China Netcom Group CORP (Hong Kong) LTD
Form 6-K
April 16, 2007

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16 of

the Securities Exchange Act of 1934

For the month of April, 2007

(Indicate by check mark whether the registrant files or will file annual reports under cover of

Form 20-F or Form 40-F.)

Form 20-F X Form 40-F

(Indicate by check mark whether the registrant by furnishing the information contained in this

form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b)

under the Securities Exchange Act of 1934. )

Yes No X

(If Yes is marked, indicate below the file number assigned to registrant in connection with

Rule 12g3-2(b): 82-__________. )

N/A

China Netcom Group Corporation (Hong Kong) Limited

Building C, No. 156, Fuxingmennei Avenue

Xicheng District

Beijing, 100031 PRC

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This Form 6-K consists of:

The explanatory statement to be sent to shareholders in connection with the proposed ordinary resolution set out in item 5 of the notice of annual general meeting and form of proxy for the same annual general meeting to be held on 22 May 2007of China Netcom Group Corporation (Hong Kong) Limited (the Registrant ), made by the Registrant in English on April 10, 2007.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the under-signed, thereunto duly authorized.

CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

By /s/ Li Fushen
By /s/ Mok Kam Wan

Name: Li Fushen and Mok Kam Wan
Title: Joint Company Secretaries

Date: April 16, 2007

3

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**If you are in any doubt** as to any aspect of this document, you should consult your licensed securities dealer, bank manager, solicitor, professional accountant or other professional adviser.

## CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED

*(Incorporated in Hong Kong with limited liability under the Companies Ordinance)*

**(Stock Code: 906)**

Executive Directors:
Zhang Chunjiang (Chairman)
Zuo Xunsheng (Chief Executive Officer)
Zhang Xiaotie
Li Fushen (Chief Financial Officer and Joint ompany Secretary)
Miao Jianhua

Non-executive Directors:
Tian Suning (Vice Chairman)
Yan Yixun
José Maríaia Álvarez-Pallete
Mauricio Sartorius

Independent Non-executive Directors:
John Lawson Thornton
Victor Cha Mou Zing
Qian Yingyi
Hou Ziqiang
Timpson Chung Shui Ming

Registered Office:
Room 6701
The Center
99 Queen s Road Central
Hong Kong

10 April 2007

*To the shareholder*

Dear Sir or Madam,

This is the Explanatory Statement required to be sent to shareholders under the Rules Governing the Listing of Securities (the **Listing Rules** ) on The Stock Exchange of Hong Kong Limited (the Stock Exchange ) in connection with the proposed Ordinary Resolution set out in item 5 of the Notice of Annual General Meeting (the AGM Notice ) dated 10 April 2007 for the approval of the renewal of the general mandate for repurchase of shares. This document also constitutes the Memorandum required under section 49BA of the Companies Ordinance. Reference in this document to Shares means share(s) of all classes in the capital of China Netcom Group Corporation (Hong Kong) Limited (the Company ).

**EXERCISE OF THE REPURCHASE MANDATE**

Whilst the Directors do not presently intend to repurchase any Shares immediately, they believe that the flexibility afforded by the mandate granted to them if the Ordinary Resolution set out as item 5 of the AGM Notice (the Repurchase Mandate ) is passed would be beneficial to the Company.

1

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It is proposed that up to 10 per cent. of the issued and outstanding Shares on the date of the passing of the resolution to approve the Repurchase Mandate may be repurchased. As at 3 April 2007, the latest practicable date for determining such figures, 6,651,114,500 Shares were issued and outstanding. On the basis of such figures, the Directors would be authorised to repurchase up to 665,111,450 Shares during the period up to the date of the next annual general meeting in 2008, or the expiration of the period within which the next annual general meeting of the Company is required by law to be held, or the revocation or variation of the Repurchase Mandate by an ordinary resolution of the shareholders at a general meeting of the Company, whichever of these three events occurs first.

**REASONS FOR REPURCHASES**

Repurchases of Shares will only be made when the Directors believe that such a repurchase will benefit the Company and its shareholders. Such repurchases may, depending on the market conditions and funding arrangements at the time, lead to an enhancement of the net value of the Company and its assets and/or its earnings per Share.

**FUNDING OF REPURCHASES**

Repurchases pursuant to the Repurchase Mandate would be financed entirely from the Company s available cash flow or working capital facilities. Any repurchases will be made out of funds of the Company legally permitted to be utilised in this connection in accordance with its memorandum and articles of association and the laws of Hong Kong, including profits otherwise available for distribution. Under the Companies Ordinance, a company s profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made.

There might be a material adverse impact on the working capital or gearing position of the Company (as compared with the position disclosed in its most recent published audited accounts for the year ended 31 December 2006 dated 2 April 2007) in the event that the Repurchase Mandate is exercised in full. However, the Directors do not propose to exercise the Repurchase Mandate to such an extent as would, in the circumstances, have a material adverse effect on the working capital requirements of the Company or the gearing levels which in the opinion of the Directors are from time to time appropriate for the Company.

**DISCLOSURE OF INTERESTS**

None of the Directors, and to the best of their knowledge, having made all reasonable enquiries, none of their associates, have any present intention, if the Repurchase Mandate is exercised, to sell any Shares to the Company or its subsidiaries.

No connected persons (as defined in the Listing Rules) have notified the Company that they have a present intention to sell Shares to the Company, nor have any undertaken not to do so, if the Repurchase Mandate is exercised.

**DIRECTOR S UNDERTAKING**

The Directors have undertaken to the Stock Exchange that, so far as the same may be applicable, they will exercise the Repurchase Mandate in accordance with the Listing Rules and the applicable laws of Hong Kong.

**SHARE REPURCHASE MADE BY THE COMPANY**

No repurchases of Shares have been made by the Company during the last six months (whether on the Stock Exchange or otherwise).

**TAKEOVERS CODE CONSEQUENCES**

If as a result of a repurchase of Shares by the Company, shareholder s proportionate interest in the voting rights of the Company increases, such increases will be treated as an acquisition for the purpose of the Hong Kong Code on Takeovers and Mergers (the Takeovers Code ). As a result, a shareholder, or group of shareholders acting in concert, depending on the level of increase of its or their shareholding, could obtain or consolidate control of the Company and become obliged to make a mandatory offer in accordance with Rule 26 of the Takeovers Code. The Directors are aware of the consequences arising under the Takeovers Code of any repurchase.

2

As at 3 April 2007 (being the latest practicable date prior to the printing of this document), the immediate controlling shareholder of the Company, China Netcom Group Corporation (BVI) Limited ( CNC BVI ), beneficially held 4,647,449,014 Shares, representing approximately 69.87 per cent. of the issued and outstanding share capital of the Company as at that date. In the event that the Repurchase Mandate is exercised in full and assuming that there is no change in the number of Shares held by CNC BVI, the number of Shares beneficially held by CNC BVI will be increased to represent approximately 77.64 per cent. of the reduced issued share capital of the Company immediately after the exercise in full of the Repurchase Mandate. The Directors are not aware of any consequences in relation to CNC BVI which would arise under the Takeovers Code as a result of such share repurchase by the Company. In addition, in exercising the Repurchase Mandate (whether in full or otherwise), the Directors will ensure that the Company shall maintain a public float of not less than 23 per cent. of the issued share capital of the Company and comply with the requirements of the Listing Rules.

**MARKET PRICES**

The highest and lowest prices at which the Shares have traded on the Stock Exchange during each of the previous twelve months before the latest practicable date prior to the printing of this document were:

| | **Traded market price** | |
|---|---|---|
| | Highest | Lowest |
| | HK$ | HK$ |
| 2006 | | |
| April | 15.40 | 13.45 |
| May | 15.70 | 11.85 |
| June | 13.70 | 12.05 |
| July | 14.65 | 13.15 |
| August | 14.60 | 12.82 |
| September | 14.20 | 13.36 |
| October | 14.34 | 13.40 |
| November | 16.00 | 13.40 |
| December | 26.00 | 14.74 |
| 2007 | | |
| January | 21.90 | 18.22 |
| February | 21.00 | 18.12 |
| March | 20.65 | 16.60 |
| April (up to and including 3 April 2007) | 20.85 | 18.80 |

**SHARE ISSUE MANDATE**

As stated in the proposed Ordinary Resolution set out in item 6 of the AGM Notice, it is proposed that a general mandate be granted to the Directors to allot, issue and deal with up to 20 per cent. of the issued and outstanding Shares on the date of the passing of the resolution (the **Issue Mandate** ), subject to the extension set out under Extension of Share Issue Mandate below. As at 3 April 2007, the latest practicable date for determining such figures, 6,651,114,500 Shares were issued and outstanding. On the basis of such figures, the Directors would be authorised to allot, issue and deal with up to 1,330,222,900 Shares during the period up to the date of the next annual general meeting in 2008, or the expiration of the period within which the next annual general meeting of the Company is required by law to be held or the revocation or variation of the Issue Mandate by an ordinary resolution of the shareholders at a general meeting of the Company, whichever of these three events occurs first.

**EXTENSION OF SHARE ISSUE MANDATE**

A resolution as set out in item 7 of the AGM Notice will also be proposed at the Annual General Meeting authorising the Directors to increase the maximum number of new Shares which may be issued under the general mandate for the issuance and allotment of Shares by adding to it the nominal amount of any Shares repurchased pursuant to the Repurchase Mandate.

3

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PROCEDURES FOR DEMANDING A POLL AT THE ANNUAL GENERAL MEETING

According to the Articles of Association of the Company, a poll may be demanded by:

(a) the chairman of the Annual General Meeting; or
(b) at least three shareholders present in person (or in the case of a shareholder being a corporation, by its duly authorised representative) or by proxy and entitled to vote at the Annual General Meeting; or
(c) any shareholder or shareholders present in person (or in the case of a shareholder being a corporation, by its duly authorised representative) or by proxy and representing in the aggregate not less than one-tenth of the total voting rights of all shareholders having the right to attend and vote at the Annual General Meeting; or
(d) any shareholder or shareholders present in person (or in the case of a shareholder being a corporation, by its duly authorised representative) or by proxy and holding Shares conferring a right to attend and vote at the Annual General Meeting on which there have been paid up sums in the aggregate equal to not less than one-tenth of the total sum paid up on all Shares conferring that right.

Yours faithfully
Zhang Chunjiang
*Chairman*

4

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**CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED**
*(Incorporated in Hong Kong with limited liability under the Companies Ordinance)*

**(Stock Code: 906)**

Form of proxy for the Annual General Meeting

to be held on 22 May 2007

I/We (Note 1) of being

the registered holder(s) of Shares (Note 2) of US$0.04 each in the share capital of the above-named Company HEREBY APPOINT THE CHAIRMAN OF THE ANNUAL GENERAL MEETING (Note 3) or of as my/our proxy to attend and act for me/us at the Annual General Meeting (and any adjournment thereof) of the said Company to be held in The Ballroom, Island Shangri-la, Hong Kong on 22 May 2007 at 3:00 p.m. for the purposes of considering and, if thought fit, passing the Resolutions as set out in the Notice of Annual General Meeting and at such Meeting (and at any adjournment thereof) to vote for me/us and in my/our name(s) in respect of the Resolutions as indicated below (Note 4).

| | RESOLUTIONS | FOR | AGAINST |
|---|---|---|---|
| 1. | To receive and consider the financial statements and the Reports of the Directors and of the Auditors for the year ended 31 December 2006. | w | |
| 2. | To declare a final dividend for the year ended 31 December 2006. | | |
| 3. | (i) To re-elect Mr. Zuo Xunsheng as a Director; | (i) | (i) |
| | (ii) To re-elect Mr. Li Fushen as a Director; | (ii) | (ii) |
| | (iii) To re-elect Mr. Yan Yixun as a Director; | (iii) | (iii) |
| | (iv) To re-elect Mr. Mauricio Sartorius as a Director; | (iv) | (iv) |
| | (v)To re-elect Dr. Qian Yingyi as a Director; | (v) | (v) |
| | (vi)To re-elect Mr. Hou Ziqiang as a Director; and | (vi) | (vi) |
| | (vii)To re-elect Mr. Timpson Chung Shui Ming as a Director. | (vii) | (vii) |
| 4. | To re-appoint Messrs. PricewaterhouseCoopers as auditors and to authorise the Directors to fix their remuneration. | | |
| 5. | To give a general mandate to the Directors to repurchase shares in the Company not exceeding 10% of the aggregate nominal amount of the existing issued share capital. | | |
| 6. | To give a general mandate to the Directors to issue, allot and deal with additional shares in the Company not exceeding 20% of the existing issued share capital. | | |
| 7. | To extend the general mandate granted to the Directors to issue, allot and deal with shares by the number of shares repurchased. | | |

Dated this day of 2007 Signed *(Note 5)*

5

Notes:

1. Full name(s) and address(es) to be inserted in BLOCK CAPITALS.
2. Please insert the number of shares registered in your name(s) to which this proxy relates. If no number is inserted, this form of proxy will be deemed to relate to all the shares in the Company registered in your name(s).
3. If any proxy other than the Chairman of the Annual General Meeting is preferred, strike out the words THE CHAIRMAN OF THE ANNUAL GENERAL MEETING and insert the name and address of the proxy desired in the space provided. A member may appoint one or more proxies to attend and vote in his stead. ANY ALTERATION MADE TO THIS FORM OF PROXY MUST BE INITIALLED BY THE PERSON WHO SIGNS IT.
4. IMPORTANT: IF YOU WISH TO VOTE FOR THE RESOLUTIONS, TICK THE APPROPRIATE BOXES MARKED FOR . IF YOU WISH TO VOTE AGAINST THE RESOLUTIONS, TICK THE APPROPRIATE BOXES MARKED AGAINST . Failure to complete any or all the boxes will entitle your proxy to cast his votes at his discretion. Your proxy will also be entitled to vote at his discretion on any resolution properly put to the Meeting other than those referred to in the Notice of Annual General Meeting.
5. This form of proxy must be signed by you or your attorney duly authorised in writing or, in the case of a corporation, must be either executed under its common seal or under the hand of an officer or attorney or other person duly authorised to sign the same.
6. In the case of joint holders of any shares, any one of such joint holders may vote at the Meeting, either personally or by proxy, in respect of such shares as if he were solely entitled thereto. However, if more than one of such joint holders is present at the Meeting, either personally or by proxy, the vote of the joint holder whose name stands first in the Register of Members and who tenders a vote, whether in person or by proxy, will be accepted to the exclusion of the votes of the other joint holder(s).
7. To be valid, this form of proxy together with the power of attorney (if any) or other authority under which it is signed (if any) or a notarially certified copy thereof, must be deposited at the registered office of the Company at Room 6701, The Center, 99 Queen s Road Central, Hong Kong not less than 48 hours before the time for holding the Meeting or any adjournment thereof (as the case may be).
8. The proxy need not be a member of the Company but must attend the Meeting in person to represent you.
9. Completion and delivery of the form of proxy will not preclude you from attending and voting at the Meeting if you so wish. In such event, the instrument appointing a proxy shall be deemed to be revoked.

6

and risk management logistical services arrangements to wholesale, retail and commercial/industrial end-users. Product storage and forward sales transactions enable us to purchase Products inventory; utilize proprietary and leased tankage, as well as line space controlled by us in major common carrier pipelines; arbitrage location product prices differentials and transportation costs; store inventory; and, depending upon market conditions, realize margins through sales in the future cash market or by using NYMEX contracts. Wholesale distribution of Products is conducted from proprietary and non-proprietary truck loading terminal, storage and delivery locations. Fuel and risk management logistical services provide both our large and small volume customers an assured, ratable and cost effective delivered source of Products supply through proprietary pipelines and terminals, as well as through non-proprietary pipeline, terminal, truck, rail and barge distribution channels. 21 Product Supply, Distribution and Marketing (continued) Generally, as we purchase a Product, we simultaneously attempt to establish or "lock-in" a margin by selling the Product for physical delivery to third party users or by entering into a future delivery obligation, such as a futures contract on the NYMEX. We seek to maintain a balanced position until we deliver or take delivery of the physical Product associated with each transaction, thereby minimizing or eliminating exposure to price fluctuations occurring after the initial transactions. However, certain basis risks (the risk that price relationships between delivery points, types of Product or delivery periods will change) cannot be completely hedged or eliminated. It is our policy not to acquire Products, futures contracts or other derivative products for the purpose of speculating on the commodity price. Risk management policies have been established by the Risk Management Committee to monitor and control these price risks. The Risk Management Committee is comprised of senior executives of TransMontaigne. In addition, we provide "supply chain management" services to our commercial and industrial customers. Through our "supply chain management" arrangements, we provide services to our customers downstream of the Products rack location. A customer of our "supply chain management" services receives the benefits of our web computer technology enabling the customers to minimize their total energy costs while meeting their volumetric needs. As a result of this service, a customer can reduce the processing time associated with dispatching Product to its physical locations, processing payments associated with Product purchases at both bulk and retail locations, and obtain other costs savings associated with procuring its Product demands. By aggregating the demands of various customers, we are able to leverage the demand and build relationships with other companies along the supply and distribution chain that benefit all the parties through reductions in the "back office" processing costs associated with buying and selling Products. In connection with our Products supply, distribution and marketing operations, where we engage in price risk management activities, we utilize mark-to-market accounting. Terminals and Pipelines We own and operate an extensive terminal infrastructure that handles Products with transportation connections via pipelines, barges, rail cars and trucks to TransMontaigne-owned facilities or to third party facilities with an emphasis on transportation connections primarily through the Colonial, Plantation, Texas Eastern, Explorer and Williams pipeline systems. The terminal and pipeline commercial operations depend in large part on the level of demand for Products by end users in the geographic locations served by such facilities and the ability and willingness of our customers to supply such demand by utilizing our terminals and pipelines as opposed to the terminals and pipelines of other companies. Our Product supply, distribution and marketing effort "directs" volumes through our terminals and pipelines wherever possible, which provides us with an advantage over many of our terminal competitors who are not involved in the marketing of Products. The net margin for terminals and pipelines is calculated as terminal revenue plus storage revenue plus pipeline revenue less direct operating costs. Terminal revenues are based on the volume of Products handled at the facility's loading racks, generally at a standard rate per gallon. Storage fees are generally based on a per barrel rate or tankage capacity committed and will vary with the duration of the arrangement, the product stored and special handling requirements, particularly when certain types of chemicals and other bulk liquids are involved. Pipeline revenues are based on the volume of Products transported and the distance from the origin point to the delivery point. The operating expenses of the terminals and pipelines include the direct related wages and employee benefits, utilities, communications, maintenance and repairs, property taxes, rent, vehicle expenses, environmental compliance costs, materials and supplies. We cannot predict the impact of future fuel conservation measures, alternate fuel requirements, governmental regulation, technological advances in fuel economy, demographic changes, weather conditions, crop prices, and energy-generation devices, all of which could reduce the demand for Products in the areas served by TransMontaigne. In connection with our terminal and pipeline commercial operations, we utilize the accrual method of accounting for revenue and expenses. 22 CRITICAL ACCOUNTING POLICIES Our accounting policies for inventories, price risk management activities, and environmental obligations, are considered to be critical in the presentation of our consolidated financial statements. These policies, and the underlying financial statement accounts, require the use of estimates, management judgments, or valuation methods, which could fluctuate if different assumptions or conditions were to prevail. In recording our inventory at market, we must estimate basis differentials and/or transportation costs to be applied to quoted market prices for the products. Accounting for price risk management activities requires us to select among acceptable valuation models, select appropriate discount rates, and estimate basis differentials and/or transportation costs to be applied to quoted market prices. Accounting for price risk management activities, requires that we provide an estimate for losses in the event a counter party defaults the performance of its obligations. 23 RESULTS OF OPERATIONS Selected financial data regarding our operations are summarized below (in thousands): Three Months Ended Six Months Ended December 31, December 31, ----------------- ---------------- 2001 2000 2001 2000 ------ ------ ------ ------ Net operating margins (1): Product supply, distribution and marketing: Sales, exchanges and product arbitrage $ 13,729 10,865 41,328 19,175 Unrealized losses recognized for the minimum inventory (12,114) (2,353) (12,963) (6,881) -------- ------ ------- ------- 1,615 8,512 28,365 12,294 Terminals and pipelines 8,513 12,031 16,854 24,383 -------- ------ ------- ------- Total net operating margins 10,128 20,543 45,219 36,677 Selling, general and administrative expenses (8,185) (8,157) (16,650) (15,394) Depreciation and amortization (4,024) (4,821) (8,306) (9,668) -------- ------ ------- ------- Operating income (loss) (2,081) 7,565 20,263 11,615 Dividend income from and equity in earnings of petroleum related investments 108 820 1,457 1,739 Interest income 315 477 423 1,275 Interest expense (1,652) (4,445) (3,581) (9,271) Other financing costs (704) (1,234) (1,458) (2,447) Gain (loss) on disposition of assets, net - 8 (1,295) 8 Gain (loss) on interest rate swap (727) (380) (5,017) 326 -------- ------ ------- ------- Earnings (loss) before income taxes (4,741) 2,811 10,792 3,245

Income tax benefit (expense) 1,801 (1,068) (4,101) (1,233) -------- ------ ------- ------- Net earnings (loss) (2,940) 1,743 6,691 2,012 Preferred stock dividends (2,437) (2,127) (4,841) (4,253) -------- ------ ------- ------- Net earnings (loss) attributable to common stockholders $ (5,377) (384) 1,850 (2,241) ======== ====== ======= ======= (1) Net operating margins represent revenues less product costs and direct operating expenses. Selected volumetric data (Barrels Per Day): Six Months Ended December 31, 2001 ------------------------------------------------------------------------------------------ July August September October November December Average ------------------------------------------------------------------------------------------ Retained Facilities 493,718 509,482 449,859 510,510 499,524 489,831 492,154 Disposed Facilities 92,045 - - - - - 15,341 ------- ------- ------- ------- ------- ------- ------- Current period volumes 585,763 509,482 449,859 510,510 499,524 489,831 507,495 ======= ======= ======= ======= ======= ======= ======= Six Months Ended December 31, 2000 ------------------------------------------------------------------------------------------ July August September October November December Average ------------------------------------------------------------------------------------------ Retained Facilities 489,164 494,829 485,849 501,788 480,769 473,961 487,727 Disposed Facilities 134,616 125,071 127,236 125,543 114,995 108,697 122,693 ------- ------- ------- ------- ------- ------- ------- Prior period volumes 623,780 619,900 613,085 627,331 595,764 582,658 610,420 ======= ======= ======= ======= ======= ======= ======= 24 THREE MONTHS ENDED DECEMBER 31, 2001 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2000 We reported a net loss of $2.9 million for the three months ended December 31, 2001, compared to net earnings of $1.7 million for the three months ended December 31, 2000. After Preferred Stock dividends, the net losses attributable to common stockholders was $5.4 million compared to $0.4 million for the three months ended December 31, 2001 and 2000, respectively. Loss per common share was $.17 based on 32.1 million weighted average basic shares outstanding compared to a loss of $.01 per share based on 31.5 million weighted average basic shares outstanding, for the three months ended December 31, 2001 and 2000, respectively. Our lower net operating margins in the current period, as compared to the prior years period, is due primarily to an increase of $9.7 million in the non- cash charge recognized for the minimum inventory, the absence of approximately $2.9 million in net operating margins contributed by the divested facilities in the prior comparable period, and a $2.6 million charge relating to a transportation and deficiency agreement with a pipeline company, all offset somewhat by higher margins realized in our Product supply, distribution and marketing activities. Product Supply, Distribution and Marketing The net operating margin reported for the Product supply, distribution and marketing commercial operations include margins realized on sales, exchanges and Product arbitrage. During the current quarter, the absolute price of crude oil and refined products has continued to decline. The current oversupply situation has dropped the value of the energy commodities and has created a "carry" or "contango" market structure whereby the current value of the commodity is less than the value quoted in a future month. This market structure enables both us and our customers the opportunity to utilize our or other's terminal infrastructure to store Products to capture the price differentials. A contango market may lessen the volatility in the Product markets and could reduce future arbitrage opportunities. During the current quarter, we have purchased and stored approximately 5.5 million barrels of additional refined products to take advantage of the contango market and the pricing spreads between current and future months. Mark-to-market accounting will create future volatility in our net operating margins due to these pricing spreads either widening or narrowing from the original spread relationship. If the spreads widen (narrow), marking these storage volumes and the related forward hedges to market will produce unrealized losses (gains) in interim reporting periods. These negative (positive) results will reverse and the originally anticipated spread will be recognized during the future periods when the physical inventory is delivered against the short future position. Our refined petroleum products inventory consists primarily of gasoline and distillates, the majority of which is held for sale or exchange in the ordinary course of business. In order to maintain our trading and marketing activities, we cannot sell our minimum inventory, and we manage it as if it were a long-term investment. As such, it is our policy not to hedge the price risk associated with this minimum inventory. However, due to the fact that all our inventory must currently be accounted for under mark-to-market accounting in accordance with EITF 98-10, we record non-cash unrealized gains and losses on this minimum inventory. As of December 31, 2001, our designated minimum inventory level was 2.0 million barrels. The unrealized loss relating to our minimum inventory was $12.1 million and $2.4 million for the three months ended December 31, 2001 and 2000, respectively. 25 Terminals and Pipelines The net operating margin from our terminal and pipeline operations for the three months ended December 31, 2001 was $8.5 million, compared to $12.0 million for the three months ended December 31, 2000, a decrease of $3.5 million. Since we sold our Little Rock terminal on June 30, 2001 and sold the NORCO system on July 31, 2001, we realized no margins from the Little Rock terminal or the NORCO system in the three months ended December 31, 2001 compared to the prior period where net operating margins were approximately $2.9 million. We also experienced increased operating costs in our terminal network, primarily from increased repair and maintenance expenses and labor costs associated with additional security measures, which reduced our margins in the current period. Selling, General, Administrative and Other Selling, general and administrative expenses for the three months ended December 31, 2001 were $8.2 million, compared to $8.2 million for the three months ended December 31, 2000, a change of less than $0.1 million. There was a decrease in wages and a reduction in travel and entertainment during the current period. The decreased costs were offset by an increase in consulting services used by us as we are undertaking a program in the current year to enhance the capabilities of our computer systems associated with the Product supply, distribution and marketing and supply chain management activities. In addition, we had an increase in the amount of incentive-based compensation expense recorded by us in the current period and an increase in communication costs. Depreciation and amortization for the three months ended December 31, 2001 was $4.0 million, compared to $4.8 million for the three months ended December 31, 2000. The reduction is due to the sale of the Little Rock terminal and the NORCO system. Dividend income from and equity in earnings of petroleum related investments for the three months ended December 31, 2001 was $0.1 million compared to $0.8 million for the three months ended December 31, 2000, a decrease of $0.7 million. The decrease resulted from us receiving no dividend from Lion and a $0.1 million dividend from West Shore during the three months ended December 31, 2001, in comparison to a $0.4 million dividend from Lion and a $0.4 million dividend from West Shore during the three months ended December 31, 2000. Interest income for the three months ended December 31, 2001 was $0.3 million, compared to $0.5 million for the three months ended December 31, 2000, a decrease of $0.2 million. The decrease in interest income was due primarily to a decrease in interest bearing cash balances and lower interest rates during the current quarter. Interest expense for the three months ended December 31, 2001 was $1.7 million, compared to $4.4 million during the three months ended December 31, 2000, a decrease of $2.7 million. This reduction was primarily attributable to a reduction in the amount of our outstanding debt as a result of the application of proceeds from asset dispositions and a reduction in our borrowing rate under our Bank Credit Facility due to declining LIBOR rates. Other financing costs for the three months ended December 31, 2001 were $0.7 million, compared to $1.2 million for the three months ended December 31, 2000. The reduction was attributable to a reduction in the amount of amortization of deferred debt issuance costs during the current period. These deferred fees were reduced in our fiscal quarter ended June 30, 2001 as a result of our paying off the bank term loan and a portion of the Master Shelf Agreement. For the three months ended December 31, 2001, we recorded an unrealized gain on the interest rate swap of $0.4 million, which represents the change in the fair market value of the interest rate swap from September 30, 2001 to December 31, 2001. We also realized a loss of $1.1 million on the interest rate swap, which represented payments associated with the monthly settlements of the interest rate swap for the three months ended December 31, 2001. In the three months ended December 31, 2000, the realized gain on the interest rate swap was $0.4 million and the unrealized loss was $0.8 million. The unrealized and realized losses on the interest rate swap are a result of changes in LIBOR rates during the periods. 26 Selling, General, Administrative and Other (continued) Income tax benefit was $1.8 million for the three months ended December 31, 2001, which represents an effective combined federal and state income tax rate of 38.0%. Income tax expense was $1.1 million for the three months ended December 31, 2000, which represents an effective combined federal and state income tax rate of 38.0%. Dividends on the Preferred Stock were $2.4 million and $2.1 million for the three months ended December 31, 2001 and 2000, respectively. The increase in the current year dividend resulted from our election to pay the preferred dividends for the quarter ended December 31, 2001 "in-kind" by issuing additional shares of Preferred Stock. 27 SIX MONTHS ENDED DECEMBER 31, 2001 COMPARED TO SIX MONTHS ENDED DECEMBER 31, 2000 We reported net earnings of $6.7 million for the six months ended December 31, 2001, compared to $2.0 million for the six months ended December 31, 2000. After preferred stock dividends, the net earnings attributable to common stockholders was $1.9 million and a net loss of $2.2 million for the six months ended December 31, 2001 and 2000, respectively. Earnings per common share for the six months ended December 31, 2001 was $.06 based on 32.0 million weighted average basic shares outstanding compared to a loss of $.07 per share for the six months ended December 31, 2000 based upon 31.1 million weighted average basic shares outstanding. Our improved net operating margins in the current period, as compared to the prior year's comparable period, is primarily attributable to increased margins from our Product supply, distribution and marketing activities despite the absence of approximately $5.5 million in net operating margins contributed by the facilities we divested of in the prior comparable period, an increase of $6.1 million in the non-cash charge recognized for the minimum inventory and a charge of $2.6 million relating to a transportation and deficiency agreement with a pipeline company. Product Supply, Distribution and Marketing The net operating margin reported for the Product supply, distribution and marketing commercial operations include margins realized on sales, exchanges and Product arbitrage. During the six-month period, we were able to benefit from the market volatility opportunities that were caused by a Chicago refinery disruption in August, which significantly increased throughput on our Midwest (Mississippi River) corridor terminals. This disruption fueled the price differentials (for both gasoline and distillates) between the Gulf Coast, Chicago and Group (Mid-Continent) regions and created significant basis arbitrage opportunities. During the disruption, our Product marketing group, utilizing our own, as well as third party, pipeline and terminal infrastructures, was able to help supply a portion of the increased demand in the Chicago and Group market areas. Immediately after the attack of September 11, 2001, we temporarily suspended operations of our facilities nationwide for approximately 12 hours to assess the security of our facilities and potential pipeline supply disruptions. Since September 12, 2001, throughput volumes to the facilities have returned to normal levels. Also, during the current six months, the "carry" or "contango" market has enabled us the opportunity to utilize our terminal infrastructure to purchase and store Products to capture the price differentials by selling the Product in a later period at a higher price. During the six months ended December 31, 2001, we have purchased and stored approximately 6.0 million barrels of refined products to take advantage of this contango market and the pricing spreads between current and future months. Mark-to-market accounting will create future volatility in our net operating margins due to these pricing spreads either widening or narrowing from the original spread relationship. If the spreads widen (narrow) marking these storage volumes and the related forward hedges to market will produce unrealized losses (gains) in interim reporting periods. These negative (positive) results will reverse and the originally anticipated spread will be recognized during the future periods when the physical inventory is delivered against the short future position. Our refined petroleum products inventory consists primarily of gasoline and distillates, the majority of which is held for sale or exchange in the ordinary course of business. In order to maintain our trading and marketing activities, we cannot sell our minimum inventory, and we manage it as if it were a long-term investment. As such, it is our policy not to hedge the price risk associated with this minimum inventory. However, due to the fact that all our inventory must currently be accounted for under mark-to-market accounting in accordance with EITF 98-10, we record non-cash unrealized gains and losses on this minimum inventory. As of December 31, 2001, our designated minimum inventory level was 2.0 million barrels. The unrealized loss relating to our minimum inventory was $13.0 million and $6.9 million for the six months ended December 31, 2001 and 2000, respectively. 28 Terminals and Pipelines The net operating margin from terminal and pipeline operations for the six months ended December 31, 2001 was $16.9 million, compared to $24.4 million for the six months ended December 31, 2000, a decrease of $7.5 million. Since we sold our Little Rock terminal on June 30, 2001 and sold the NORCO system on July 31, 2001, we realized no margins from the Little Rock terminal and only one month of earnings from the NORCO system in the six months ended December 31, 2001 compared to the prior period. The impact from the asset sales was approximately $5.5 million reduction in margin during the current period. We also experienced increased operating costs in our terminal network, primarily from increased repair and maintenance expenses and labor costs associated with additional security measures, which reduced our margins in the current period. Selling, General, Administrative and Other Selling, general and administrative expenses for the six months ended December 31, 2001 were $16.7 million, compared to $15.4 million for the six months ended December 31, 2000, an increase of $1.3 million. The increase is primarily attributable to an increase in consulting services used by us as we are undertaking a program in the current year to enhance the capabilities of our computer systems associated with the Product supply, distribution and marketing group, an increase in the amount of incentive-based compensation expense recorded by us in the current period and an increase in communication costs. The increased costs were partially offset by lower wages and a reduction in travel and entertainment during the current period. Depreciation and amortization for the six months ended December 31, 2001 was $8.3 million, compared to $9.7 million for the six months ended December 31, 2000. The reduction is due to the sale of the Little Rock terminal and the NORCO system. Dividend income from and equity in earnings of petroleum related investments for the six months ended December 31, 2001 was $1.5 million compared to $1.7 million for the six months ended December 31, 2000, a decrease of $0.2 million. The decrease resulted from a decrease in the dividend from West Shore during the six months ended December 31, 2001 due to the sale of the West

Shore common stock. Interest income for the six months ended December 31, 2001 was $0.4 million, compared to $1.3 million for the six months ended December 31, 2000, a decrease of $0.9 million. The decrease in interest income was due primarily to a decrease in interest bearing cash balances and lower interest rates during the current period. Interest expense for the six months ended December 31, 2001 was $3.6 million, compared to $9.3 million during the six months ended December 31, 2000, a decrease of $5.7 million. This reduction was primarily attributable to a reduction in the amount of our outstanding debt as a result of the application of proceeds from asset dispositions and a reduction in our borrowing rate under our Bank Credit Facility due to declining LIBOR rates. Other financing costs for the six months ended December 31, 2001 were $1.5 million, compared to $2.4 million for the six months ended December 31, 2000. The reduction was attributable to a reduction in the amount of amortization of deferred debt issuance costs during the current period. These deferred fees were reduced in our last fiscal year ended June 30, 2001 as a result of our paying off the bank term loan and a portion of the Master Shelf Agreement. Loss on the disposition of assets was $1.3 million for the six months ended December 31, 2001, and less than $0.1 million of gains were recognized in the comparable period ended December 31, 2000. For the six months ended December 31, 2001, we recorded an unrealized loss on the interest rate swap of $3.2 million for the change in the fair market value of the interest rate swap from June 30, 2001 to December 31, 2001. We also realized a loss of $1.8 million on the interest rate swap, which represented payments associated with the monthly settlement of the swap. In the six months ended December 31, 2000, the realized gain on the interest rate swap was $1.1 million and the unrealized loss was $0.8 million. The unrealized and realized losses on the interest rate swap are a result of changes in the LIBOR rates during the periods. 29 Selling, General, Administrative and Other (continued) Income tax expense was $4.1 million for the six months ended December 31, 2001, which represents an effective combined federal and state income tax rate of 38.0%. Income tax expense was $1.2 million for the six months ended December 31, 2000, which represents an effective combined federal and state income tax rate of 38.0%. Dividends on the Preferred Stock were $4.8 million and $4.3 million for the six months ended December 31, 2001 and 2000, respectively. The increase in the current year dividend resulted from our election to pay the preferred dividends for the six months ended December 31, 2001 "in-kind" by issuing additional shares of Preferred Stock. 30 LIQUIDITY AND CAPITAL RESOURCES The following summary reflects our comparative EBITDA, adjusted EBITDA and net cash flows for the three months and six months ended December 31, 2001 and 2000 (in thousands): Three Months Ended Six Months Ended December 31, December 31, -------------------------- -------------------------- 2001 2000 2001 2000 ------ ------ ------ ------ EBITDA (1) $ 2,051 13,206 30,026 23,022 Adjusted EBITDA (2) $ 14,165 15,559 42,989 29,903 Net cash used by operating activities $ (65,318) (8,872) (122,314) (26,271) Net cash provided (used) by investing activities $ 20,702 (962) 114,501 (5,175) Net cash provided (used) by financing activities $ 36,929 (2,693) (4,041) 1,166 (1) EBITDA is defined as total net operating margin, less selling, general and administrative expenses, plus dividend income from petroleum related investments. We believe that, in addition to cash flow from operations and net earnings (loss), EBITDA is a useful financial performance measurement for assessing operating performance since it provides an additional basis to evaluate our ability to incur and service debt and to fund capital expenditures. In evaluating EBITDA, we believe that consideration should be given, among other things, to the amount by which EBITDA exceeds interest costs for the period; how EBITDA compares to principal repayments on debt for the period; and how EBITDA compares to capital expenditures for the period. To evaluate EBITDA, the components of EBITDA such as revenue and direct operating expenses and the variability of such components over time, should also be considered. EBITDA should not be construed, however, as an alternative to operating income (loss) (as determined in accordance with GAAP) as an indicator of our operating performance, or to cash flows from operating activities (as determined in accordance with GAAP) as a measure of liquidity. Our method of calculating EBITDA may differ from methods used by other companies and, as a result, EBITDA measures disclosed herein might not be comparable to other similarly titled measures used by other companies. (2) Adjusted EBITDA is defined as EBITDA, plus unrealized losses recognized for our minimum inventory. We believe that Adjusted EBITDA is the most useful measure in evaluating our performance because it eliminates the impact on operating results from the revaluation of our minimum inventory. 31 LIQUIDITY AND CAPITAL RESOURCES (continued) We received approximately $117 million of cash from asset sales during the six-month period ended December 31, 2001. During this period, we also increased our inventories by $137 million by purchasing 6.0 million barrels of refined petroleum products. This inventory was purchased to take advantage of this contango market structure. Also during the period, the company repaid long term debt by $4.0 million. The cash proceeds received from assets sales, combined with the cash provided from operating activities, funded the increase in inventory and other working capital requirements. Refined petroleum products inventories at December 31, 2001 and June 30, 2001 are as follows: December 31, 2001 June 30, 2001 -------------------- -------------------- (in thousands) (in thousands) Amount Bbls Amount Bbls -------------------- -------------------- Refined petroleum products - Mins $ 45,298 2,000 $ 58,261 2,000 Refined petroleum products - Discretionary 157,651 6,758 20,234 468 ---------- ----- ---------- ----- 202,949 8,758 78,495 2,468 Refined petroleum products due to others under exchange agreements - 76,754 2,778 ---------- ----- ---------- ----- $ 202,949 8,758 $ 155,249 5,246 ========== ===== ========== ===== Relative month-end commodity prices from June 30, 2001 to December 31, 2001 are as follows: Heating Crude Oil Gasoline ----- ------- -------- Relative commodity prices (NYMEX close on last day of month) 6/30/01 $26.25 .709 .721 7/31/01 26.35 .697 .732 8/31/01 27.20 .766 .806 9/30/01 23.43 .664 .680 10/31/01 21.18 .598 .552 11/30/01 19.44 .532 .534 12/31/01 19.84 .551 .573 32 LIQUIDITY AND CAPITAL RESOURCES (continued) The following table indicates the maturities of our unrealized gain position by the credit quality of our contract counter parties at December 31, 2001. Fair value of Contracts (in thousands) ------------------------------------------------------------------------------------------ Maturity Maturity less than 1 Maturity Maturity in excess Total Fair year 1-3 years 4-5 years of 5 years Value ----------- --------- --------- ---------- ---------- Investment grade $26,948 647 27,595 Non-investment grade 17,137 10,999 28,136 No external rating 10,933 705 11,638 ------- ------ ------- ----- ------ Unrealized gain position $55,018 12,351 - - 67,369 ======= ====== ======= ====== ====== Due to the volatility that can occur in refined petroleum product prices, the following table estimates the sensitivity of the fair market value of our net asset position at December 31, 2001. $ per gallon change ------------------------------------------------ +.0.0 +.10 +.05 -.05 -.10 ------- ------ ------ ------ ------ Investment grade $23,547 18,081 20,814 26,280 29,013 Non-investment grade 27,812 13,754 20,783 34,840 41,869 No external rating 8,219 8,620 8,419 8,019 7,818 ------- ------ ------ ------ ------ Net asset position $59,578 40,455 50,016 69,139 78,700 ======= ====== ====== ====== ====== If refined petroleum product prices decline, a significant portion of the above referenced change in net asset position would require cash for upfront margin calls. Conversely, if refined product prices were to increase, a significant portion of the above referenced change in net asset position would generate cash by the return of related margin calls. We have contractual rights with some of our counter parties that require them to post additional letters of credit or cash deposits, to diminish our counter party exposure and related cash margin calls. Our Bank Credit Facility consists of a $240 million revolving credit facility due December 31, 2003. At December 31, 2001, we had borrowings of $101 million outstanding under the Bank Credit Facility at an average interest cost of 5.1%. We had working capital of $199.4 million and availability under our Bank Credit Facility of approximately $139.0 million and availability under our letter of credit facility of $34.6 million. The availability under the Bank Credit Facility is calculated weekly and is based upon our working capital. At December 31, 2001, we had $25.0 million of 7.22% senior promissory notes due October 17, 2004 outstanding under the Master Shelf Agreement. Each of the Bank Credit Facility and Master Shelf Agreement is secured by certain current assets and fixed assets, and each also includes financial covenants relating to fixed charge coverage, current ratio, maximum leverage ratio, consolidated tangible net worth, cash distributions and open inventory positions. As of December 31, 2001, we were in compliance with all such covenants. We believe that our current working capital position; future cash provided by operating activities; available borrowing capacity under the Bank Credit Facility and the Master Shelf Agreement; and our relationship with institutional lenders and equity investors should enable us to meet our planned capital and liquidity requirements. 33 LIQUIDITY AND CAPITAL RESOURCES (continued) Capital expenditures anticipated for the fiscal year ending June 30, 2002 are estimated to be $4.5 million for terminal and pipeline facilities, and assets to support these facilities. Future capital expenditures will depend on numerous factors, including the availability, economics and cost of appropriate acquisitions which we identify and evaluate; the economics, cost and required regulatory approvals with respect to the expansion and enhancement of existing systems and facilities; the customer demand for the services we provide; local, state and federal governmental regulations; environmental compliance requirements; and the availability of debt financing and equity capital on acceptable terms. 34 INFORMATION REGARDING FORWARD LOOKING STATEMENTS This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Although we believe that our expectations are based on reasonable assumptions, we can give no assurance that our goals will be achieved. Important factors, which could cause actual results to differ materially from those in the forward-looking statements, include: . that we will expand our business . that we will generate net operating margins from high sales volumes . that we will generate net operating margins affected by price volatility of Products purchased and sold . that we will enter into transactions with counter parties having the ability to meet their financial commitments to us . that we will incur unanticipated costs in complying with current and future environmental regulations . that we will capitalize on the trend by other companies in the oil and gas industry to divest assets and outsource certain services . that we will acquire strategically located operating facilities from third parties . that we will generate working capital internally, or have the ability to access debt and equity resources, to meet our capital requirements. 35 ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK The information contained in Item 3 updates, and should be read in conjunction with information set forth in Part II, Item 7A in our Annual Report on Form 10-K for the year ended June 30, 2001, in addition to the interim consolidated financial statements and accompanying notes presented in Items 1 and 2 of this Form 10-Q. There are no material changes in market risks faced by us from those reported in our Annual Report on Form 10-K for the year ended June 30, 2001. 36 PART II. OTHER INFORMATION --------------------------- ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS At the TransMontaigne Annual Meeting of Stockholders held on November 15, 2001, the stockholders of TransMontaigne elected eight directors to serve until the next Annual Meeting of Stockholders and until their successors have been elected and qualified. The following persons were elected as directors: Votes For Votes Against Abstentions Cortlandt S. Dietler 19,644,654 430,083 0 Donald H. Anderson 19,644,644 430,093 0 Peter B. Griffin 18,928,647 1,146,090 0 Ben A. Guill 19,592,999 481,738 0 John A. Hill 18,847,068 1,227,669 0 Bryan H. Lawrence 18,925,947 1,148,790 0 Harold R. Logan, Jr. 19,648,654 426,083 0 Edwin H. Morgens 19,671,878 402,859 0 37 ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K (a) Exhibits: There are no exhibits. (b) Reports on Form 8-K: There were no reports on Form 8-K filed during the quarter ended December 31, 2001. 38 SIGNATURES Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized. Dated: February 13, 2002 TRANSMONTAIGNE INC. (Registrant) /s/ DONALD H. ANDERSON ---------------------- Donald H. Anderson President, Chief Executive and Chief Operating Officer /s/ RODNEY R. HILT ------------------- Rodney R. Hilt Vice President, Controller and Chief Accounting Officer 39