MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW

The Year of 2006 was yet another one of strong economic growth for Mainland China with its GDP having grown 10.7% (in constant prices terms) to RMB20,940.7 billion, according to economic data released by the State Statistics Bureau of the PRC. This has made China the fourth largest economy in the world. The impressive growth rate was among the highest in the past eleven years and has, for four consecutive years, surpassed the 10% annual growth rate benchmark. Fixed assets investments and foreign trade totals (imports and exports included) continued to rise and have become the major forces in driving the economy's rapid growth.

Foreign trade, led by Mainland China's export-oriented economy, has continued to grow in 2006 and displayed a record-high volume valued at US$1,760.69 billion, an increase of 23.8% over the corresponding figure for the previous year, consecutively for the fifth year exceeding the 20% annual growth rate benchmark. The Group's[1] ports operations continue to benefit from the favourable external economic environment and have performed satisfactorily, as demonstrated by increases in both profit contribution and the share of EBIT[2] due to this sector. This performance, in turn, further anchors the Group's ports business in the Mainland China market.

In 2006, the Group continued its progress to successively launch, as scheduled, its ports operation activities in various economic zones in the coastal regions. Following upon the official launch of the first berth of its Qingdao project, the Group's ports operations presence, for the first time in its corporate history, are firmly and fully established in all four key economic zones in China. The Group aims to ensure that its ports operations maintain a sustainable and steady development path with a view to enhancing their competitive advantage and, in turn, optimizing the economic benefits to the Group. To achieve this, significant efforts have been dedicated towards further integrating its internal resources and improving its operational flows, which has led to more efficient utilization of assets. Communication and exchange flows between the Group's headquarter and its investee companies have been strengthened so as to bring about better co-ordination among different operating units. The design and implementation of these internal improvements have taken into account all possible risks and challenges, as comprehensively assessed by the Group as possible from time to time, associated with the Group's business operation in future. Having expanded its business rapidly through the making of a series of significant and strategic investments in the last few years, the Group's key focus during the year under review has been to seek ways to continue to increase its operational efficiency through leveraging off the capabilities of both its existing and new or add-on assets. While it will continue to look for new investment opportunities, the Group is of the view that the staged implementation of a steady business policy of managing port assets will not only help to avoid any inefficient use of resources, but is essential in solidifying the Group's operation from which to leap the next step forward.

The Group's ports operations, now clearly standing out as core among the Group's business segments, have gathered strong momentum and have displayed encouraging growth performance, benefiting from China's continuing economic growth and the trends of globalization in world trade, as well as improved operational leverage and efficiencies resulted from its continuous efforts in integrating internal resources.

1. China Merchants Holdings (International) Company Limited ("CMHI" or the "Company"), its subsidiaries, associates and jointly controlled entities.

2. Earnings before net interests, tax, unallocated income less expenses and minority interest ("Adjusted Earnings") for the Company and its subsidiaries, and its share of Adjusted Earnings of associates and jointly controlled entities.

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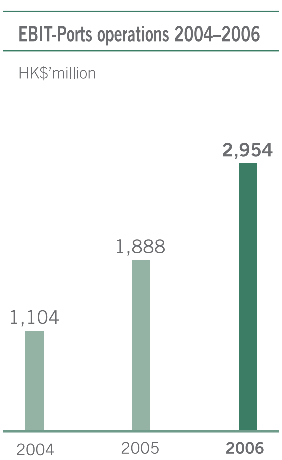
As at 31 December 2006, the Group recorded a recurrent profit of HK$2,621 million, representing an increase of 22.5% over the corresponding figure year-on-year. In addition, EBITDA[3] derived from the core segment of ports operations increased 47.4% year-on-year to HK$3,573 million, and accounted for 71.0% of the Group's total EBITDA for the year under review (against 62.1% for 2005).

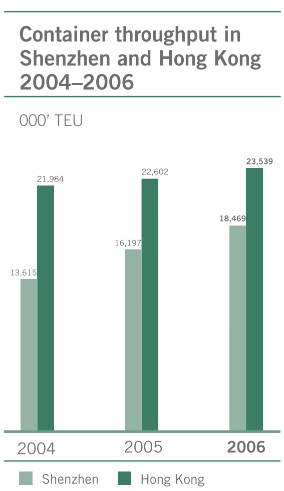
In 2006, the Group's turnover was HK$4,365 million, representing an increase of 46.9% year-on-year. Of this amount, contribution from the ports operations amounted to HK$1,919 million, an increase of 79.9% over the previous year.

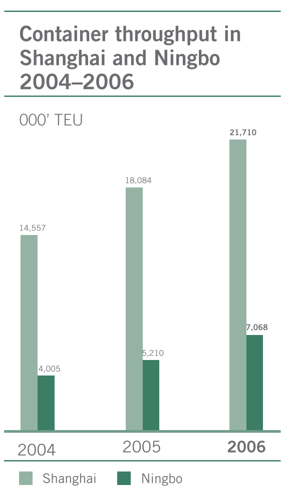
PORTS OPERATIONS

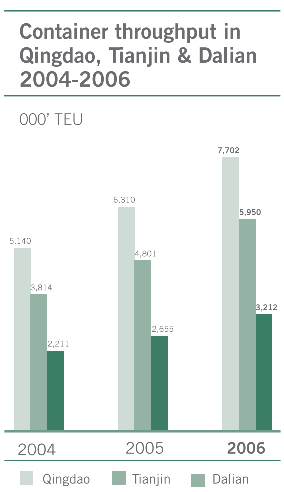
During the year under review, EBIT attributable to the Group's ports operations, excluding the one-off attributable losses arising from restructurings of SIPG and Shenzhen Chiwan Wharf Holdings Co., Ltd. of approximately HK$199 million, reached HK$2,954 million, representing an increase of 56.5% over the corresponding figure for the previous financial year. Its share of the Group's total EBIT (which includes contributions from other investment operations of the Group) rose to 71.1% from 60.3% in the previous year.

In 2006, container throughputs handled by the ports in which the Group invests in and/or manages totaled 40.24 million TEUs, an increase of 64% over the corresponding figure last year. Of this volume, the Group's ports in Mainland China handled 33.5 million TEUs and the Group's ports in Hong Kong, 6.74 million TEUs, representing respective increases of 85% and 6% over the corresponding figures for the year before. Moreover, the Group's Western Shenzhen Ports Zone - its core operating base for container handling - handled a total of 9.55 million TEUs in the year under review, an increase of 14% over that of last year. The Group continued to share more than 50% of the market in the entire Shenzhen district. For the Group's project in Ningbo, 2006 saw the first full year operation for its two berths that were successively launched in 2005. The Group









3. Earnings before net interest, tax, depreciation and amortisation, unallocated income less expenses and minority interest ("Defined Earnings") for the Company and its subsidiaries, and its share of Defined Earnings of associates and jointly controlled entities.

is pleased to have made significant progress in developing the Ningbo market during the year. Container throughput handled totaled 300,000 TEUs, thereby offering a firm base for the Ningbo project's business to grow in the future. In addition, the Group's investments in Zhangzhou and Tianjin terminals have also recorded satisfactory growth. Equally, the Group's bulk cargo business has also maintained satisfactory performance whilst revealing sustainable growth trends. Together with that handled by Shanghai International Ports Group, the Group's total volume of bulk cargo handled amounted to approximately 149 million tons, an increase of 69% over that of last year.

During the year under review, the Group has completed or agreed to complete a series of important transactions, including the acquisition of lands both at or behind the shore-line area of terminals at Western Shenzhen Ports Zone, the acquisition of equity stakes in port assets held by Nanyou Group, and the re-alignment of equity interests among shareholders in Phases I, II and III of Shekou Container Terminal. Not only have these transactions enabled the Group to progress meaningfully and significantly in integrating its ports assets in the Western Shenzhen Ports Zone, the completion of these transactions has also advantaged and strengthened the Group's business positioning, which is essential for the Group to seek further integration or development of its existing businesses or to pursue further expansion in the future. In addition, improvements to streamline internal procedures and release potential from existing resources with a view to enhancing the Group's overall competitiveness also helped to strengthen its business foundation.

The Group has been placing significant emphasis on the development of ports-related integrated logistics operations. In 2006, the Group expedited the development of the two port logistics parks in Qingdao and Shenzhen respectively. Satisfactory progress has been made in attracting customers like shipping companies and logistics operators. The Group regards this business segment to gradually become an important element in supporting the Group's ports operations. The operation of the south China shuttle barge system, which services the terminals at the Western Shenzhen Ports Zone, has also progressed well. At the end of 2006, the system's network has expanded to cover 24 ports, which greatly enhanced the Group's coverage for the Pearl River Delta and its hinterland from the Western Shenzhen Ports Zone.

The Group firmly believes all these measures implemented will comprehensively strengthen the Group's competitive edge, thereby paving a solid foundation that supports and facilitates the Group's future development.

Ports-related operations

During the year under review, EBIT from the Group's ports-related operations amounted to HK$871 million, representing a slight drop of 3.4% compared to that of the last financial year.

China International Marine Containers (Group) Co., Ltd. (the "CIMC Group"), an investee company of the Group in which the Group is its single largest shareholder, reported significant improvement in its sales during the second half of 2006. During the year, the CIMC Group sold a total of 1.57 million TEUs (or container boxes), reflecting an increase of 15% over that of last

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year. The special-purpose vehicle segment has emerged as a new driving force for the profit growth of the CIMC Group. Expansion of the manufacturing capacity for these vehicles is expected to continue. Vehicle sales in 2006 totaled approximately 88,000 units, a significant increase of 67% over that of the previous year.

Hempel-Hai Hong (China) Limited, a subsidiary of the Group, benefitted from significant expansion in industrial constructions during the second half of 2006 which has led to improved sales of decoration paints. Total sales during the year reached 84 million liters, representing an increase of approximately 9% over that of 2005.

Other Operations

During the year under review, China Merchants Holdings (Pacific) Limited ("CMHP"), the Group's Singapore-listed subsidiary, reported a traffic flow of 29.24 million vehicles for its toll road business in China, an increase of 8% over that (excluding that for the Ning Zhen Luo Project for 2005) of the last financial year. EBIT contributed by the toll road operations during the year amounted to HK$207 million, an increase of 13.1% over the same period last year.

Liquidity and treasury policies

As at 31 December 2006, the Group held approximately HK$781 million in cash, 33.2% of which was denominated in Hong Kong dollars, 38.2% in US dollars, 25.4% in Renminbi and 3.2% in other currencies.

The Group's source of funds is mainly derived from its operating activities related to ports and ports-related businesses and investment returns from associates and jointly controlled entities, contributing HK$1,994 million in total. During the year, the Group contributed more than HK$2,339 million in capital expenditure. While the Group has been expanding its investment, the Group continues to adopt a prudent financial policy. The Group is currently financially sound and has abundant cash to meet its daily operating requirements. Besides, as most of the Group's bank loans are medium- to long- term borrowings while the Group does not anticipate any difficulty in renewing short-term loans, thus the pressure for repaying the short-term loans is limited.

Share capital and financial resources

As at 31 December 2006, the Company had 2,333,280,168 shares in issue. During the year, the Company issued 17,618,000 new shares upon the exercise of share options and received HK$175 million as a result. In additional to the above-mentioned newly issued shares and the issue of 36,152,938 shares under the Company's scrip dividend scheme, the Company also issued 84,952,620 shares in the amount of approximately HK$1,427 million, which represented partial consideration for the acquisition of certain pieces of land in Shekou, Shenzhen in January 2006.

As at 31 December 2006, the Group had total outstanding interest-bearing debts of HK$8,725 million, of which HK$2,643 million were repayable within one year, whilst the remaining HK$6,082 million were medium- to long- term borrowings. Existing bank loans equivalent to HK$90 million were secured by the assets of subsidiaries. The remaining interest-bearing debts were unsecured. Other than the listed 10-year notes payable of US$500 million issued by the Group in March 2005, all other loans were at floating interest rates.

As at 31 December 2006, the Group's gearing ratio (total interest-bearing debts divided by net assets) was about 41.7%.

80.8% of the interest-bearing debts were denominated in HK dollars and US dollars, while the balance were in Renminbi or local currencies. These debts were for the benefit of certain member companies of the Group with repayment sourcing from income generated in their respective local currencies. As such, the Group did not make use of any financial instruments to hedge against currency risks.

The Group held its assets mainly in HK dollars and Renminbi. The Board is of the view that, as the probability of future depreciation of Renminbi is minimal, it is not necessary to make hedging arrangements for its foreign currency investments.

Assets Charge

As at 31 December 2006, the Company did not have any charge over its assets. However, certain bank loans borrowed by the Company's subsidiaries were secured. Bank loans of HK$60 million were secured by mortgage debenture over all assets of certain subsidiaries with an aggregate carrying value of HK$411 million including freehold land and buildings with an aggregate carrying value of HK$11 million. Bank loans of HK$30 million were secured by the property, plant and equipment with net book value at 31 December 2006 of HK$73 million.

Employees and remuneration

As at 31 December 2006, the Company and its subsidiaries employed 3,881 full time staff, of which 280 were working in Hong Kong, 10 were working overseas and the remaining 3,591 were working in the PRC. The remuneration paid for 2006 amounted to HK$514 million, representing 13.9% of the total operating expenses of the Group. The remuneration policy of the Group is reviewed every year and appropriate adjustments are made to staff's remuneration with reference to the conditions of the human resources market and the general economy.

The Group also provides internal training to its staff to enable them to achieve self-improvement and to enhance their job-related skills. Moreover, the Group offers year-end bonus as a reward to its staff for their efforts and contribution. The Group also operates a share option scheme, under which qualified staff may exercise their options at an agreed price. The remuneration of directors has been determined with reference to individual's duties, responsibilities and experience, and to prevailing market conditions.

PROSPECTS AND OUTLOOK

Although most economic data recently released elucidate to the likelihood of the US economy slowing down, a healthy developing trend continues to sustain. At the same time, the risk of further rises in the global fuel oil prices appears to be weakening while both the Euro zone and the Japanese economy display in different scales signs of accelerating economic growth. Barring unforeseen changes in fundamental factors that may cause the current state of the global economy to significantly deteriorate, the Group anticipates the global economy to still maintain its current steady momentum during 2007. China's economy at its current scale and sustainability, combined with the growth momentum of its foreign trade volume, is expected to continue to support and encourage the development of the ports sector in Mainland China. While the much expected appreciation of the Chinese currency, Renminbi, may impact on China's export trade, prudent strategies which would enable China's foreign trade to develop on a total, stable and balanced basis with a view to ensuring the sustainable development of China's overall economy are being actively sought and pursued by Mainland China. These factors combined will support China's ports operation in the long run.

In 2007, the Group will continue to intensify measures to integrate its port resources with an ultimate goal of ensuring customer satisfaction at all times. On this basis, the Group will proactively implement procedures to optimise the capacity of its port assets, consolidate customer network and relationship, step up continued internal improvements which include technical innovations and cost reductions, and enhance the competitiveness of its ports in the respective regions. In the face of on-going competitions in the ports market where opportunities and challenges co-exist, the Group will put more resources to strengthen its market research ability in order to track, analyse and project any changes in macro and micro environments, and will fully leverage on the Group's control experience and operating capabilities in managing its port business. In addition, the Group aims to enhance internal efficiency by introducing, wherever practicable, modern management concept to its investee companies and encourage two-way communications at all levels. More importantly, the Group aims to strengthen the working relationship with strategic partners through closer co-operation and frequent dialogues. The Group will continue to monitor changes in the macro-environment and to identify new and suitable investment opportunities wherever possible so as to continue to gloom new revenue sources for the benefit of the Group's future growth.

In 2007, apart from its core ports operations, another area which will focus the Group's attention is to enhance the integrated facilities associated with the development of Qingdao Qianwan Logistics Park and Western Shenzhen Logistics Park. This will be achieved by upgrading the capabilities of the Group's core ports operations both in northern and southern China via the establishment of a working environment, both in hardware and software terms, that ensures the Group's services are unique. These logistics parks, which provide integrated and value-added services to customers of the ports operation, function as an integral part of the Group's ocean-going marine logistics service and will help to further anchor its ability to offer comprehensive services along the entire marine logistics value chain. Based on the effectiveness of the existing south China shuttle barge network to bring about business to the Group's ports in Western Shenzhen, the Group will on the one hand seek to expand the network's geographical coverage and on the other pursue active communications and co-operation with government authorities with a view to further streamlining existing procedures and behaviours in processing transshipment and customs clearance and, in turn, enhancing the efficiency in cross-regional customs clearance. By leveraging on the Group's established position in Western Shenzhen and the characteristics of freight forwarding in the Pearl River waters, the Group aims to gravitate more container traffic to its ports at Western Shenzhen through the offering of cost-effective and convenient modes of marine shuttle transportation to shippers and freight consigners.

With China continuing to demonstrate a rapid economic development, this will in turn lead to, first, the gradual diminishing in disparity characteristics currently existing among the different regions and the continuing adjustments and, secondly, improvements for China's economic structure carried out from time to time by the Central Government. On the international scene, multi-lateral exchanges among different nations are expected to intensify as a consequence. The Group maintains that, considering all the above influencing factors, the ports industry in China will continue to display significant development potential for a long period to come. It is the Group's intention to capitalize on the financial and human capitals thus far accumulated to actively explore and rationally assess each and every investment opportunity emerged. Besides, based on the principle of growing together with its strategic partners, the Group aims to promote the long-term development of the Group's core ports operations.

The Group will place emphasis on enhancing its corporate core competence and maintaining the Group's competitive edge through the continuous introduction of a series of improvement measures aimed towards cost reductions, process technology, information technology, customer satisfaction, process-flow renovation and safety protection. Through effectively integrating resources, capitalizing on the scale and network so achieved, the Group intends to create synergy that benefits the Group internally. Through mobilizing all internal units of the Group in complementing and supplementing one another, the Group intends to establish and/or enrich competitive advantages relating to customer services, operation management, financial management, engineering and purchase management, and human resources management, which collectively will enhance the Group's overall competitiveness, profitability and risk control capabilities.

As regards its ports-related operations, the Group will actively induce the CIMC Group and Hempel-Hai Hong in formulating their respective development strategies, and will encourage co-ordinated co-operation between the Group's related operations. As for its toll road operations, the Group aims to steadily increase the level of investment return in highway operations through the implementation of enhanced control measures and the optimization of corporate governance structure.

The Group's prime objective is to optimize return to shareholders. This is achieved through the Group's continuous efforts to enhance service quality by adopting flexible business and operation strategies and by creating sustainable competitive edges, to integrate the Group's resources and the scale so established, to raise the Group's corporate competitiveness by fully capitalizing on the network synergy existing among the Group's investee companies and continuous improvement in internal systems and control measures.

...Integrated Logistic Services Enhance Customer Satisfaction