Capitalise on Opportunities in a Dynamic Market

Management Discussion and Analysis

Operation Review

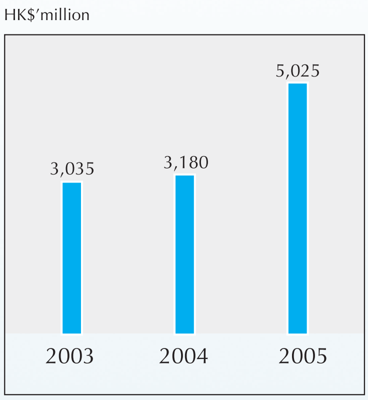
During the year under review, Mainland China has experienced another year of strong economic growth and recorded a GDP of RMB18,232 billion, an increase of 9.9% over that of last year. The imports and exports together amounted to US$1,422 billion, an increase of 23.2% year-on-year. At the same time, the world economy has grown steadily alongside increasing international trade flows as a result of globalisation. This has brought about an increased level of activities in the marine shipping sector, which in turn led to growth in the ports and ports-related operations.

The Group's core ports businesses, which are located in Hong Kong and Mainland China, have benefited from the favourable external market environment. During the year under review, the Group has successfully captured prevailing opportunities and strengthened its management in various investee companies through the implementation of strategic, financial and/or operational measures or controls, thereby increasing the Group's overall operational efficiency, tightening its risk control and improving its overall profitability.

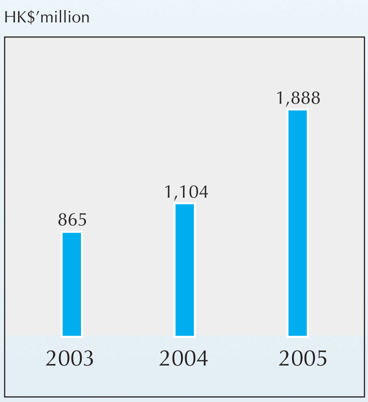
During 2005, ports operations which continue to be the Group's core businesses have all achieved satisfactory growth.

The Group always aims to increase the cashflow generating capability of its various operating units. For the year under review, EBITDA totaled HK$3,903 million, representing an increase of 54.0% year-on-year. Of this amount, ports operations contributed HK$2,424 million, an increase of 71.4% over the corresponding figure of HK$1,414 million recorded for the preceding fiscal year.

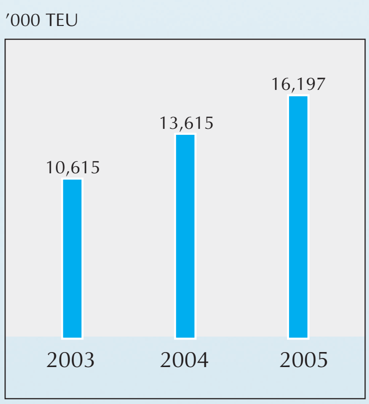
During the year, the Group recorded a profit attributable to shareholders of HK$2,364 million, representing an increase of 15.1% year-on-year. Excluding one-off gains (net of tax) of HK$224 million from the disposal of PPG, DiChain and CMF Technology Fund and from property revaluation during the year, the Group's recurrent profit amounted to HK$2,140 million, an increase of 30.2% over the corresponding figure of HK$1,644 million (excluding operating profit and gain on disposal from discontinued operation) for the previous year. The Group's basic earnings per share for the year was 107.94 HK cents, an increase of 12.5% over that of last year.



Turnover-Ports operations 2003-2005



EBIT-Ports Operations 2003-2005



Container throughput in Shenzhen 2003-2005

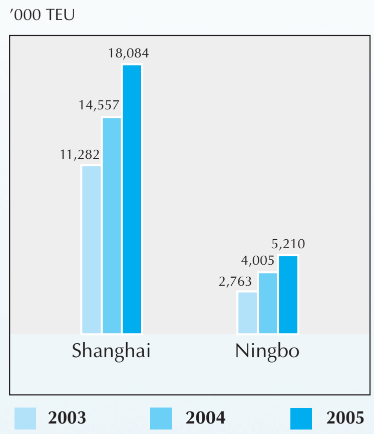
Ports Operations

During the year under review, EBIT (Earnings before interest and tax, unallocated income less expenses, profit from discontinued operation and minority interest, if applicable, ("Adjusted Earnings") for the Company and its subsidiaries, and its share of Adjusted Earnings of associates and jointly controlled entities) derived from the Group's ports operations amounted to HK$1,888 million, an increase of 71.0% over the corresponding figure of HK$1,104 million in the preceding year. Turnover from the ports operations (including share of turnover of its associates and jointly controlled entities) was HK$5,025 million, 58.0% over that of last year.

Taking also into account that handled by SIPG in the second half of 2005, the total container throughput handled in 2005 by the terminals in which the Group is interested reached 24.49 million TEUs, representing an increase of approximately 92% over that of the previous year.

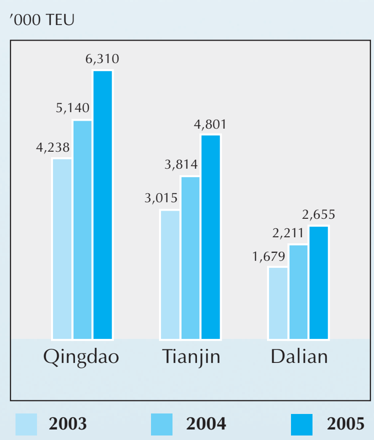
Benefiting from the continuous economic development in the Pearl River Delta, especially noticeable in general trading as well as value-adding manufacturing activities, ports in the Shenzhen district have all shown increases in container throughput. During the year under review, the number of container boxes handled by ports in the Shenzhen district approximates 16.2 million TEUs. Due in part to the commencement of operation by the 5 new berths the Group has invested in, that is, Shekou Container Terminals ("SCT") Phase III, Mawan and Chiwan Container Terminal Co., Ltd. ("CCT"), and in part to the improvement in the operational efficiency of existing terminals, the volume of container boxes handled by the ports in Western Shenzhen in which the Group is interested has grown by almost 19% to 8.35 million TEUs. This reflects a market share of about 52% in terms of throughput volume handled in the Shenzhen district.

The Yangtze River Delta is the fastest developing region in Mainland China. Currently, the region accounts for more than 20% of China's GDP, one-fifth of the country's total Fixed Asset Investments, and over half of the China's Actual-used Foreign Capital. Against this favorable environment, the two largest ports in the region, Shanghai and Ningbo, recorded a total container throughput in 2005 of 23.29 million TEUs, an increase of approximately 25% over that of the previous year. The Group completed its acquisition of the 30% stake in SIPG at the end of June 2005 and started to account for the share of the operating results of the latter in the second half of the year. The total container throughput of the ports in which SIPG is interested reached 18.08 million TEUs in 2005. During the period under review, the Group's operation in Ningbo, Ningbo Daxie China Merchants International Terminals Co., Ltd. ("Ningbo Daxie Teminal"), has completed the construction of its initial phase of operation. This phase comprises over 900 meters of deep water shoreline and can cater for the latest generation of container-vessels. The new handling capacity enables the Group to swing in full strength into servicing the market surrounding Ningbo in 2006.

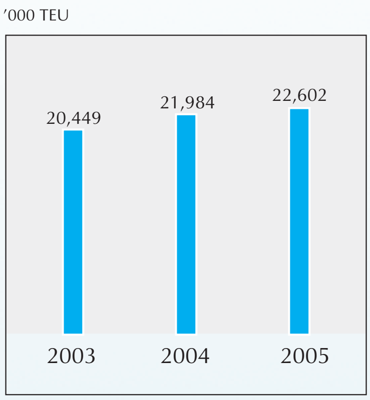


Container throughput in Shanghai and Ningbo 2003-2005

Along with changes in the economic structure of Mainland China in recent years came the release of development potential possessed by the three major provinces in the Northeastern China (Liaoning, Heilongjiang and Jilin), the Beijing-Tianjin-Hebei economic belt, and the Shandong Province. As a result, container throughput handled by the ports in the Bohai Bay Area has continued to increase. In 2005, terminals located at Qingdao, Tianjin and Dalian, the three major cities in the Bohai Bay Area, handled a combined container throughput of 13.76 million TEUs, representing an increase of approximately 23% year-on-year. In November 2005, the Group became a substantial shareholder of Tianjin Five Continents International Container Terminal Co., Ltd., ("Tianjin Five Contients International Container Terminal") following completion of all legal formalities for the acquisition of a 14% equity stake in this entity. Meanwhile, the Group has made strong efforts to develop the business of the Qingdao Qianwan Bonded Logistics Park while progressing speedily with the construction of the Qingdao Qianwan Terminal with a view to launching these new handling capacities as soon as possible.



Container throughput in Qingdao, Tianjin and Dalian 2003-2005



Container throughput in
Hong Kong 2003-2005

During the year under review, the throughput volume recorded by ports in Hong Kong showed a moderate increase to 22.60 million TEUs, representing an increase of approximately 3% year-on-year when compared with that of the last year. Through efforts to further penetrate the market as well as to enhance services to customers, the Group's ports operations in Hong Kong achieved a total container throughput of 6.38 million TEUs, which reflects an increase of approximately 14% when compared to that of last year and was far better than the market average.

Taking also into account that of SIPG for the second half of 2005, the bulk cargo handled by the Group totaled 88.22 million tonnes, an increase of approximately 147% over that of the previous year.

The operation of the air freight terminal in Hong Kong in which the Group is interested has grown in line with that of the Hong Kong market. During the year under review, the total volume of cargo handled reached 580,000 tonnes, which represents an increase of approximately 5% over that of the previous year.

Ports-related operations

During the year under review, EBIT derived from the Group's ports-related operations was HK$902 million, representing an increase of 19.9% when compared to that of last year. Of this amount, EBIT contribution from China International Marine Containers (Group) Ltd. and its subsidiaries ("CIMC Group") was HK$666 million, an increase of 14.4% year-on-year. The CIMC Group continues to be the leading growth driver in the Group's ports-related operations.

The CIMC Group has maintained its leading position in the global container manufacturing market. During the year, it sold a total of approximately 1.36 million TEUs of various types of containers. This sales volume, which was subject to the influence of industrial cyclical factors, has remained largely the same as that of last year. Apart from the container manufacturing business, the CIMC Group is also committed to developing the market for producing special transportation vehicles. In particular, the semi-trailer business has become a new driving force of growth for the group. Indeed, the CIMC Group has now become one of the few most influential special vehicle manufacturing groups in Mainland China. The CIMC Group's objective is to become a major supplier of transportation equipment and services in the world.

Other Operations

During the year, China Merchants Holdings (Pacific) Limited ("CMHP"), a Singapore-listed company controlled by the Group, made an EBIT contribution of HK$233 million, an increase of 37.1% over that of last year. The toll roads in Mainland China in which CMHP is interested recorded a total traffic flow of 29.92 million vehicles, an increase of approximately 3% compared with that of the last year. Meanwhile, the Western Harbour Tunnel, a Hong Kong investment of the Group, recorded a traffic flow of 15.03 million vehicles, an increase of approximately 5% compared with that of the last year.

The majority of the Group's toll roads have benefited from increases in traffic volumes, which were mainly driven by the rapid economic growth, the narrowing of economic gaps among different regions, and the surge in per capita car ownership in the PRC.

OTHER INFORMATION

Major Strategy Deployed

During the year under review, the strategic layout of the Group's ports network was further refined. The Group completed the acquisition of the 30% stake in SIPG in June 2005 and started to account for profits contributed by SIPG in the second half of the year. In addition, the Group also completed the legal formalities for the acquisition of the 14% stake in Tianjin Five Continents International Container Terminal, the acquisition of an additional 17.5% stake in SCT Phase I and an additional 4.9% stake in Modern Terminals Limited ("MTL"). In order to facilitate the Group's intended plan to consolidate its ports resources in the Shenzhen district with a view to further enhancing its ports operations, the Group agreed to purchase in December 2005 a land parcel of 1.15 million square metres in Western Shenzhen for a consideration of approximately HK$2,066 million, HK$1,427 million of the consideration amount was satisfied by way of 84,952,620 new shares issued by the Company on 27 January 2006.

During 2005, the following new berths of the Group commenced operation: the five new berths in SCT Phase III, Mawan and CCT, and another two at the Ningbo Daxie Terminal. The Group's interest in SIPG and the commencement of operation of the Ningbo Daxie Terminal combined signified the entry by the

Group into the container handling operations in the Yangtze River Delta. Furthermore, acquisitions by the Group of additional equity interests respectively in SCT Phase I and MTL have not only helped strengthen the co-operation between the Group's ports in Shenzhen and Hong Kong, but also create a platform of significance based on which to further consolidate the Group's ports business in Shenzhen, thereby laying the foundation for more in-depth co-operation among ports in Southern China.

Major fund-raising event

On 7 March 2005, CMHI Finance (Cayman) Inc., a wholly-owned subsidiary of the Group, raised funds in the international capital market by issuing a 10-year US$500 million 5.375% fixed-rate notes against the guarantee of the company and the investment-grade ratings on the Group issued by respectively Moody's and S&P. The notes, which were subscribed mainly by institutional investors like banks, investment funds and insurance groups and were jointly underwritten by BOCI Asia Limited, The Hong Kong and Shanghai Banking Corporation Limited and Merrill Lynch International, are listed on the Stock Exchange. The proceeds raised were used by the Group as general working capital for purposes including the repayment of existing debts and the financing of potential investments in ports and ports-related businesses.

Managing and control of business operations

Alongside efforts to pursue continuous development of its core ports businesses, the Group has strengthened its endeavours in business and market researches with a view to exploring new development opportunities on the one hand and to further improving the managing of its existing operations on the other. The comprehensive level of understanding acquired or accumulated by the Group of each of its investment projects, including the respective stage of development each such project is at, has enabled the Group to apply various control measures, including financial control, to these projects to ensure the risks associated with each project have been thoroughly managed and the Group's overall financial structure is streamlined. Simultaneously, the Group has sought to continuously improve the internal control systems and management measures for the relatively more matured projects so as to smoothen their respective operational flows, in turn reinforcing the Group's control. The Group has also sought to raise the operational efficiency of these projects, and hence profitability, through technical innovation and improvements in the operation process. In addition, progress has been made in further improving the Group's engineering management systems and in establishing IT systems for the Group. At the same time, the Group has strengthened communications and co-operation with its various joint venture partners with a view to further increasing the level of mutual understanding in the respective entities in which the Group has no controlling stakes. By doing so, it has helped to not only align the interests of these operations with the Group's overall development strategy, but also strengthen the strategic co-operation and create synergy between the Group's network and those of each of its partners. The Group believes that, upon the continuing implementation of appropriate management and control measures, the Group's risk control capability will be further enhanced and the profitability of its core businesses further improved.

Liquidity and treasury policies

As at 31 December 2005, the Group had approximately HK$940 million in cash, 25.4% of which was denominated in Hong Kong dollars, 38.7% in US dollars, 30.1% in Renminbi and 5.8% in other currencies.

The Group's net cash flow from operating activities which totaled HK$1,316 million. In addition, there were one-off cash inflows of HK$372 million from the divestment of PPG, DiChain and CMF Technology Fund. During the year, the Group invested more than HK$8,951 million in cash for its port projects (of which HK$6,653 million was financed by interest-bearing debts), repaid short-term borrowings of HK$122 million and paid dividends of HK$447 million in cash.

The stable source of income has enabled the Group to maintain a sound financial position to meet its daily operating needs. As the Group's existing bank loans mainly comprise of medium and long term borrowings, there is little debt repayment pressure in the short term.

Capital and financial resources

As at 31 December 2005, the Company had 2,194,556,610 shares in issue. During the year, approximately HK$53 million was received from the issue of 9,839,000 shares as a result of the exercise of certain share options. Apart from the above and the issue of 42,524,636 shares under the Company's scrip dividend scheme, the Company did not issue any new shares in 2005.

As at 31 December 2005, the Group had total outstanding interest-bearing debts of HK$8,269 million, of which HK$477 million were repayable within one year, whilst the remaining was medium to long term borrowings. Bank loans equivalent to HK$90 million were secured by pledging of assets of certain subsidiaries, and all remaining loans were unsecured. Except for the US$500 million fixed-rate notes due in 2015, all remaining loans bear interests at floating rates.

As at 31 December 2005, the Group's gearing ratio (interest-bearing debts divided by net assets) was about 51.2%.

85.1% of the interest-bearing debts were denominated in HK dollars and US dollars, while the balance were in Renminbi or local currencies and all were made by member companies of the Group and repayable in local currencies. As such, the Group did not make use of any financial instruments to hedge against the currency risks.

Assets held by the Group are mainly denominated in HK dollars and Renminbi. The Board is of the view that it is not likely that the Renminbi will depreciate in the future, and hence, did not make any hedging arrangements for its foreign currency investments.

Charge on assets

As at 31 December 2005, the Company did not have any charge on its assets, whilst the assets amounting to HK$416 million were pledged by certain subsidiaries of the Group for securing their bank borrowings.

Contingent liabilities

As at 31 December 2005, the amount of bank guarantee given by the Company in respect of its subsidiaries, associates and an investee company totaled HK$6,424 million.

Employees and remuneration

As at 31 December 2005, the Company and its subsidiaries employed 2,973 full time staff, of which 253 were based in Hong Kong, 41 overseas and the remaining 2,679 in the PRC. The remuneration paid for 2005 amounted to HK$348 million, representing 12.7% of the total operating expenses of the Group. The remuneration policy of the Group is reviewed annually and appropriate adjustments to staff's remuneration are made with reference to prevailing conditions of the human resources market and the general economy.

Outlook and Prospects

According to a journal entitled "Global Economic Outlook 2006" published by the United Nations on 24 January 2006, the world economy is anticipated to grow by 3.3% in 2006, largely the same as the 3.25% growth rate recorded for 2005. This forecast is basically in line with the respective views expressed by the World Bank and the International Monetary Fund in that the growth rate in 2006 will be similar to that of 2005. Currently, it is generally believed that the growth of the US economy is likely to slow down mildly, Japan and Europe will see continued improvement, while the Asian economy will remain vibrant. Although potential threats of high oil prices, possible US property bubble and the outbreak of avian flu still prevail, no material change in the economic fundamentals is expected.

In 2005, the PRC government reviewed and approved the "Proposed Eleventh Five-year Development Plan", paving the general directions for the State's development plan for the coming five years to 2010. Under the development strategies of the Eleventh Five-year Plan, the PRC will continue to implement various economic policies to prevent the mainland economy from becoming overheated, to accelerate the country's economic restructuring process to transform its growth model, and to actively pursue co-ordinated regional development programme so as to maintain the overall sustainability of the Mainland's economic growth. In light of the policy aimed for balanced development, the Group expects to see a higher degree of economic cohesion and stability to the benefit of the promotion of social harmony and healthy growth in Mainland China. The Group considers that the widespread coverage development strategy of its core ports business conforms with the balanced development principle of the "Eleventh Five-year Plan", which is positive for the strategy implementation and long-term growth of the Group. At the same time, the PRC government has stressed that it will continue to actively pursue various policies to stimulate domestic demand in order to improve the trade balance with certain countries.

On this basis, the Group believes that in 2006 exports from Mainland China will continue to grow steadily while imports into Mainland China will increase at a faster pace, which together will likely improve the PRC's trade balance position. The Group maintains that the above development in the external environment will have a positive effect on its business in terms of ensuring its sustainable growth and operational efficiency.

In 2006, the Group will continue to actively seek investment opportunities that offer synergy value to its existing business strategies. Furthermore, greater efforts will be put in rationalising the integration

between new and existing assets and resources for a better synergy effect and management control over the Group's resources. The Group will leverage its integrated competitive advantages to aggressively build its brand name in ports operations and management. The Group will further reinforce and improve the integration between its core ports operations and value-added businesses. It will speed up the development of its bonded logistics parks operation, drive the integration between its ports and bonded logistics parks in order to optimise the functions and customer base of its ports assets, thereby to fully reflect the Group's multi-facet modern marine logistics services. Besides, the Group will pursue active communications with SIPG with a view to aligning a harmonious relationship to facilitate closer strategic co-operation. The Group will support SIPG in respect of the latter business strategy for the Yangtze River Delta and its plan to establish a feeder route network that capitalises on the geographical advantages of the waterways, thereby realising the business values brought about by any expansion in resources associated. The Group will further consolidate its ports businesses in the Pearl River Delta Region to actively pursue and push ahead the inter-modal maritime transportation services along the Pearl River so as to ensure a closer co-operation between the feeder route network and the port hubs.

In 2006, the Group's ports in Shenzhen, Qingdao, Zhangzhou and Ningbo will all have new berths coming into operation, which will further expand the handling capacities of the Group's terminals. In this connection, the Group will rely on the resources and management of its more developed ports to support the operation of these new assets and to drive the overall business development. These assets will provide the Group with new sources of profit growth in the long term.

In respect of its ports-related operations, the Group will continue to encourage the CIMC Group to grow on the foundation of its current success. Apart from maintaining the leading position in the container manufacturing business, the Group expects the CIMC Group to actively pursue the strategy of further developing its semi-trailer business in a steady manner with a view to growing this sector to generate a new source of profitability for the Group.

With regard to the toll road business, the Group will strengthen, through CMHP, its control over various project companies by improving the management and asset structures of these entities in order to increase the returns on investment. In light of the PRC's robust economic growth, narrowing gaps in economic development between different regions and further increases in consumer spending, it is expected that traffic flows of the toll roads in which CMHP is interested will continue their growth momentum in 2006.

Having established its ports strategic network in 2005, 2006 will be the year during which the Group will see its presences spreading across all major economic regions in Mainland China. The Group firmly believes that, with its prudent development strategies, professional management and comprehensive management control measures, it is entering into a new era of corporate development. The Group is confident that its various operations will continue to see improving operating results such that it will deliver better investment returns to its shareholders.