

# Management Discussion and Analysis

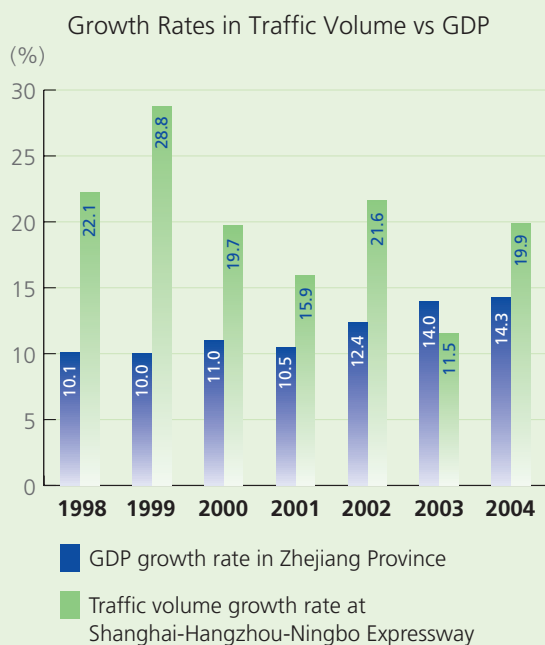
Fang Yunti



## BUSINESS REVIEW

Economic growth in the PRC was brought to a steadier pace in 2004 with the introduction of a series of macro economic control measures by the government at the start of the year. Amid a favorable economic environment in Zhejiang Province, the ongoing process of rapid industrialization and urbanization continued to generate a strong demand for road transport, which was met with a rapidly expanding expressway network and growing number of vehicle sales, both for passenger cars and trucks.

In contrast to an estimated 14.3% GDP growth rate in Zhejiang Province during the Period, traffic volumes on the two expressways operated by the Group grew more than 20% and 30%, respectively, while expressway-related business operations, such as the operation of service areas, advertising and vehicle servicing along the expressways, grew at an even higher rate of more than 50%.



A detailed breakdown in turnover for the Group during the Period is set out below:

	Year ended December 31,		
	2004 Rmb'000	2003 Rmb'000	% Change
Toll income	<b>3,066,954</b>	2,458,726	24.7%
Shanghai-Hangzhou-Ningbo Expressway	<b>2,327,733</b>	1,908,764	21.9%
Shangsans Expressway	<b>739,221</b>	549,962	34.4%
Other income			
Service areas	<b>183,637</b>	117,205	56.7%
Advertising	<b>41,159</b>	26,138	57.5%
Road maintenance	<b>7,244</b>	2,669	171.4%
	<b>3,298,994</b>	2,604,738	26.7%
Revenue taxes	<b>(167,001)</b>	(132,933)	25.6%
Turnover	<b>3,131,993</b>	2,471,805	26.7%

## TOLL ROAD OPERATIONS

The operation of the two toll roads, namely the Shanghai-Hangzhou-Ningbo Expressway and the Shangsans Expressway, continued to be the mainstay of the Group, together contributing 92.8% of the Group's total turnover.



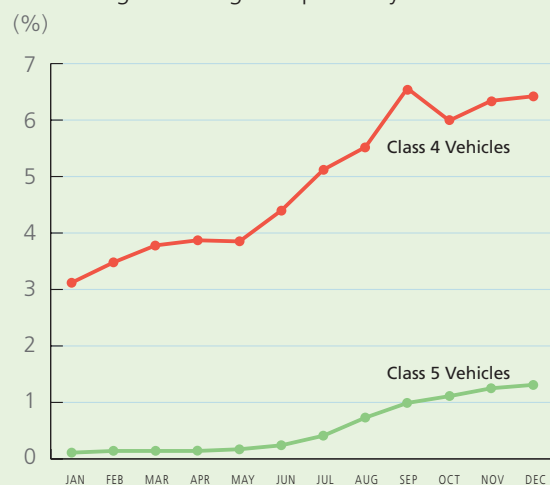
In its sixth year of operation since full completion and opening to traffic in late 1998, the 248km Shanghai-Hangzhou-Ningbo Expressway recorded an average daily traffic volume in full-trip equivalents of 33,525, generating a toll income of Rmb2,327.7 million during 2004, representing growth rates of approximately 20.3% and 21.9% over 2003, respectively.

The 142km Shangsan Expressway, on the other hand, was in its fourth year of operation since its full completion and opening to traffic in late 2000. Average daily traffic volume in full-trip equivalents during 2004 was 19,401 while toll income was Rmb739.2 million, representing growth rates of approximately 29.9% and 34.4% over 2003, respectively.

The growth rates in traffic volume in 2004 for the two expressways were amplified by a lower-than-usual comparison basis in 2003, especially for the Shanghai-Hangzhou-Ningbo Expressway where traffic diversions by a local city ring road as well as a short-term disruption brought about by the outbreak of SARS had dampened traffic volume growth in 2003.

Coordinated actions taken by the relevant PRC authorities starting from mid 2004 to curb the widespread practice of overloading trucks on the roads had effectively increased the proportion of heavy trucks amongst the traffic mix, aside from creating a safer traveling environment on the roads. As a result, the two expressways had higher growth rates in toll income than traffic volume growth rates during the second half of 2004.

Percentage of Class 4 & 5 Vehicles in Shanghai-Hangzhou-Ningbo Expressway in 2004



Traveling conditions on the Shanghai-Hangzhou-Ningbo Expressway also improved substantially following the conclusion of the major road surface-overlaying project in 2004. Initiated in 2002, the project incurred a total cost of approximately Rmb411.1 million during the three-year span, amongst which Rmb95.4 million was incurred in 2004.

Phase II of the ongoing project to widen the Shanghai-Hangzhou-Ningbo Expressway from four lanes to eight lanes proceeded as scheduled in 2004 without causing any significant impact on the normal traffic flow along the Dajing-Fengjing section between Shanghai and Hangzhou. Phase III of the widening project, to be carried out along the Guzhu-Duantang section between Hangzhou and Ningbo, commenced construction in October 2004, and is targeted for completion by the end of 2007.

During the Period, the Company assessed the status of expressway assets along the section of Shanghai-Hangzhou-Ningbo Expressway under widening, and disposed of the remaining value of demolished expressway assets that amounted to Rmb202.4 million, thus reducing the net profit attributable to shareholders by Rmb139.1 million.

### **EXPRESSWAY-RELATED BUSINESS OPERATIONS**

The Group's expressway-related business operations, such as the operation of service areas, advertising and vehicle servicing along the expressways, were carried out by Zhejiang Expressway Investment Development Co., Ltd. (the "Development Co"), a 51% owned subsidiary of the Company.

Benefiting from growing traffic volumes on the expressways, improved quality of service provided to passing travelers and expanded facilities at the service areas, the expressway-related business operations enjoyed a strong across-the-board growth in 2004. Turnover for Development Co grew 55.2% during the Period to reach Rmb218.5 million, while net profit realized was Rmb38.7 million, representing a growth of 58.9% over 2003 on a pro forma basis.

### **LONG-TERM INVESTMENTS**

Networking effect had a greater impact on the 9.45km Shida Road due to its proximity to Hangzhou City Ring Road. Owned and operated by Hangzhou Shida Highway Co., Ltd. (a 50% owned jointly-controlled entity of the Company), Shida Road saw its traffic volume grow 64.9% whereas its toll income grow 67.4% over 2003. Net profit realized by the jointly-controlled entity during the Period was Rmb39.2 million, representing an increase of 120.5% over 2003.

The retail gas station business, operated by Zhejiang Expressway Petroleum Development Co., Ltd. (a 50% owned associate of the Company) within Zhejiang Province, encountered growing demand as well as increasing competition. While turnover for the associate company grew 27.5% in 2004, net profit realized during the Period was Rmb16.0 million, representing a decrease of 24.7% over 2003.

Digital printing business and network equipment business, both carried out by JoinHands Technology Co., Ltd. (a 27.58% owned associate of the Company), experienced both rising costs and increasing market competition in 2004. Net profit realized by the associate company was Rmb3.8 million, representing a decrease of 43.7% over 2003.

### **PROJECT INVESTMENT**

On October 25, 2004, Development Co invested Rmb9 million to acquire a 45% equity interest in a newly established company, Zhejiang Concord Property Investment Company, with the remaining 55% being owned by World Trade Center Zhejiang Real Estate Development Co., Ltd. Zhejiang Concord Property Investment Company is principally involved in real estate development and management, as well as sales in related building materials.

On November 26, 2004, the Company entered into an agreement to invest a total of Rmb1,145,375,000 for a 35% shareholders' interest in Zhejiang Jiashao Expressway Co., Ltd. that was established for the development and operation of Jiashao Expressway, a proposed 69km expressway connecting the Shangsan Expressway with the Zajiasu Expressway across the Qiantang River. Details of the investment were set out in a circular of the Company dated December 20, 2004.



## Customers

Providing customers good-value-for-money with our superior service. Superior service refers to smooth, safe and comfortable travel conditions; an efficient toll collection system...well-equipped and customer-oriented service areas, and so forth...to satisfy varied, increasingly demanding customer needs.

## HUMAN RESOURCES

To better equip frontline staff of the Group to deal with heavy demand and workload as a result of the higher than anticipated traffic volume growth on the expressways operated by the Group, the Company placed greater emphasis on providing adequate training and improved remunerations for the staff working in the fields of toll collection, maintenance, as well as monitoring and controls during the Period.

As at December 31, 2004, there were a total of 2,744 employees under the Group, amongst whom 205 were administrative staff, 419 were engineering technicians, and 2,120 were staff working in the fields of toll collection, maintenance and service areas. Total remunerations for the Period amounted to Rmb118.0 million.

## FINANCIAL ANALYSIS

The Group adopts a financial policy that is both prudent and active in realizing its long-term strategic goal of maximizing shareholders' wealth.

During the Period, turnover and net profit attributable to shareholders for the Group were approximately Rmb3,132.0 million and Rmb1,225.7 million, respectively, representing increases of 26.7% and 21.5% over 2003, respectively; earnings per share increased by 21.5% to Rmb28.22 cents, while return on equity for the Period increased from 9.9% to 11.4%.

### PROFITABILITY

With compound annual growth rates of 17.8% and 12.6% in earnings per share and return on equity, respectively, the investor's share of profits generated by the Group represents a steady growth in the last five years. Details are as follows:

	Year ended December 31,				2004
	2000	2001	2002	2003	
EPS (Rmb cents)	14.64	17.51	20.50	23.23	<b>28.22</b>
Growth rate	16.0%	19.6%	17.1%	13.3%	<b>21.5%</b>
ROE	7.1%	8.2%	9.2%	9.9%	<b>11.4%</b>
Growth rate	10.9%	15.5%	12.2%	7.6%	<b>15.2%</b>

The high rate of growth in earnings per share and ROE reflected both the profitability and growth potentials of the expressways operated by the Group.

To ensure our shareholders receive a substantial return from the Group's earnings, the management follows a steady dividend policy with a high payout ratio. During the period, the dividend payout ratio reached 67.3%. Details of dividends in the last five years are as follows:

	Year ended December 31,				2004
	2000	2001	2002	2003	
Dividends (Rmb'000)	390,880	434,311	564,604	651,467	<b>825,191</b>
Dividend payout ratio	61.5%	57.1%	63.4%	64.6%	<b>67.3%</b>

## LIQUIDITY AND FINANCIAL RESOURCES

### Liquidity

As at December 31, 2004, the total current assets held by the Group amounted to Rmb1,894.2 million, of which 21.9% were account receivables, other receivables and inventories.

Due to the nature of its core business operations, the Group had adequate net cash inflows from operating activities, which amounted to Rmb1,497.8 million as at the end of the Period.

As an indication of the Group's ability to meet short-term debt obligations, the current ratio was 1.2 as at December 31, 2004, representing a high level of financial liquidity for the Group.

## Financial Resources

As at December 31, 2004, the Group held Rmb722.0 million in cash and cash equivalents, Rmb81.7 million in time deposits and Rmb676.4 million in short-term investments, totaling Rmb1,480.1 million. Details are as follows:

As at December 31,		
	2004 Rmb'000	2003 Rmb'000
Cash and cash equivalents	<b>721,999</b>	567,195
Rmb	<b>717,559</b>	565,251
US\$ in Rmb equivalents	<b>4,434</b>	1,393
Euro in Rmb equivalents	–	59
HK\$ in Rmb equivalents	<b>6</b>	492
Time deposits	<b>81,740</b>	251,600
Rmb	<b>81,740</b>	251,598
US\$ in Rmb equivalents	–	–
Euro in Rmb equivalents	–	–
HK\$ in Rmb equivalents	–	2
Short-term investments	<b>676,447</b>	1,104,266
Rmb	<b>676,447</b>	1,104,266
Total	<b>1,480,186</b>	1,923,061
Rmb	<b>1,475,746</b>	1,921,115
US\$ in Rmb equivalents	<b>4,434</b>	1,393
Euro in Rmb equivalents	–	59
HK\$ in Rmb equivalents	<b>6</b>	494

Amongst the total short-term investments of Rmb676.4 million held by the Group during the Period, approximately 91.3% were treasury bonds, with the remaining being close-ended security investment funds. The Company intends to further reduce the size of its short-term investments by the end of 2005 to meet its capital expenditure needs.

The Directors believe that the Group has sufficient financial resources to meet its operational as well as capital expenditure needs in the foreseeable future.

## BORROWINGS AND SOLVENCY

As at December 31, 2004, the Group had total interest-bearing borrowings of Rmb2,443.5 million, representing a decrease of 10.2% since the beginning of the year. Of the Rmb2,443.5 million total interest-bearing borrowings, short-term interest-bearing borrowings decreased by 19.3% to Rmb787.9 million by the end of the year, while long-term interest-bearing borrowings decreased by 5.1% to Rmb1,655.6 million. Details are as follows:

### Maturity Profiles

	Gross amount Rmb'000	Within 1 year Rmb'000	2-5 years inclusive Rmb'000	Beyond 5 year Rmb'000
Floating rates				
World Bank loan	800,862	157,892	365,826	277,144
Fixed rates				
Commercial				
bank loans	570,000	570,000	–	–
Corporate bonds	1,000,000	–	–	1,000,000
Government loans	72,600	60,000	12,020	580
Total as at				
December 31, 2004	2,443,462	787,892	377,846	1,277,724
Total as at				
December 31, 2003	2,720,126	975,950	365,211	1,378,965

During the Period, the interest rate of the Group's semi-annual borrowings was 4.536%, whereas the interest rates of the Group's annual borrowings were 4.779%, 5.045%, and 5.310%, corresponding to 50.0%, 37.5%, and 12.5% of the total annual borrowings, respectively. The floating rates of the Group's Rmb800.9 million World Bank loans, denominated in US dollars, varied from 4.850% to 3.800% during the Period, averaging at approximately 4.325%. The interest rate of government loans in Renminbi remained at 3.000%, the same as that applicable as at December 31, 2003. The annual coupon rate for the Rmb1 billion corporate bonds issued by the Company for a term of 10 years was fixed at 4.290%, with interests payable annually.



Due to further reduction in the borrowings from domestic commercial banks and reduction in interest rates on the World Bank loans, interest expenses of the Group for the Period decreased by 27.3% to Rmb103.5 million. With profit before interest and tax at approximately Rmb2,014.4 million, the Group's interest cover ratio (profit before interest and tax over interest expenses) for the Period was 19.5 (2003: 12.2), representing the Group's strong ability to meet its interest obligations.

	2004 Rmb'000	2003 Rmb'000
Profit before tax and interest	<b>2,014,438</b>	1,735,492
Interest expenses	<b>103,457</b>	142,303
Interest cover ratio	<b>19.5x</b>	12.2x

Furthermore, the asset-liability ratio, which is the proportion of the Group's assets that are financed through debt, was 23.6% during the Period, representing strong solvency of the Group.

## CAPITAL STRUCTURE

As at December 31, 2004, the Group's capital structure comprised Rmb10,720.2 million in shareholders' equity, Rmb1,642.6 million in fixed rate liabilities, Rmb800.9 million in floating rate liabilities and Rmb2,297.8 million in interest-free liabilities and minority interests, representing approximately 69.3%, 10.6%, 5.2% and 14.9%, respectively, of the Group's total capital.

With long-term interest bearing liabilities at approximately Rmb1,655.6 million, the Group's gearing ratio (total amount of the long-term interest-bearing liabilities vs. the shareholders' equity) as at December 31, 2004 was 15.4% (2003: 17.2%).

	As at December 31, 2004		As at December 31, 2003	
	Rmb'000	%	Rmb'000	%
Shareholders' equity	<b>10,720,211</b>	<b>69.3%</b>	10,145,979	67.3%
Fixed rate liabilities	<b>1,642,600</b>	<b>10.6%</b>	1,872,600	12.4%
Floating rate liabilities	<b>800,862</b>	<b>5.2%</b>	847,526	5.6%
Interest-free liabilities	<b>2,297,766</b>	<b>14.9%</b>	2,202,582	14.6%
Total	<b>15,461,439</b>	<b>100.0%</b>	15,068,687	100.0%
Long-term interest-bearing liabilities	<b>1,655,570</b>	<b>10.7%</b>	1,744,176	11.6%
Gearing ratio 1		<b>44.2%</b>		48.5%
Gearing ratio 2		<b>15.4%</b>		17.2%
Asset-liability ratio		<b>23.6%</b>		26.0%

Notes: Gearing ratio 1 represents the sum of fixed rate liabilities, floating rate liabilities, interest-free liabilities and minority interest vs. the shareholders' equity; gearing ratio 2 represents the total amount of the long-term interest-bearing liabilities vs. the shareholders' equity.

## CAPITAL EXPENDITURE COMMITMENTS AND UTILIZATION

During the Period, capital expenditure incurred by the Group amounted to approximately Rmb994.5 million, while capital expenditure incurred by the Company amounted to approximately Rmb322.6 million. Amongst the total amount of the Group's capital expenditure, Rmb890.0 million was used on the project to widen the Shanghai-Hangzhou-Ningbo Expressway.

Capital expenditure commitments for the Group and the Company as at December 31, 2004 amounted to Rmb5,377.1 million and Rmb3,786.3 million, respectively. Amongst the capital expenditure that will be spent by the Group for 2005 and beyond, 67.4% will be used on the expressway-widening project, while 21.3% will be used toward construction of the Jiaxing-Shaoxing Expressway.

## As at December 31, 2004

	Commitments Rmb'000	Group Utilization Rmb'000	Balance Rmb'000	Commitments Rmb'000	Company Utilization Rmb'000	Balance Rmb'000
Expressway Widening Project						
From Dajing to Fengjing	2,508,190	991,626	1,516,564	–	–	–
From Guzhu to Duantang	2,300,000	194,034	2,105,966	2,300,000	194,034	2,105,966
Acquisition of additional 18.4% equity interest in Shangsang Co	485,000	–	485,000	485,000	–	485,000
Renovation of Service Area	1,371	–	1,371	–	–	–
Remaining construction works of the Shangsang Expressway	47,667	–	47,667	–	–	–
Purchase of machinery	72,459	–	72,459	47,224	–	47,224
Decoration of office	5,489	2,796	2,693	5,489	2,796	2,693
Jiashao Expressway Project	1,145,375	–	1,145,375	1,145,375	–	1,145,375
Total	6,565,551	1,188,456	5,377,095	3,983,088	196,830	3,786,258

The aforementioned capital expenditure of the Group will firstly be funded with its internal financial resources, with a preference for debt financing in meeting any shortfalls.

#### CONTINGENT LIABILITIES AND PLEDGE OF ASSETS

As at December 31, 2004, the Group did not have any contingent liabilities nor any pledge of assets.

#### FOREIGN EXCHANGE EXPOSURE

The Group has a World Bank loan of approximately Rmb800.9 million, denominated in US Dollars and borrowed for the construction of the Shanghai-Hangzhou-Ningbo Expressway. In addition, dividends for H shares payable by the Company are settled in HK dollars.

In view of the status of the exchange rate between Renminbi and US Dollars, the Directors do not foresee any material foreign exchange risk for the Group. However, there is no assurance that any foreign exchange exposure will not adversely affect the operating results of the Group in the future.



## OUTLOOK FOR 2005

First introduced in 2004, the macro economic control measures will continue into 2005. With a series of structural adjustments that are expected to take place as well as a growing emphasis on sustainability and equitability in the process of economic development, the general consensus on the PRC economic prospects for 2005 points to continued strong growth, although the growth has slowed down.

Taking advantage of economic growth in the Yangtze River Delta Region, which is the most economically robust region in China and Zhejiang Province in particular, is expected to continue with its double-digit growth in 2005 amid an ongoing process of rapid industrialization and urbanization in the region.

As an integral part of the effort to reinforce the rules and regulations against the practice of overloading trucks and to ease the financial burden on truck operators for not overloading, toll rates for heavy trucks of above 10 tons were lowered by varying degrees across roadways in the PRC, including the two expressways operated by the Group, starting from January 1, 2005. The measure has proven to be both effective and positive for expressway operators, as the resulting higher truck traffic volume has led to a higher growth rate in toll income that has more than compensated the impact brought about by lowered toll rates. More importantly, it has provided a safer traveling environment and led to lower maintenance costs in the long run.

Following completion of Phase I of the ongoing project to widen the Shanghai-Hangzhou-Ningbo Expressway from four lanes to eight lanes by the end of 2003, Phase II of the project is expected to be fully completed by the end of 2005, thereby substantially increasing the carrying capacity while improving traveling conditions between Shanghai and Hangzhou.

To accommodate the growing economy and the demand generated on road transport, the Ministry of Communications of the PRC has recently announced a long-term national expressway plan, calling for the construction of more than 50,000km expressways, in addition to the 34,000km expressways already in operation.

The newly announced plan includes an addition of 3,500km expressways to be constructed in Zhejiang Province in the next 15 years. This should provide more investment and acquisition opportunities for the Company, in addition to the sustained impetus for continued traffic growth on the existing expressways through networking effect for many more years to come.