

Management Discussion and Analysis

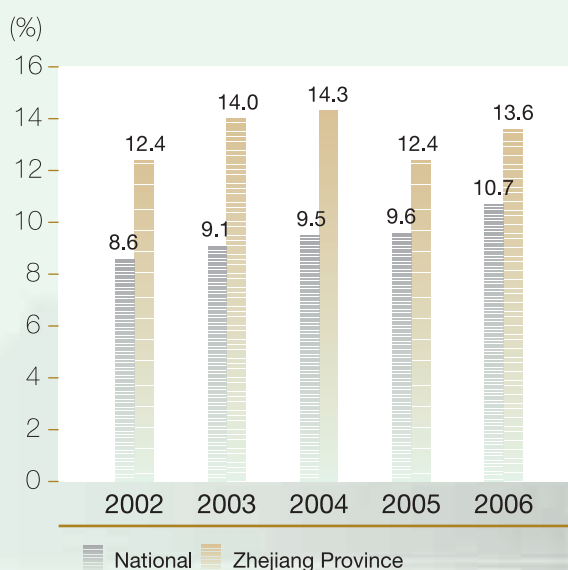


FANG Yunti

BUSINESS REVIEW

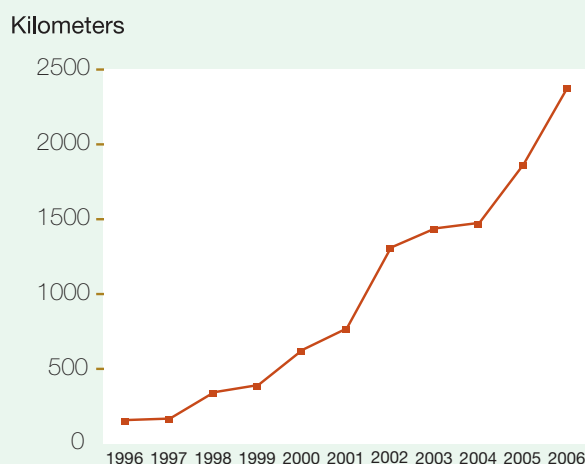
As the first year in the eleventh Five-Year National Economic Development Plan, year 2006 saw the economy in Zhejiang Province expand by 13.6% in GDP compared to the national GDP growth rate of 10.7%. More important than the rate of economic growth was improved quality of economic growth achieved in the province: better coordination among various industries and a more balanced growth throughout different regions of the province.

GDP Growth Rates



The strong economic growth in Zhejiang Province during the Period continued to generate increased demand for road transport. Such demand was in turn met by an expanding road network, providing an impetus for sustained traffic volume growth on roadways in general and expressways in particular.

Mileage of Expressways in Operation In Zhejiang Province

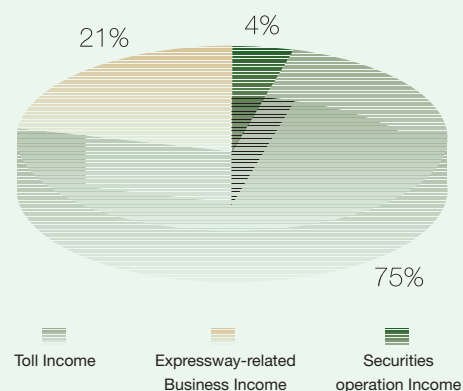


While toll income from expressway operations remained the mainstay of the Group during the Period, the proportion of contribution to total income from the Group's other business operations, such as gas stations, restaurants and shops in service areas, continued to grow. Together with revenue contribution in the second half of 2006 from the newly acquired securities business, total revenue of the Group during the Period amounted to Rmb4,763.8 million, representing an increase of 37.8% over 2005.

A detailed breakdown of the Group's income for the Period is set out below:

	2006 Rmb'000	2005 Rmb'000	% Change
Toll income			
Shanghai-Hangzhou-Ningbo Expressway	2,810,489	2,519,676	11.5%
Shangsans Expressway	833,823	830,994	0.3%
Other income			
Service areas business income	968,476	230,183	320.7%
Advertising business income	53,228	48,045	10.8%
Road maintenance income	5,633	2,568	119.4%
Securities operation Commission and brokerage income	173,372	—	—
Bank interest income	20,491	—	—
Subtotal	4,865,512	3,631,466	34.0%
Less: Revenue taxes	(101,732)	(175,081)	-41.9%
Revenue	4,763,780	3,456,385	37.8%

Income Breakdown



EXPRESSWAY OPERATIONS

Total toll income from the 248km Shanghai-Hangzhou-Ningbo Expressway and the 142km Shangsans Expressway amounted to Rmb3,644.3 million during the Period, representing an increase of 8.8% over 2005 and contributing to 74.9% of the Group's total income. Traffic volume growth during the Period, however, varied substantially for different sections of the expressways.

Management Discussion and Analysis

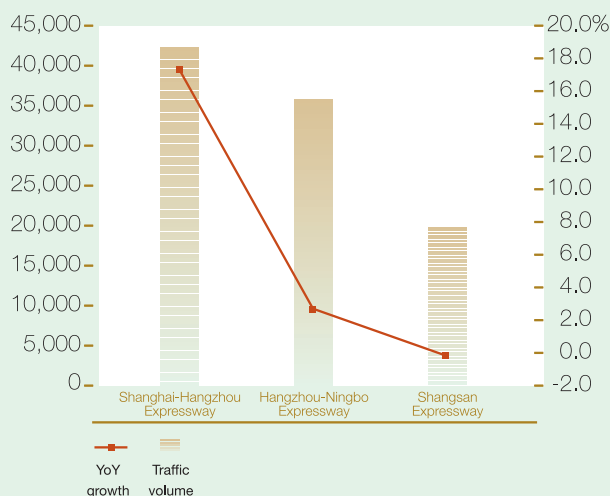


The Shangsán Expressway saw its traffic volume dip by 0.2% during the Period, averaging 19,783 full-trip equivalents per day, mainly due to a parallel national road reopened to traffic after an extended period of partial closure for renovation, and also to a lesser degree, due to traffic diversions to other expressways that had been newly opened.



As part of the Company's continued effort to increase operating efficiency and reduce cash transactions in its expressway operations, starting from November 1, 2006, toll stations along the Shanghai-Hangzhou-Ningbo Expressway and the Shangsán Expressway began to accept widely distributed China Unionpay bankcards (銀聯卡), the first such adoption of the bankcards on expressways in China.

Traffic Volume & Growth Rates



After the completion of the second phase of the widening project along the Shanghai-Hangzhou-Ningbo Expressway by the end of 2005, traffic volume on the Shanghai-Hangzhou Expressway experienced a strong rebound with a 17.4% increase over 2005, averaging 42,297 full-trip equivalents per day.

Traffic volume on the Hangzhou-Ningbo Expressway grew by a substantially lower rate of 2.7% during the Period, averaging 35,806 full-trip equivalents per day, mainly due to the ongoing third phase widening works carried out along the section, and to a lesser degree, due to traffic diversions to other expressways that had been newly opened.

EXPRESSWAY-RELATED BUSINESS OPERATIONS

The Company operates gas stations, shops and restaurants in service areas, as well as roadside advertising and vehicle service businesses along the expressways through its subsidiaries. In the past few years, demand for these services has been growing at a faster rate than the rate of traffic volume growth.

During the Period, benefiting from a change in operating mode of gas stations from consigning to self-operating, as well as increased capacities after the completion of the current phase of service area expansion, income from the above business operations reached Rmb1,043.4 million, representing an increase of 249.5% over 2005.

SECURITIES BUSINESS

The Company took over the management of Kinghing Securities Co., Ltd. (金信證券有限責任公司) on July 1, 2006 after participating in a successful reorganization of the securities company during the first half of 2006, and subsequently renamed the securities company as “Zheshang Securities Co., Ltd.” (浙商證券有限責任公司) (“Zheshang Securities”).

After the reorganization, the Company has strengthened the risk control for Zheshang Securities and enhanced its management quality. Meanwhile, benefitting from an upturn of China’s securities market, Zheshang Securities has achieved better-than-expected operating results. Income of the securities company during the second half of the year was Rmb193.9million, while profit realized after taxation was Rmb121.9million.

Details of the reorganization had been provided in a circular to the shareholders of the Company dated May 16, 2006.

LONG-TERM INVESTMENTS

During the Period, Hangzhou Shida Highway Co., Ltd., a 50%-owned jointly-controlled entity of the Company that owns and operates the 9.45km Shida Road, saw its traffic volume increased by 17.3% over 2005 and toll income increased by 16.4% over 2005. Profit for the Period realized by the jointly-controlled entity was Rmb46.7 million, representing an increase of 43.3% over 2005. The much higher rate of increase in profit for the period was primarily due to lower-than-usual maintenance expenditures.



Demand for gasoline products in Zhejiang Province continued to grow substantially during the Period, leading to a 41.3% increase in revenue over 2005 for Zhejiang Expressway Petroleum Development Co., Ltd., a 50%-owned associate of the Company. Profit for the Period attributable to equity holders of the parent realized by the associated company during the Period was Rmb19.3 million, representing an increase of 38.5% over 2005.

JoinHands Technology Co., Ltd., a 27.582%- owned associate of the Company, failed to pull out of a slump in its main printing business despite improved sales for its computer hardware and software products. Revenue for the associated company decreased by 10.1% over 2005 during the Period, resulting in a loss attributable to equity holders of the parent of Rmb7.5 million.

EXPRESSWAY WIDENING PROJECT

The third and last phase of the project to widen the Shanghai-Hangzhou-Ningbo Expressway from four lanes to eight lanes (the “Widening Project”) continued along the Hangzhou-Ningbo section during the Period, with most of the foundation and structure works finished.

The Company has taken every measure available to minimize the impact of related construction works upon normal traffic flow along the Hangzhou-Ningbo section. It is expected that the section will be kept open for traffic, though with reduced capacity, throughout the rest of construction works until its completion by the end of 2007.

Upon completion of the Widening Project, the Shanghai-Hangzhou-Ningbo Expressway will be the first eight-lane expressway in Zhejiang Province, with substantially increased carrying capacity and improved quality of service in terms of greater reliability and safer traveling conditions.

Management Discussion and Analysis

PROJECT INVESTMENT

On March 10, 2007, the Company entered into agreements to acquire an aggregate of 23.45% equity interest in Zhejiang Jinhua Yongjin Expressway Co., Ltd. (浙江金華甬金高速公路有限公司) ("Jinhua Co.") from the Jinhua Municipal Road Management Bureau (金華市公路管理處) and Dongyang Municipal Transport Investment Co., Ltd. (東陽市交通投資有限公司) for a total consideration of Rmb281.4 million in cash.

Jinhua Co. is the project company holding 100% equity interests in the Jinhua Section (金華段) of the Ningbo-Jinhua Expressway (甬金高速公路) for a concession period of 25 years. The Jinhua Section is a four-lane expressway totaling 69.7km that was completed and opened to traffic on December 28, 2005.

The investment in Jinhua Co. is in line with the Company's development strategy of further expanding its expressway network within Zhejiang Province to capture a greater share of growing expressway traffic and to derive additional synergy from an expanded network.

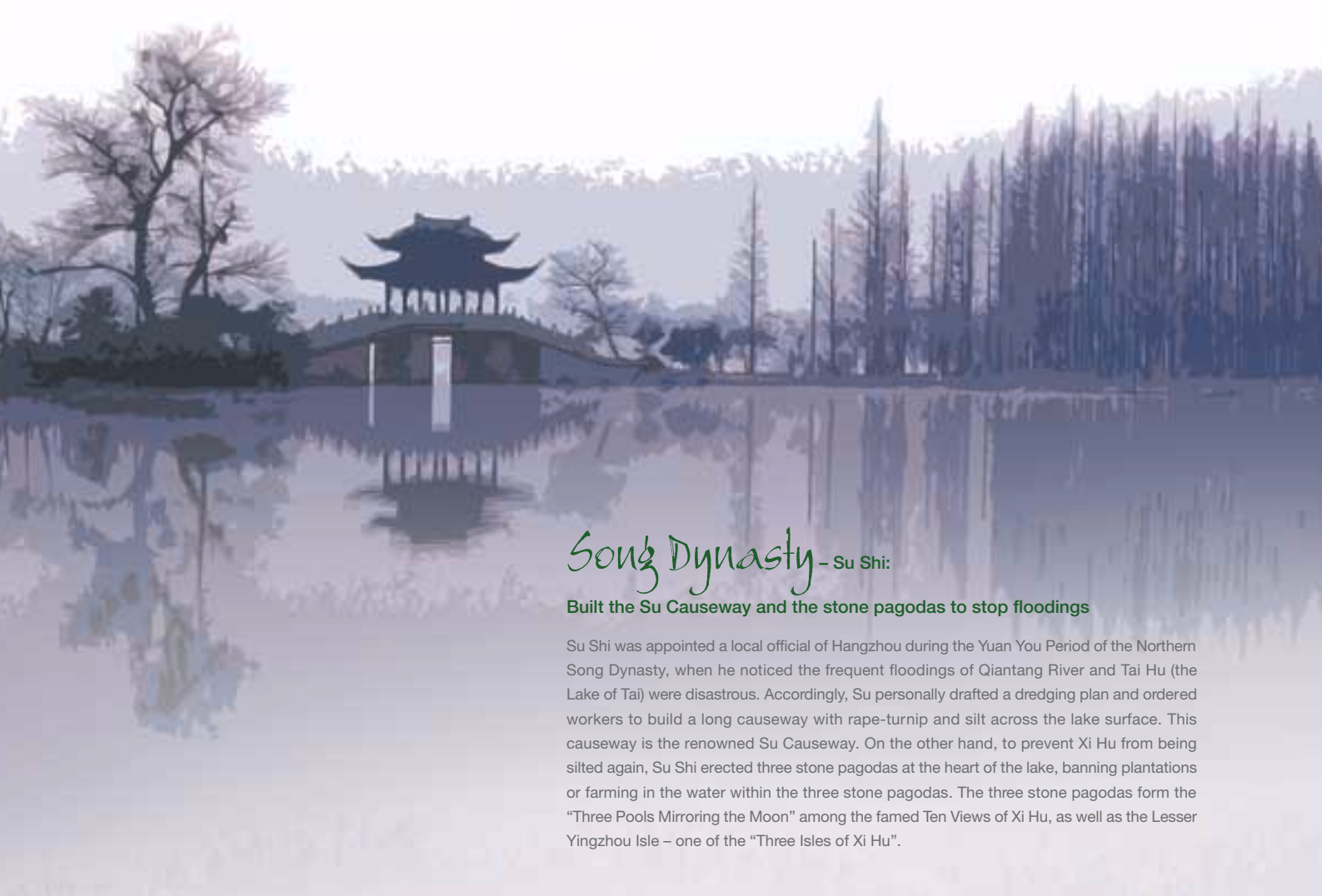
The parent company of the Company, Zhejiang Communications Investment Group Co., Ltd., is another substantial shareholder of Jinhua Co. with its 35% equity interest. Pursuant to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, the above acquisition is not considered as a connected transaction or a discloseable transaction.



1998

Full operation of the Shanghai-Hangzhou-Ningbo Expressway: Kicking off the Company's continued growth

1998 is a monumental year in which the Company's major assets commenced crucial development. The Shanghai-Hangzhou-Ningbo Expressway came into full operation that year, with Shangsang Co incorporated in the same year for the operation of the Shangsang Expressway. To date, the mileage of expressways under the Company has increased from the initial 158km to nearly 400km. During the years, the traffic volume and toll income of the Company's expressways have been rising continuously with the asset scale constantly expanding, making the Company the only listed State-owned toll-road operator to post ten consecutive years of double-digit net profit growth.



Song Dynasty – Su Shi:

Built the Su Causeway and the stone pagodas to stop floodings

Su Shi was appointed a local official of Hangzhou during the Yuan You Period of the Northern Song Dynasty, when he noticed the frequent floodings of Qiantang River and Tai Hu (the Lake of Tai) were disastrous. Accordingly, Su personally drafted a dredging plan and ordered workers to build a long causeway with rape-turnip and silt across the lake surface. This causeway is the renowned Su Causeway. On the other hand, to prevent Xi Hu from being silted again, Su Shi erected three stone pagodas at the heart of the lake, banning plantations or farming in the water within the three stone pagodas. The three stone pagodas form the “Three Pools Mirroring the Moon” among the famed Ten Views of Xi Hu, as well as the Lesser Yingzhou Isle – one of the “Three Isles of Xi Hu”.

Management Discussion and Analysis

FINANCIAL ANALYSIS

The Group adopts a prudent financial policy with an aim to providing shareholders with sound returns over the long-term.

During the Period, the Group's profit attributable to equity holders of the Company was approximately Rmb1,652.9 million, representing an increase of 15.5% over 2005, while earnings per share for the Group was Rmb38.06 cents.

PROFITABILITY

The compound annual growth rates of earnings per share and return on equity in the last five years were 16.7% and 10.9%, respectively. Details are as follows:

	Year ended December 31,				
	2002	2003	2004	2005	2006
EPS (Rmb cents)	20.50	23.23	28.22	32.95	38.06
YoY Growth rate	17.1%	13.3%	21.5%	16.8%	15.5%
ROE	9.2%	9.9%	11.4%	12.8%	13.9%
YoY Growth rate	12.2%	7.6%	15.2%	11.8%	8.7%

During the Period, the annual dividend payout ratio was 71.0%, reflecting a stable dividend payout policy that the management maintained in past years. Details of dividends in the last five years are as follows:

	Year ended December 31,				
	2002	2003	2004	2005	2006 (Proposed)
Dividends					
(Rmb'000)	564,604	651,467	825,191	955,485	1,172,641
Dividend payout ratio	63.4%	64.6%	67.3%	66.8%	71.0%

LIQUIDITY AND FINANCIAL RESOURCES

The financial position of the Group remained sound and healthy during the year under review. As at December 31, 2006, current assets of the Group amounted to Rmb4,674.3 million in aggregate (2005: Rmb 1,919.8 million), of which cash and cash equivalents accounted

for 32.2% (2005: 37.7%), while time deposits accounted for 2.8% (2005: 5.5%) and short-term investments accounted for 4.9% (2005: 31.9%).

	As at December 31,	
	2006 Rmb'000	2005 Rmb'000
Cash and cash equivalents		
Rmb	1,493,866	723,452
US\$ in Rmb equivalent	8,661	2
HK\$ in Rmb equivalent	1,546	59
Time deposits		
Rmb	131,312	105,632
Short term investments		
Rmb	229,880	612,097
Total	1,865,265	1,441,242
Rmb	1,855,058	1,441,181
US\$ in Rmb equivalent	8,661	2
HK\$ in Rmb equivalent	1,546	59

As at December 31, 2006, the Group had Rmb229.9 million in short-term investments that were fully attributable to Zheshang Securities, and was invested in the stock market.

During the Period, net cash inflow generated from the Group's operating activities amounted to Rmb2,413.6 million, representing an increase of 21.7% over 2005.

The Directors do not expect the Company to experience any problem with liquidity and financial resources in the near future.

BORROWINGS AND SOLVENCY

As at December 31, 2006, the total liabilities of the Group were Rmb6,218.0 million, of which 29.7% were borrowings and 40.2% were client deposits arising from securities dealing.

The borrowings comprised mainly outstanding balances of the World Bank loans of Rmb657.8 million in Renminbi equivalent, loans from several domestic commercial banks totaling Rmb125.0 million and corporate bonds amounting to Rmb1 billion that was issued by the Company in 2003 for a term of 10 years. Among Rmb1,845.4 million of the Group's total borrowings, 78.5% were not repayable within one year (2005: Rmb2,434.7 million and 63.6%, respectively). Details as follows:

Maturity Profiles				
	Gross amount Rmb'000	Within 1 year Rmb'000	2-5 years inclusive Rmb'000	Beyond 5 years Rmb'000
Floating rates				
World Bank				
loan	657,807	211,761	380,503	65,543
Fixed rates				
Commercial				
bank loans	125,000	125,000	—	—
Government loans	62,600	60,380	2,220	—
Corporate bonds	1,000,000	—	—	1,000,000
Total as at				
December 31,				
2006	1,845,407	397,141	382,723	1,065,543
Total as at				
December 31,				
2005	2,434,737	886,540	377,615	1,170,582

As at December 31, 2006, the interest rates of the Group's semi-annual and annual domestic commercial bank borrowings, totaling Rmb125.0million, were fixed between 5.02% and 5.58% per annum; the interest rate for Rmb62.6 million government loans remained fixed at 3.00% per annum; the annual coupon rate for the Rmb1 billion corporate bonds was fixed at 4.29%, with interest payable annually; the annual interest rate for client deposits arising from securities dealing was fixed at 0.72%; the floating rate of the Group's Rmb657.8 million World Bank loans, denominated in US dollar, varied from 4.51% to 5.16%.

Total interest expense for the Period amounted to Rmb102.8 million, while profit before interest and tax amounted to Rmb2,829.4 million. The interest cover ratio (profit before interest and tax over interest expenses) stood at 27.5 (2005: 22.1).

	2006 Rmb'000	2005 Rmb'000
Profit before tax and interest	2,829,399	2,371,858
Interest expenses	102,782	107,196
Interest cover ratio	27.5	22.1

The asset-liability ratio (total liabilities over total assets) was 31.8% as at December 31, 2006 (2005: 24.2%).

CAPITAL STRUCTURE

The total equity of the Group increased by 8.0% from Rmb12,363.9 million as at December 31, 2005 to Rmb13,352.5 million as at December 31, 2006. The fixed-rate liabilities of the Group amounted to Rmb3,689.2 million, while the floating-rate liabilities of the Group amounted to Rmb657.8 million and the interest-free liabilities of the Group amounted to Rmb1,871.0 million, representing 18.9%, 3.4% and 9.6% of the Group's capital, respectively.



Management Discussion and Analysis

	As at December 31, 2006		As at December 31, 2005	
	Rmb'000	%	Rmb'000	%
Total equity	13,352,452	68.2%	12,363,868	75.8%
Fixed rate liabilities	3,689,193	18.8%	1,702,600	10.4%
Floating rate liabilities	657,807	3.4%	732,137	4.5%
Interest-free liabilities	1,870,967	9.6%	1,513,051	9.3%
Total	19,570,419	100.0%	16,311,656	100.0%
Long-term interest-bearing liabilities	1,448,266	7.4%	1,548,199	9.5%
Gearing ratio 1 (Note)	46.6%		31.9%	
Gearing ratio 2 (Note)	10.8%		12.5%	
Asset-liability ratio	31.8%		24.2%	

Note: Gearing ratio 1 represents the sum of fixed rate liabilities, floating rate liabilities and interest-free liabilities to the total equity; gearing ratio 2 represents the total amount of the long-term interest-bearing liabilities to the total equity.

CAPITAL EXPENDITURE COMMITMENTS AND UTILIZATION

Total capital expenditures of the Group and of the Company for the Period amounted to Rmb1,169.6 million and Rmb555.3 million, respectively, with Rmb468.9 million incurred by the investment in Zheshang Securities and Rmb485.9million incurred by the Widening Project.

The capital expenditures committed by the Group and by the Company as at December 31, 2006 were Rmb3,873.3 million and Rmb2,941.1 million, respectively. Amongst the Rmb3,873.3 million committed by the Group, 47.1% will be used on the Widening Project, 28.7% will be used on the construction of Jiashao Expressway and 7.3% will be used on the equity acquisition of Jinhua Co.

	As at December 31, 2006					
	Group			Company		
	Commitments Rmb'000	Utilization Rmb'000	Balance Rmb'000	Commitments Rmb'000	Utilization Rmb'000	Balance Rmb'000
Expressway Widening Project						
From Dajing to Fengjing	2,532,514	1,719,141	813,373	—	—	—
From Guzhu to Duantang	2,218,118	1,208,104	1,010,014	2,218,118	1,208,104	1,010,014
Acquisition of additional 18.4% equity interest in Shangsang Co	485,000	—	485,000	485,000	—	485,000
Office decoration	1,939	—	1,939	—	—	—
Renovation of Service Area	49,256	—	49,256	—	—	—
Remaining construction works of the Shangsang Expressway	47,667	5,700	41,967	—	—	—
Purchase of machinery	80,000	—	80,000	54,340	—	54,340
Jiashao Expressway Project	1,145,375	35,000	1,110,375	1,145,375	35,000	1,110,375
Acquisition of 23.45% equity interest in Jinhua Co	281,400	—	281,400	281,400	—	281,400
Total	6,841,269	2,967,945	3,873,324	4,184,233	1,243,104	2,941,129

The Group will finance its abovementioned capital expenditure commitments with internally generated cash flow, with a preference for debt financing to meet any shortfalls thereof.

CONTINGENT LIABILITIES AND PLEDGE OF ASSETS

Fourteen customers of Zheshang Securities previously entered into state bond investment agency agreements with Kinghing Trust Investment Co., Ltd ("Kinghing Investment"), whereby Zheshang Securities kept in custody state bonds in an aggregate principal amount of Rmb106.5 million. These state bonds were pledged as security for certain third party repo trading transactions and the funds obtained were misappropriated by Kinghing Investment. Kinghing Investment was unable to return the misappropriated funds in time and as a result, the security over the state bonds was enforced to settle the relevant repo trading transactions.

In the opinion of directors, Kinghing Investment should take full responsibility for breach of the state bond investment agency agreements. Currently, Kinghing Investment has ceased its operations and its restructuring is underway. It is understood that the 14 customers have already registered their claims with Kinghing Investment's restructuring team. At the date of this report, one of the 14 customers has started legal proceedings against Zheshang Securities for disputes over the state bond investment agency agreement.

After consultation with their legal advisors and other legal experts, the directors believe that, from a legal point of view, Zheshang Securities should not take any legal responsibility, whether or not all the 14 customers choose to take them to court. However, one should not rule out the possibility that the court may, after considering, inter alia, Zheshang Securities role in the performance of the state bond investment agency agreements, request Zheshang Securities to share part of the liability. The impact to the consolidated financial statements as a whole is not expected to be material though should this situation arise.

In addition, a full provision has been made for guarantees issued in respect of the state bond investment agency agreements and fund trust agreements entered into between Kinghing Investment and its corporate customers.

No provision has been made for guarantees amounting to Rmb17.8 million issued in respect of the fund trust agreements entered into between Kinghing Investment and its individual customers because (i) these individuals have already registered their claims with Kinghing Investment's restructuring team; and (ii) under the relevant state policies, these individuals are expected to be compensated in full by the state.

Other than the aforementioned, the Group did not have any other contingent liabilities nor any pledge of assets as at December 31, 2006.

Other than the aforementioned, the Group did not have any other contingent liabilities nor any pledge of assets as at December 31, 2006.

FOREIGN EXCHANGE EXPOSURE

Except for the repayment of a World Bank loan of Rmb657.8 million in US dollars, as well as dividend payments to overseas shareholders in Hong Kong dollars, the Group's principal operations are transacted and booked in Renminbi. Therefore, the Group's exposure to foreign exchange fluctuations is limited and the Group has not entered into any financial instrument for hedging purposes.

Although the Directors do not foresee any material foreign exchange risks for the Group, there is no assurance that any further changes in the foreign exchange environment will not adversely affect the operating results of the Group in the future.



Management Discussion and Analysis

HUMAN RESOURCES

There had been an increase in total number of employees within the Group from 3,028 to 3,873 during the Period, due primarily to the addition of Zheshang Securities Co., Ltd. as a subsidiary to the Company starting from July 1, 2006. Amongst the 3,873 employees, 732 worked in the managerial, administrative and technical positions, while 3,141 worked in fields such as toll collection, maintenance, service areas and securities business outlets.

The Company adopts a remuneration policy that aims to be competitive for attracting and retaining talents. Overall remuneration package for employees is mainly comprised of basic salaries, bonuses and benefits.

Bonuses are designed to reflect individual job performances, as well as business and share price performances of the Group, while benefits for employees come in the form of contributions made by the Group to various local social security agencies covering pension, medical and accommodation concerns that are calculated as a percentage of employees' income and in accordance with relevant rules and regulations.

To supplement the existing pension scheme, the Company adopted a corporate annuity scheme during the Period in accordance with relevant rules and regulations. With the implementation of the corporate annuity scheme, total pension cost charged to the income statement during the Period amounted to Rmb20.8 million.

OUTLOOK FOR 2007

China's economy is expected to continue with its rapid growth in 2007 under the new focus on scientific development and on quality over speed. As the most economically vibrant province, Zhejiang Province will see its GDP to continue to achieve double-digit growth in 2007, a growth rate higher than the national average GDP growth rate. At the same time, cars are widely used by families, and the era of rapid growth in vehicle consumption has arrived. There will be a substantial increase in the total number of vehicles in China.

Owing to the positive impact of the fundamentals mentioned above, we estimate with optimism that the growth rates for both traffic volume and toll income on the Shanghai-Hangzhou-Ningbo Expressway will be higher in 2007 than in 2006. After a gradual dissipation of the impact of vehicle diversion on the Shangsang Expressway, traffic volume on the Shangsang Expressway will also enjoy certain rebounded growth.

To meet the growing traffic flow, and following the Company's introduction of Unionpay bankcards for the first time in China, we will start to introduce non-stop toll collection booths and automatic IC card issuance at entrance booths in 2007, with an aim to further improve the carrying capacity and rapid-through capabilities of the expressways operated by the Company.

In 2007, there will be a new pair of service areas completed and put into operation. Having grown rapidly for three consecutive years, the Company's non-core business operations will continue to enjoy excellent performance in 2007.

Following the successful reorganization of Zheshang Securities, and benefitting from the unusually robust performance of the Chinese stock market, Zheshang Securities will be bringing sizable profit contributions to the Company. However, the Company intends to maintain its investment in, and operation of, expressways as its core business.



2000

The Board formed independent committees: Continuously enhancing corporate governance

In 2000, the number of independent non-executive directors of the Company has increased to one-third of the membership of the Board of Directors. The Audit Committee, the Strategic Committee and the Nomination and Remuneration Committee were established under the Board of Directors to ensure that all decisions by the Board of Directors will be to the best interests of the shareholders. Throughout the years, Zhejiang Expressway has been insisting on a regulated operation and has established an effective accountability system, as well as striving to reinforce internal controls and risk management, thereby actively enhancing the transparency and governance standard of the Company.

A scenic view of a traditional Chinese garden. In the foreground, there is a calm lake reflecting the surrounding landscape. A long, low bridge with a traditional Chinese architectural style spans the lake. On the right side of the bridge, there is a small pavilion with a tiled roof. In the background, there are more trees and a hill. The overall atmosphere is peaceful and serene.

Early Ming Dynasty – Yang Mengying:

Built the Yang Gong Causeway despite strong opposition

After the demise of the Song Dynasty in the Yuan Dynasty's hands, Xi Hu shared the fate of female beauties who were blamed for catastrophes in times of upheavals. The Yuan rulers claimed that Song emperors neglected the State's affairs for pleasures in Xi Hu all the time, thereby leading to Song's demise. Accordingly, the Yuan rulers adopted a policy of "abandon and neglect" for Xi Hu. The situation continued until early Ming Dynasty, when the most severe silt in Xi Hu finally occurred. Ultimately, Yang Mengying, the then-governor of Hangzhou, defeated strong opposition and overcame numerous obstacles to re-dredge Xi Hu. Yang dredged over 3,000 acres of paddy fields in the lake occupied by the rich and elevated the Su Causeway, as well as building the Yang Gong Causeway, thereby returning Xi Hu to its glamour in the Tang and Song dynasties.