. To care about our staff, we commit to provide a pleasant working environment and development opportunities for them. Under such an objective, it would definitely enhance the creativity of our staff, and thereby promoting the harmonious relationship between the Company and our staff.

### PROSPECTS OF BUSINESS DEVELOPMENT

The Company believes that as the China economic growth continues to gain pace in 2005, it will provide a force to drive further growth in the Group's business. However, various potential factors such as high international oil price, trade protection, growing trade conflict and periodical changes in the international marine transportation market cause adverse impacts to the Group's business. According to the commitment for entering WTO, the transportation and logistics market of the PRC would be fully opened up this year, and we will definitely face competitions and will be under even more intensive pressure.

The Company is confident about the Group's future development. We will continue to make effort to improve coverage of our business network, expand our new product development, upgrade our products, extend our effort in sales and marketing and optimise the client portfolio. We firmly believe that with our capability and our abundance of resources, and under the established development strategies, the Group can grasp the invaluable opportunities presented by the rapid development of the PRC economy and will attain even more outstanding results in future.