



# Management Discussion and Analysis

## Business Review

For the year ended 31 December, 2005, the Group recorded a turnover of RMB28,374,680,000, representing an increase of 26.9% as compared to the previous year; profit before income tax was RMB4,309,263,000, representing a decrease of 8.2% as compared to the last year; profit attributable to equity holders amounted to RMB3,582,782,000, representing a decrease of 10.7% as compared to the last year; loaded cargo volume for the whole year amounted to 4,597,395 TEU, representing an increase of 25.8% as compared to the last year. For the year ended 31 December, 2005, the average freight rate per TEU of the Group amounted to RMB6,049.8, representing an increase of 0.8% as compared to the previous year.

As at 31 December, 2005, the total shipping capacity of the Group reached 347,851 TEU. The average shipping capacity for the year increased 30.4% as compared to last year.

## Financial Review

### TURNOVER

The Group's turnover increased by RMB6,010,829,000 or 26.9% from RMB 22,363,851,000 for the year ended 31 December, 2004 to RMB28,374,680,000 for the year ended 31 December, 2005. The increase in turnover was primarily due to:

- Increased volume of loaded cargoes  
The volume of loaded cargoes for the year ended 31 December, 2005 amounted to 4,597,395 TEU, representing an increase of 25.8% as compared to year 2004 as a result of

the enhanced shipping capacity on major trade lanes and the improving of the overall structure of the global trade lanes through the deployment of new and large container vessels.

### ANALYSIS OF LOADED CONTAINER VOLUME BY TRADE LANES

Principal market	2005 TEU	2004 TEU	Change
America	<b>1,124,841</b>	892,838	26.0%
Europe/Mediterranean	<b>1,229,289</b>	885,981	38.7%
Australia	<b>194,216</b>	163,883	18.5%
East and Southeast Asia	<b>572,215</b>	488,017	17.3%
China domestic	<b>1,402,272</b>	1,101,882	27.3%
Others	<b>74,562</b>	122,166	-39.0%
Total	<b>4,597,395</b>	3,654,767	25.8%

- Freight rate:  
The Group's average freight rate per TEU amounted to RMB6,049.8, representing an increase of 0.8% as compared to year 2004. In particular, the average freight rate per TEU for international trade lanes recorded an increase of about 2.0% as compared to year 2004 to RMB8,098.2. The main reason for the slow down in growth rate of international trade lanes was that from the fourth quarter of year 2005, the decrease of freight rates for Europe/Mediterranean and Australian trade lanes dragged down the average freight rate for the whole year. The average freight rate per TEU for domestic trade lanes decreased by RMB131.5 as compared to the same period last year to RMB1,382.6 as a result of the PRC's macroeconomic control and the more severe competition in the domestic market.



General Manager & Executive Director:  
Mr. Huang Xiaowen



#### OPERATING COSTS

For the year ended 31 December, 2005, total operating costs amounted to RMB23,331,132,000, representing an increase of 38.2% as compared to year 2004. However, operating costs, on a per TEU basis, increased by 9.9% as compared to year 2004 to RMB4,996.2. The increase in operating costs was mainly due to:

- Container and cargo costs increased by 30.9% from RMB 8,003,143,000 in 2004 to RMB10,473,989,000 mainly due to the increase in the volume of loaded cargoes. Port charges amounted to RMB1,856,747,000, representing an increase of 51.9% as a result of extended services, higher voyage frequencies and increase in port calling and canal passing frequency. The stevedore charges for loaded and empty containers amounted to RMB6,506,474,000, representing an increase of 26.6%, principally due to the increase in the volume of loaded cargoes in the international and domestic trade lanes and repositioning of empty containers.

- Vessel and voyage costs amounted to RMB7,752,946,000 for the year ended 31 December, 2005, representing an increase of 37.3% as compared to year 2004. To a certain extent, vessel and voyage costs per TEU decreased with the deployment of large vessels which were ordered by the Group at low costs during the down cycle of the shipping industry. However, with the rapid rise in fuel price in 2005, the annual average closing price of crude oil in the New York commodity exchange was US\$56.4 per barrel, representing an increase of 37.2% as compared to year 2004. As a result, the average unit price of fuel increased by US\$69.8 per ton or 37.9% as compared to last year to US\$253.9 per ton in 2005 and accordingly fuel and oil costs increased by RMB1,154,000,000. As a result, the Group's vessel and voyage costs per TEU increased by RMB141.3 from RMB1,545.1 in 2004 to RMB1,686.4 in 2005.

- Sub-route and other costs amounted to RMB5,104,197,000, representing an increase of 58.0% as compared to year 2004. The increase was mainly due to an increase in volume of sub-route services and the amount of inland cargo.

#### GROSS PROFIT

Due to the above reasons, the Group recorded a gross profit of RMB5,043,548,000 in 2005, representing a decrease of RMB440,721,000 or 8.0% as compared to year 2004.

#### INCOME TAX EXPENSE

Before 3 March, 2004, the Company and certain of its subsidiaries (the "Tax Entities") were covered in the consolidated enterprise income tax filing

of China Shipping (Group) Company, the Tax Entities' parent company and hence were exempt from enterprise income tax ("EIT"). With effect from 3 March, 2004, on which date the Company was converted into a joint stock limited company under the Company Law of the PRC in the Pudong New District, the EIT rate applicable to the Company has been 15% and the Company's subsidiaries previously covered by the consolidated EIT filing have been subject to EIT at a rate of 33%. The Company's other subsidiaries incorporated in the PRC are subject to EIT at a rate ranging from 0% to 33% for the year ended 31 December, 2005. The profits derived by the Company's overseas subsidiaries are subject to EIT at a fixed rate of 16.5%, as approved by the tax bureau, on the profits of the overseas subsidiaries for EIT purpose. Accordingly, the effective tax rate of the Group increased from 14.4% in 2004 to 16.8%.

#### ADMINISTRATIVE AND GENERAL EXPENSES

As at 31 December, 2005, the Group's administrative and general expenses were RMB551,234,000, representing an increase of 64.2% as compared to year 2004. This is mainly due to exchange losses of RMB58,699,000 recorded in the year as a result of RMB appreciation.

#### PROFIT ATTRIBUTABLE TO EQUITY HOLDERS

Due to the above reasons, the profit attributable to equity holders of the Company decreased by RMB430,840,000 or 10.7% from RMB 4,013,622,000 in 2004 to RMB3,582,782,000 in 2005.

#### LIQUIDITY AND FINANCIAL RESOURCES

The Group's principal sources of working capital have been the cash flow from operations and bank borrowings. Cash is mainly used in financing operating costs, new vessels, purchase of containers, payment of dividends and the repayment of principal and interest for bank borrowings and finance leases.

As at 31 December, 2005, the Group's total bank loans were RMB5,608,165,000. The maturity profile spreads over a period between 2006 and 2015, with RMB501,053,000 repayable within one year, RMB753,461,000 between one to two years, RMB2,543,910,000 between two to five years, and RMB1,809,741,000 over five years. The Group's long-term bank loans are mainly used for the purchase of new vessels and containers.

As at 31 December, 2005, the long-term bank loans were secured by mortgages over several container vessels and vessels under construction with a net book value, RMB6,727,496,000 (31 December, 2004: RMB 4,061,047,000), assignment of shipbuilding contracts and charges over shares of certain vessel owning subsidiaries.

As at 31 December, 2005, the Group had fixed interest loans in the amount of RMB3,996,800,000 and USD loans at floating interest rates in the amount of RMB1,611,365,000. The Group's loans are primarily denominated in Renminbi and US dollars while cash and cash equivalents are also denominated in these two currencies.

#### NET CURRENT ASSETS

As at 31 December, 2005, the Group's net current assets amounted to RMB3,933,154,000.

Current assets mainly comprised bunker inventory of RMB553,080,000, trade and notes receivables of RMB4,054,345,000, prepayments and other receivables of RMB129,154,000 and cash and bank balances of RMB3,423,373,000.

Current liabilities mainly comprised trade and notes payables of RMB2,759,412,000, accrual and other payables of RMB305,702,000, income tax payable of RMB201,950,000, long-term borrowings due within one year of RMB501,053,000 and finance lease obligations payable within one year of RMB458,681,000.

#### CASH FLOWS

As at 31 December, 2005, the Group's net cash generated from operating activities was RMB5,141,148,000, denominated principally in RMB, US dollars and Hong Kong dollars, and which represented a decrease of RMB19,457,000 from the year 2004. Cash balances at the end of year 2005 decreased by RMB2,440,118,000 as compared to the same period last year, mainly reflecting the net cash used in financing activities and investing activities in construction of vessels and containers, payment of dividends, repayment of principal and interest for bank borrowings and repayment of finance leases obligations exceeded the net cash generated from operating activities. Net cash generated from operations, when not needed for working capital requirements, is principally held as short-term and demand deposits.

The following table provides information regarding the Group's cash flows for the reporting periods.

	For the year ended 31 December,	
	2005 RMB	2004 RMB
Net cash generated from operating activities	<b>5,141,148,000</b>	5,160,605,000
Net cash used in investing activities	<b>(4,997,605,000)</b>	(6,285,895,000)
Net cash (used in)/generated from financing activities	<b>(2,583,661,000)</b>	5,504,317,000
Net (decrease)/increase in cash and cash equivalents	<b>(2,440,118,000)</b>	4,379,027,000

#### NET CASH GENERATED FROM OPERATING ACTIVITIES

For the year ended 31 December, 2005, the net cash generated from operating activities was RMB5,141,148,000, representing a decrease of RMB19,457,000 from RMB5,160,605,000 in 2004. The decrease was mainly due to the increase in operating costs and decrease in the gross profit. The net cash generated from operations for 2005 was RMB5,304,218,000, representing a decrease of 3.2% as compared with RMB 5,479,183,000 in 2004. Whereas, the payment of income tax within the stipulated period decreased by RMB155,508,000 or 48.8% as compared to last year.

#### NET CASH USED IN INVESTING ACTIVITIES

For the year ended 31 December, 2005, net cash used in investing activities was RMB4,997,605,000, representing a decrease of RMB1,288,290,000 from RMB6,285,895,000 in 2004. The decrease was mainly due to decrease in the Group's capital expenditure on vessels and other construction in progress of RMB5,088,539,000 (2004: RMB6,277,173,000).

#### NET CASH (USED IN)/GENERATED FROM FINANCING ACTIVITIES

For the year ended 31 December, 2005, net cash used in financing activities was RMB2,583,661,000, representing a net decrease of RMB8,087,978,000 as compared to the net cash generated from financing activities of RMB 5,504,317,000 in 2004. The main reason for this change was in 2004, cash proceeds of RMB7,159,713,000 were raised upon the listing of the Group. Another main reason was in this year, dividends of RMB1,686,098,000 were paid.

#### AVERAGE DEBTOR TURNOVER

The Group's average debtor turnover days were similar to last year, mainly due to management's effort to strengthen credit control over settlement from customers.

#### GEARING RATIO

As at 31 December, 2005, the Group's gearing ratio (i.e. the ratio of net debt over shareholder's equity) was 30%, which is higher than the 11% for 2004. The main reason for the higher level of the gearing was capital expenditure on construction of vessels and containers and payment of dividends exceeded net cash inflow from operating activities.

#### FOREIGN EXCHANGE RISK AND HEDGING

Most of the revenue of the Group are settled or denominated in US dollars and most of the operating expenses are also settled or denominated in US dollars. As a result, the negative impact on the operating income due to the RMB appreciation since July, 2005 can be offset by each other to a certain extent. With the RMB appreciation, monetary net assets including cash and cash equivalents in US dollars and HK dollars continued to depreciate. During the year, the Group



devoted much efforts to improve the currency structure of such assets and the exchange losses of the Group amounted to RMB 58,699,000. The Group continues to monitor the exchange rate fluctuation of RMB, timely convert net cash inflow from operating activities into RMB so as to minimize foreign currency risk. The Group will continue to implement the policy of timely conversion of foreign currency assets into RMB, reducing the net currency assets denominated in foreign currency and consider appropriate measures including making hedging arrangements (e.g. forward exchange contracts), based on its operating needs to mitigate the Group's currency exposure. However, as at 31 December, 2005, the Group had not entered into any hedging arrangement including any forward exchange contracts.

#### CAPITAL EXPENDITURE

During the year ended 31 December, 2005, capital expenditure on vessels and vessels under construction amounted to RMB4,020,253,000, improvement on vessels under operating leases RMB8,456,000, development of information system RMB13,022,000, containers RMB2,492,475,000, motor

vehicles RMB6,571,000 and office equipment RMB40,415,000.

#### CAPITAL COMMITMENTS

As at 31 December, 2005, the Group had contracted but not provided for capital commitments of approximately RMB4,315,787,000 for vessels under construction and RMB160,036,000 for containers. It is expected that part of the commitments will be financed by cash generated from operating activities, with the remaining portion by bank borrowings.

#### ACQUISITION

In 2005, the Group did not enter into any acquisition activities.

#### CONTINGENT LIABILITIES

As at 31 December, 2005, the Group did not have any material contingent liabilities.

#### EMPLOYEES, TRAINING AND BENEFITS

As at 31 December, 2005, the Group had 3,447 employees, representing an increase of 305 employees compared to year 2004. Staff cost was approximately RMB605,171,000 (including a provision

for the year of RMB1,451,000 in relation to the H share share appreciation rights granted to the Company's Directors (the "Directors") and employees). In addition, the Group entered into contracts with a number of subsidiaries of China Shipping (Group) Company, pursuant to which those companies provided the Group with approximately 3,058 crew members in aggregate who mainly worked on the Group's self-owned or bare-boat chartered vessels.

Remuneration of the Group's employees includes basic salaries, other allowances and performance bonuses. The Group also adopts a performance discretionary incentive scheme for its staff. The scheme links up the financial benefits of the Group's staff with certain business performance indicators. Such indicators may include but not limited to the profit target of the Group.

Details of the performance discretionary incentive scheme vary among the members of the Group. The Group sets out certain performance indicators for each of its subsidiaries to achieve. Each subsidiary has the discretion to formulate its own detailed performance related remuneration policies according to its local circumstances.

The Group has adopted a compensation scheme, which is to be satisfied by cash payments and is share-based, known as the "H Share Share Appreciation Rights Scheme". The fair value of services provided by the employees of the Company who are granted appreciation rights is recognised as an expense of the Company. Employees might in the future be entitled to a compensation in the form of a cash payment, which is calculated based on the appreciation in the price of the Company's share from the date of grant to the date of exercise.