

# REPORT OF THE DIRECTORS

The Board is pleased to present the Company's annual report together with the audited financial statements for the year ended 31 December 2006.

## Principal activities and geographical analysis of operations

The Company is an investment holding company. The principal activities of its subsidiaries, associates and jointly controlled entities are set out in notes 40 to 42 to the financial statements, respectively.

An analysis of the Group's performance for the current year by business and geographical segments is set out in note 6 to the financial statements.

## Results and appropriations

The results of the Group for the year are set out in the consolidated income statement on page 56.

The Board had declared an interim dividend of HK17.0 cents per share, totalling HK\$394 million, which was paid on 29 November 2006.

The Directors have resolved to recommend the payment of a final scrip dividend of HK36.0 cents per share, totalling HK\$841 million for the year ended 31 December 2006 by way of an issue of new shares with an alternative to the shareholders to elect to receive the final dividend (or part thereof) in cash in lieu of such allotment (2005: scrip dividend of HK 33.0 cents per share by way of issue of new shares equivalent with cash alternative), payable on or around 4 July 2007 to the shareholders whose names appear on the Register of Members of the Company as at the date of the 2007 Annual General Meeting (the "Scrip Dividend Scheme").

Subject to the approval by shareholders in the 2007 Annual General Meeting, a circular containing details of the Scrip Dividend Scheme together with the relevant election form will be sent to shareholders on or around 6 June 2007. The Scrip Dividend Scheme is conditional upon the granting by the Listing Committee of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") of the listing of and permission to deal in the new shares to be issued pursuant thereto. It is expected that the final dividend warrants and certificates for the new shares will be despatched to shareholders on or around 4 July 2007.

## Reserves

Details of the movements in reserves of the Group and the Company during the year are set out in note 31 to the financial statements.

## Property, plant and equipment

Details of the movements in property, plant and equipment of the Group and the Company are set out in note 17 to the financial statements.

## Share capital

Details of the movements in share capital of the Company are set out in note 30 to the financial statements.

## Distributable reserves

Distributable reserves of the Company at 31 December 2006, calculated under section 79B of the Hong Kong Companies Ordinance, amounted to HK\$1,540 million (2006: HK\$1,100 million).

## Five year financial summary

A summary of the results and the assets and liabilities of the Group for the last five financial years is set out on page 21.

### Purchase, sale or redemption of shares

The Company and any of its subsidiaries has not purchased, sold or redeemed any of the Company's listed securities during the year.

### Directors

The Directors in 2006 were:

#### Executive Directors:

Dr. Fu Yuning  
*(Chairman & Managing Director)*  
 Mr. Zhao Huxiang  
*(Vice Chairman)*  
 Mr. Li Yinquan  
 Mr. Hu Zheng  
 Mr. Meng Xi  
 Mr. Wang Hong  
 Mr. Yu Liming  
 Mr. To Wing Sing

#### Independent non-executive Directors:

Mr. Tsang Kam Lan  
 Mr. Kut Ying Hay  
 Mr. Lee Yip Wah Peter  
 Mr. Li Kwok Heem John

In accordance with Article 91 of the Company's Articles of Association, Mr. Hu Zheng, Mr. Meng Xi, Mr. Yu Liming and Mr. To Wing Sing will retire from the Board at the forthcoming annual general meeting but, being eligible, will offer themselves for re-election.

Each of the Independent Non-executive Directors has been appointed for a term of three years commencing on 22 March 2005. In addition, the appointment of each of the Independent Non-executive Directors is subject to retirement by rotation in accordance with the Company's Articles of Association.

The Company has received annual confirmations from each of the Independent Non-executive Directors in relation to their independence to the Company and considers that each of the Independent Non-executive Directors is independent of the Company.

### Directors' service contracts

None of the Directors who are proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable within one year without payment of compensation, other than statutory compensation.

### Directors' interests in contracts

No contracts of significance in relation to the Group's business to which the Company, its holding companies, its fellow subsidiaries or its subsidiaries was a party and in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

### Directors' interests in securities

As at 31 December 2006, the interests of the Directors of the Company in the securities of the Company and its associated corporations, within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO"), as recorded in the register maintained by the Company under Section 352 of the SFO were as follows:

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## Shares and Share Options in the Company

Name of director	Capacity	Nature of interest	Number of shares in the Company	Number of shares in the Company subject to share options granted <sup>1</sup>	Percentage of aggregate long position in shares to the issued share capital as at 31 December 2006
Dr. Fu Yuning	Beneficial owner	Personal interest	1,219,029	800,000	0.0865%
Mr. Zhao Huxiang	Beneficial owner	Personal interest	—	760,000	0.0326%
Mr. Li Yinquan	Beneficial owner	Personal interest	—	850,000	0.0364%
Mr. Hu Zheng	Beneficial owner	Personal interest	—	700,000	0.0300%
Mr. Meng Xi	Beneficial owner	Personal interest	—	900,000	0.0386%
Mr. Wang Hong	Beneficial owner	Personal interest	38,000	900,000	0.0402%
Mr. Yu Liming	Beneficial owner	Personal interest	—	1,350,000	0.0579%
Mr. To Wing Sing	Beneficial owner	Personal interest	—	500,000	0.0214%
Mr. Lee Yip Wah	Beneficial owner	Personal interest	137,246	—	0.0059%
Mr. Li Kwok Heem John	Interest of spouse	Family interest	1,379,843	—	0.0591%
			2,774,118	6,760,000	0.4086%

<sup>1</sup> Included share options granted under the Existing Scheme.

## Shares in China Merchants Holdings (Pacific) Limited (“CMHP”), a subsidiary of the Company

Name of director	Capacity	Nature of interest	Number of shares in CMHP	Number of shares in CMHP subject to share options granted	Percentage of aggregate long position in shares to the issued share capital of CMHP as at 31 December 2006
Mr. Zhao Huxiang	Beneficial owner	Personal interest	400,000	—	0.090%
Mr. Wang Hong	Beneficial owner	Personal interest	—	1,200,000	0.269%

Save as disclosed above and based on the register maintained by the Company under Section 352 of the SFO, as at 31 December 2006, none of the Directors or chief executive of the Company or any of their associates had any interests and short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which are required, pursuant to section 352 of the SFO, to be entered in the register or which are required, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies in the Rules Governing the Listing of Securities on The Stock Exchange (the "Listing Rules"), to be notified to the Company and the Stock Exchange.

Apart from the share option schemes disclosed below, at no time during the current year was any of the Company, its subsidiaries, its fellow subsidiaries or its holding companies a party to any arrangement to enable the Directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

## Share option schemes

### *(a) Terminated Scheme*

Under the share option scheme of the Company adopted on 26 June 1992 (the "Terminated Scheme"), the Directors of the Company may, at their discretion, grant options to any director or employee of the Company or any of its subsidiaries to subscribe for shares in the Company at a price equal to the higher of the nominal value of the shares or not less than 80% of the average of the closing prices of the shares of the Company for the five trading days immediately preceding the date of offer of the options. The purpose of the Terminated Scheme was to provide an incentive to the employees and directors of the Group. The maximum number of shares in respect of which options may be granted may not exceed 10% of the issued share capital of the Company at the time of granting of the options. Under the terms of the Terminated Scheme, a director or employee may only exercise share options granted after he or she has completed two years service with the Group.

The Terminated Scheme was terminated on 20 December 2001 (the "Termination Date") without prejudice to the rights and benefits of and attached to those options granted thereunder which are outstanding as at that date. No further grants were made after the Termination Date. Following the termination, the provisions of the Terminated Scheme remain in force and effect to the extent necessary to give effect to the exercise of any option granted prior to the Termination Date.

As at 31 December 2006, there was no outstanding share option under the Terminated Scheme and accordingly, no further shares will be issued pursuant to exercise of options granted under the Terminated Scheme.

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Details of the outstanding share options for the year ended 31 December 2006 which have been granted under the Terminated Scheme are as follows:

Name	Date of grant	Exercise price HK\$	Options held as at 1 January 2006	Options exercised during the year Note	Options lapsed/ cancelled during the year	Other changes during the year	Options held as at 31 December 2006
<b>Directors</b>							
Nil	—	—	—	—	—	—	—
<b>Continuous contract employees</b>							
(I)	1 March 2000	5.054	350,000	(100,000)	(250,000)	—	—
(II)	19 September 2000	5.615	350,000	(350,000)	—	—	—
(III)	6 July 2001	5.610	350,000	(350,000)	—	—	—
			1,050,000	(800,000)	(250,000)	—	—

Outstanding share options may be exercised at any time during a period of 6 years commencing on the date of grant of the options.

**Note:**

The weighted average closing market price per share immediately before the dates of which the share options were exercised was HK\$25.41.

**(b) Existing Scheme**

Under the share option scheme (the “Existing Scheme”) approved by the shareholders of the Company at an Extraordinary General Meeting of the Company held on 20 December 2001 (the “Adoption Date”), the Board may, at their discretion, invite any director or employee of the Company or

any of its subsidiaries or associates (“Eligible Persons”), to take up options to subscribe for fully paid ordinary shares in the Company subject to the terms and conditions stipulated therein.

In view of the on-going support given to the Company by the CMHK Group (representing China Merchants Holdings (Hong Kong) Company Limited, an intermediate holding company of the Company, together with its subsidiaries (excluding the Group) and associated companies), the Board considered that it is in the best interest of the Company to extend the Existing Scheme to directors and employees of members of the CMHK Group. A resolution was passed at the Extraordinary General Meeting held on 27 August 2002 to amend the Existing Scheme to effect such extension of Eligible Persons.

Details of the Existing Scheme are as follows:

(i) Purpose

The purpose of the Existing Scheme is to provide the Company with a flexible means of incentivising, rewarding, remunerating, compensating and/or providing benefits to Eligible Persons.

(ii) Qualifying participants

Any Eligible Person.

(iii) Maximum number of shares

(1) 10% limit

Subject to (iii) (2) and (iii) (3) below, the total number of shares which may be issued upon exercise of all options to be granted under the Existing Scheme and any options granted under the Terminated Scheme must not in aggregate exceed 10% of the shares in issue as at the Adoption Date. Options lapsed in accordance with the terms of the Existing Scheme and the Terminated Scheme will not be counted for the purpose of calculating the 10% limit.

(2) Refreshing the 10% limit

Subject to (iii)(5) below if applicable, the Board may, with the approval of the shareholders in general meeting “refresh” the 10% limit under (iii) (1) above (and may further “refresh” such limit once refreshed in accordance with the provisions of this rule), provided that the total number of shares which may be issued upon the exercise of all options to be granted under the Existing Scheme and options

granted under the Terminated Scheme under the limit as refreshed shall not exceed 10% of the shares in issue at the date on which the shareholders approve the “refreshed” limit. Options previously granted under the Existing Scheme and the Terminated Scheme (including those outstanding, cancelled, lapsed or exercised in accordance with the terms of the relevant schemes) will not be counted for the purpose of calculating the limit as “refreshed”.

(3) Exceeding the 10% limit

The Board may grant option to any Eligible Person or Eligible Persons specifically identified by them which would cause the limit under (iii) (1) above (including, for the avoidance of doubt, any such limit as “refreshed” under (iii) (2) above) to be exceeded, but only with the approval of the shareholders of the Company in general meeting, and subject always to (iii) (5) below.

(4) Individual limit

(a) Subject to (iii)(4)(b) below (and subject always to (iii) (5) below), the Board shall not grant any option (the “Relevant Options”) to any Eligible Person which, if exercised, would result in such Eligible Person becoming entitled to subscribe for such number of shares as, when aggregated with the total number of shares already issued or to be issued to him under all options granted to him in the 12 month period up to and including the offer date of the relevant options, exceed 1% of the shares in issue at such date.

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- (b) Notwithstanding (iii)(4)(a) above, the Board may grant options to any Eligible Person or Eligible Persons causing the limit under (iii)(4)(a) above in relation to such Eligible Person to be exceeded, but only with the approval of the shareholders of the Company in general meeting (with such Eligible Person and his associates abstaining from voting), and subject always to (iii) (5) below.
- (5) 30% maximum limit  
The number of shares which may be issued upon exercise of all outstanding options granted and not yet exercised under the Existing Scheme and the Terminated Scheme to Eligible Persons must not exceed 30% of the shares in issue from time to time.
- (iv) Option period  
Subject to certain provisions, an option under the Existing Scheme which is vested and has not lapsed may be exercised at any time up to the expiry of 10 years (or less, as the case may be) from the date of grant of the option. The exercise of the options may be subject to any conditions imposed by the Board at the time of offer. The rules of the Existing Scheme do not contain specific provisions for the minimum period which an option must be held before exercise or performance targets applicable to the options.
- (v) Payment on acceptance of option  
Option-holders are not required to pay for acceptance of an option.
- (vi) Exercise price  
The subscription price for the shares in respect of which options are granted shall not be less than the higher of the closing price of the shares as stated in the Stock Exchange's daily quotations sheet on the offer date, the average closing price of the shares as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the offer date and the nominal value of the shares.
- (vii) The remaining life of the Existing Scheme  
The life of the Existing Scheme is 10 years commencing on the Adoption Date and will end on 19 December 2011.
- (viii) Shares available for issue under the Existing Scheme  
As at 31 December 2006, the total number of shares which may be issued pursuant to the exercise of options granted under the Existing Scheme was 50,743,000 shares.  
As at 31 December 2006, the total number of shares available for issue under the Existing Scheme was 198,332,238 shares, which represented approximately 8.5% of the total issued share capital of the Company.

Details of the share options outstanding at 31 December 2006 which have been granted under the Existing Scheme are as follows:

Name	Date of grant	Exercise price HK\$	Options held as at 1 January 2006	Options granted during the year	Options exercised during the year	Options lapsed/ cancelled during the year	Other changes(+/-) during the year	Options held as at 31 December 2006
Directors								
Dr. Fu Yuning	11 October 2002	4.985	600,000	—	(600,000)	—	—	—
	27 October 2004	11.08	1,000,000	—	(1,000,000)	—	—	—
	25 May 2006	23.03	—	800,000	—	—	—	800,000
Mr. Zhao Huxiang	27 October 2004	11.08	700,000	—	(340,000)	—	—	360,000
	25 May 2006	23.03	—	400,000	—	—	—	400,000
Mr. Li Yinquan	11 October 2002	4.985	200,000	—	(200,000)	—	—	—
	27 October 2004	11.08	500,000	—	(50,000)	—	—	450,000
	25 May 2006	23.03	—	400,000	—	—	—	400,000
Mr. Hu Zheng	27 October 2004	11.08	500,000	—	(200,000)	—	—	300,000
	25 May 2006	23.03	—	400,000	—	—	—	400,000
Mr. Meng Xi	27 October 2004	11.08	500,000	—	—	—	—	500,000
	25 May 2006	23.03	—	400,000	—	—	—	400,000
Mr. Wang Hong	27 October 2004	11.08	350,000	—	(100,000)	—	—	250,000
	25 May 2006	23.03	—	650,000	—	—	—	650,000
Mr. Yu Liming	11 October 2002	4.985	450,000	—	(100,000)	—	—	350,000
	27 October 2004	11.08	500,000	—	—	—	—	500,000
	25 May 2006	23.03	—	500,000	—	—	—	500,000
Mr. To Wing Sing	27 October 2004	11.08	600,000	—	(600,000)	—	—	—
	25 May 2006	23.03	—	500,000	—	—	—	500,000
			5,900,000	4,050,000	(3,190,000)	—	—	6,760,000



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Name	Date of grant	Exercise price HK\$	Options held at 1 January 2006	Options granted during the year	Options exercised during the year	Options lapsed/cancelled during the year	Other changes(+/-) during the year	Options held at 31 December 2006
Continuous contract employees								
(I) The Group	11 October 2002	4.985	1,050,000	—	(600,000)	—	—	450,000
	27 October 2004	11.08	13,171,000	—	(9,268,000)	—	—	3,903,000
	25 May 2006	23.03	—	20,070,000	—	—	—	20,070,000
	21 June 2006	20.91	—	150,000	—	—	—	150,000
(II) The CMHK Group	11 October 2002	4.985	1,250,000	—	(1,050,000)	—	—	200,000
	27 October 2004	11.08	5,800,000	—	(2,710,000)	—	—	3,090,000
	4 May 2005	15.31	200,000	—	—	—	—	200,000
	25 May 2006	23.03	—	15,920,000	—	—	—	15,920,000
			21,471,000	36,140,000	(13,628,000)	—	—	43,983,000
			27,371,000	40,190,000	(16,818,000)	—	—	50,743,000

The above outstanding share options can be exercised at any time during a period of 10 years commencing on the date of grant of the options.

## Note:

- The closing market price of the shares was HK\$22.75 and HK\$20.45 immediately preceding the dates of grant (i.e. 24 May 2006 and 20 June 2006).
- The weighted average closing market price per share immediately before the date on which the share options were exercised was HK\$25.41.

## 3. Values of options

The values of the options that were granted under the Existing Scheme as of 25 May 2006 and 21 June 2006 are reasonably stated by the amount of HK\$3.705 and HK\$3.802 per option respectively. The valuation of the options is based on the closing price of the shares of the Company as of 25 May 2006 and 21 June 2006.

The methodology applied in valuing each option is the Black-Scholes option pricing model. As the Black-Scholes option pricing model applies to stocks that do not pay dividends, we made an adjustment developed by Robert Merton to approximate the option value of a dividend-paying stock such as the Company's stock. Under this adjustment method, it is assumed that the Company's stock will generate a constant dividend yield during the remaining life of the options.

In calculation of the fair market value of the options granted as of 25 May 2006, the following assumptions have been made:

- i. The eligible person has no right to exercise their respective options during the period from their grant date to the date before vesting of the options;
- ii. The eligible person has right to exercise the respective options at any time during the remaining time to maturity from the date after the options have been vested and before the expiration of the relevant options;
- iii. Transferability of the options is not allowed;
- iv. Forfeiture rate of the options is assumed to be 0%;
- v. The share price is assumed to be equal to the closing price of the Company as of 25 May 2006 (i.e. HK\$22.15);
- vi. Historical volatility of the Company (i.e. 27.83%) is deemed to be appropriate figure to serve as the expected volatility of the options;
- vii. The dividend yield of the Company is assumed to be 2.48% as of 25 May 2006.

In calculation of the fair market value of the options granted as of 21 June 2006 the following assumptions have been made:

- i. The eligible person has no right to exercise their respective options during the period from their grant date to the date before vesting of the options;
- ii. The eligible person has right to exercise the respective options at any time during the remaining time to maturity from the date after the options have been vested and before the expiration of the relevant options;
- iii. Transferability of the options is not allowed;
- iv. Forfeiture rate of the options is assumed to be 0%;
- v. The share price is assumed to be equal to the closing price of the Company as of 21 June 2006 (i.e. HK\$20.80);

- vi. Historical volatility of the Company (i.e. 28.18%) is deemed to be appropriate figure to serve as the expected volatility of the options;
- vii. The dividend yield of the Company is assumed to be 2.64% as of 21 June 2006.

Given the above assumptions and the inherent limitations of the Black-Scholes option pricing model, shareholders and other investors are hereby warned of the subjectivity and uncertainty of the aforementioned values of the options.

#### ***(c) China Merchants Holdings (Pacific) Limited - 2002 Scheme***

China Merchants Holdings (Pacific) Limited ("CMHP") Share Option Scheme 2002 (the "CMHP 2002 Scheme") was approved and adopted by the members of CMHP at an Extraordinary General Meeting held on 30 May 2002 and modifications to the CMHP 2002 Scheme were approved by the members of CMHP at an extraordinary general meeting held on 27 April 2006 and by the shareholders of the Company on 26 May 2006. The CMHP 2002 Scheme is administered by the CMHP Remuneration Committee, which comprises the following directors:

Dr Hong Hai (*Chairman*)

Mr Jiang Yan Fei

Dr Lim Heng Kow

#### **(i) Purpose**

The purpose of the CMHP 2002 Scheme is to provide CMHP with a flexible means of incentivising, rewarding, remunerating, compensating and/or providing benefits to CMHP's employees.

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**(ii) Qualifying participants**

CMHP's employees (including executive directors), non-executive directors, parent company employees and associated company employees, subject to certain conditions, are eligible to participate in the CMHP 2002 Scheme. Controlling shareholders and their associates are not eligible to participate in the CMHP 2002 Scheme.

**(iii) Maximum number of shares**

Total number shares of CMHP to be issued upon the exercise of the options granted to each grantee (including exercised and outstanding options) in any 12-month period must not exceed one per cent. of the shares of CMHP in issue. Such further grants of more than one per cent. must be separately approved by shareholders of the Company in a general meeting.

The aggregate number of options available to the Company's employees shall not exceed twenty per cent. of the total number of shares of CMHP which may be issued pursuant to the exercise of the options under the CMHP 2002 Scheme.

Each grant of options to a director, chief executive or substantial shareholder of the Company must be approved by independent non-executive directors of the Company (excluding any independent non-executive director who is the proposed grantee of the options).

Options to an employee of the Company that, together with the Options already granted, represents five per cent. or more of the total number of options available to such employees of the Company, shall be approved by independent shareholders of CMHP in a separate resolution for each such employee of the Company.

In addition, grant of options to a substantial shareholder or an independent non-executive director of CMHP, the Company or any of their respective associates, which would result the shares of CMHP issued and to be issued upon the exercise of all options granted to such person in the 12 month period up to including the date of such grant representing in aggregate over 0.1 per cent. of the shares of CMHP in issue and having an aggregate value, based on the closing price of the shares of CMHP at the date of each grant, in excess of HK\$5 million, such grant must be approved by the shareholders of the Company in general meeting.

#### (iv) Size of Scheme

The directors of CMHP are authorised and empowered to offer and grant options under the CMHP 2002 Scheme and to issue from time to time such number of shares in the capital of CMHP as may be required to be issued pursuant to the exercise of options granted by CMHP under the CMHP 2002 Scheme, whether granted during the subsistence of this authority or otherwise, provided always that:

- (a) the aggregate nominal amount of shares over which the options may be granted on any date, when added to the nominal amount of shares issued and issuable in respect of all options granted under the CMHP 2002 Scheme or any other scheme, shall not exceed ten per centum (10%) of the issued shares in the capital of CMHP as of 30 May 2002, being the date on which the CMHP 2002 Scheme was adopted by shareholders of CMHP and if such ten per centum (10%) limit is refreshed by the directors of CMHP with the approval (the "Approval") of the shareholders of the Company, being the parent company of the CMHP, then the total number of shares which may be issued upon exercise of all options to be granted under the CMHP 2002 Scheme and any options to be granted under any other scheme under the limit as "refreshed" shall not exceed ten per centum (10%) of the issued shares of CMHP as at the date on which the

shareholders of the Company approve the "refreshed" limit; and

- (b) the aggregate number of additional ordinary shares which may be issued upon the exercise of all outstanding options granted and not yet exercised under the CMHP 2002 Scheme and any options granted and not yet exercised under any other schemes shall not exceed fifteen per centum (15%) of the issued shares in the capital of CMHP from time to time.

and that such authority shall, unless revoked or varied by CMHP in a general meeting, continue in force until the conclusion of the next annual general meeting of CMHP or the date by which the next annual general meeting of CMHP is required by law to be held, whichever is earlier.

#### (v) Payment on acceptance of option

Option-holders are required to pay S\$1.00 for acceptance of an option.

#### (vi) Exercise Price

S\$1.00 or such other amount as required by the CMHP Remuneration Committee is payable upon acceptance of an option. Exercise price may be exercised at the market price as well as at a price set at a discount to the market price provided that maximum discount shall not exceed 20% of the market price.

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## (vii) Option Period

Options granted with the exercise price set at market price may be exercised after the first anniversary of the offer date. If options are granted with exercise price set at a discount to market price, options may be exercised after the second anniversary of the offer date.

The life span of an option granted to a CMHP non-executive director is 5 years from the offer date. The life span of options granted to an employee or an executive director of CMHP is 10 years from the offer date.

## (viii) Options granted during the year

During the financial year, 12,350,000 options were granted under the CMHP 2002 Scheme and there were no options granted with exercise price set at a discount to market price.

Details of the share options outstanding at 31 December 2006 which have been granted under the CMHP 2002 Scheme are as follows:

Name	Date of grant	Exercise price per share S\$	Options held at 1 January 2006	Options granted during the year Note	Options exercised/ lapsed/ cancelled during the year	Other changes during the year	Options held at 31 December 2006
Directors							
Wang Hong	6 October 2006	0.789	—	1,200,000	—	—	1,200,000
Continuous contract employees							
	10 February 2003	0.5	500,000	—	—	—	500,000
	6 October 2006	0.789	—	11,150,000	—	—	11,150,000

The above outstanding share options can be exercised at any time during a period of 5 or 10 years commencing on the date of grant of the options.

Note:

1. CMHP is a company listed in Singapore. The Company's interest in CMHP as at 31 December 2006 is 71.92%.

## (ix) Issue of shares under option

During the financial year, no shares were issued by CMHP under the CMHP 2002 Scheme.

## (x) CMHP Shares available for issue under the CMHP 2002 Scheme

As at 31 December 2006, the total number of shares which may be issued pursuant to the exercise of the options granted under the CMHP 2002 Scheme was 12,850,000 CMHP Shares, which represented approximately 2.88% of the total issued share capital of CMHP.

## Substantial shareholders

As at 31 December 2006, the following persons, other than a Director or chief executive of the Company, have interest or short position in the shares and underlying shares of the Company as recorded in the register of the Company required to be kept under section 336 of the SFO:

### Long Positions

Name of Substantial Shareholder	Nature of interest	Ordinary Shares held <sup>1, 4</sup>	Percentage of total issued Shares <sup>1, 4</sup>
China Merchants Group Limited	Interest of Controlled Corporation	1,332,560,700 <sup>2,3</sup>	57.11%
China Merchants Steam Navigation Company Limited	Interest of Controlled Corporation	1,186,500,999 <sup>3</sup>	50.85%
China Merchants Holdings (Hong Kong) Company Limited	Interest of Controlled Corporation	1,186,500,999 <sup>3</sup>	50.85%
China Merchants Union (BVI) Limited	Beneficial Owner	1,156,169,282 <sup>3</sup>	49.55%
Top Chief Company Limited	Interest of Controlled Corporation	146,059,701 <sup>3</sup>	6.26%
China Merchants Shekou Industrial Zone Company Limited	Interest of Controlled Corporation	146,059,701 <sup>3</sup>	6.26%
Orienteur Holdings Company Limited	Beneficial Owner	57,655,178 <sup>2</sup>	
	Interest of Controlled Corporation	86,299,778 <sup>2, 3</sup>	6.17%

#### Notes:

- The figures are based on the Corporate Substantial Shareholder Notice submitted by China Merchants Group Limited to the Stock Exchange on 17 November 2006 and do not include the new Shares issued as scrip dividend on 29 November 2006 pursuant to the scrip dividend scheme of the Company.
  - China Merchants Group Limited is deemed to be interested in 1,332,560,700 Shares, which represents the aggregate of 1,156,169,282 Shares held by China Merchants Union (BVI) Limited, 13,593,283 Shares held by Cm Development Limited ("CmD"), 16,738,434 Shares held by Best Winner Investment Limited, 57,655,178 Shares held by Orienteur Holdings Company Limited ("OHC"), 86,299,778 Shares held by Super Talent Group Limited, 2,104,745 Shares held by Orienteur International Financing Limited which includes 50,988,000 Shares to be issued to CmD and OHC as the consideration shares for the sale of the entire interest in Elite Vantage Investments Limited as referred to in the circular of the Company dated 5 December 2006.
  - China Merchants Group Limited is deemed to be interested in the Shares held by its wholly-owned subsidiaries Orienteur International Financing Limited, Super Talent Group Limited, OHC, Top Chief Company Limited, China Merchants Shekou Industrial Zone Company Limited, CmD, Best Winner Investment Limited, China Merchants International Finance Company Limited, China Merchants Union (BVI) Limited, China Merchants Holdings (Hong Kong) Company Limited and China Merchants Steam Navigation Company Limited. China Merchants Group Limited is also deemed to be interested in the consideration shares to be issued to CmD and OHC upon completion of the acquisition of the entire interest in Elite Vantage Investments Limited as referred to in the circular of the Company dated 5 December 2006.
- OHC is deemed to be interested in the 86,299,778 Shares held by Super Talent Group Limited.
- OHC is deemed to be interested in the Shares held by its wholly-owned subsidiary, Super Talent Group Limited.

## REPORT OF THE DIRECTORS

4. This figure includes the consideration Shares to be issued to the sellers upon completion of the acquisition of Elite Vantage Investments Limited as referred to in Note 3 above.

### Short Positions

Nil

Save as disclosed above, there was no person, other than a Director or chief executive of the Company, who has an interest or short position in the shares and underlying shares of the Company as recorded in the register of the Company kept under section 336 of the SFO.

### Connected transactions

During the year ended 31 December 2006, the Group entered into the following transactions, which constituted connected transactions under the Listing Rules, and are required to be disclosed in accordance with Chapter 14A of the Listing Rules:

- (a) On 5 January 2006, Media Port Investments Limited (“Media Port”), a 50%-owned subsidiary of the Company, entered into a supplemental joint venture contract and a supplemental articles of association with Shenzhen Nanyou (Group) Company Limited (“Nanyou”), pursuant to which the total investment of the joint venture company, Shenzhen Mawan Terminals Co., Ltd. (“Mawan Terminals”), was to be increased by an amount of RMB200 million and the registered capital of Mawan Terminals was to be increased by an amount of RMB135 million. The additional registered capital will be contributed by Media Port and Nanyou on 60:40 basis, in proportion to their respective equity interests in Mawan Terminals.
- (b) On 3 April 2006, I.T. Development Co., Ltd. (“ITD”), a wholly-owned subsidiary of the Company, entered into a share transfer agreement with China Nanshan Development (Group) Inc. (“Nanshan”), pursuant to which ITD acquired 55% equity interest in Shenzhen Haiqin Engineering Supervision & Management Co., Ltd., (“Shenzhen Haiqin”) at a total consideration RMB8,294,000. Nanshan is a connected person of the Company by being an associate of Shenzhen Chiwan, a substantial shareholder of several subsidiaries of the Company, including Media Port and Shenzhen Cyber-Harbour Network Co., Ltd.
- (c) On 14 November 2006, the Company entered into a sale and purchase agreement with Cm Development Limited (“CmD”), Orienture Holdings Company Limited (“OHC, together with CmD, the “Sellers”), China Merchants Shekou Industrial Zone Company Limited (“CMSIZ”) and China Merchants Holdings (Hong Kong) Company Limited (“CMHK”), pursuant to which the Company acquired the entire issued share capital of Elite Vantage Investments Limited at a total consideration of RMB1.62 billion and HK\$30 million (of which, RMB1.17 billion and HK\$30 million were paid in the form of 50,988,000 new shares to be issued by the Company) with a view to acquiring, inter alia, 33% interest in Shenzhen Haixing Harbour Development Company Limited and certain land interests in Shenzhen. The Sellers, CMSIZ and CMHK are wholly-owned subsidiaries of CMG, the ultimate holding company of the Company, and therefore are connected persons of the Company.

- (d) On 14 December 2006, the Company entered into a sale and purchase agreement with Swire Pacific Limited, P&O Dover (Holdings) Limited, MTL Shekou Holdings Limited and Modern Terminals Limited (“MTL”), pursuant to which the Company acquired 40% interest in Shekou Container Terminals Company Limited (“SCT1”) and 39.2% in Shekou Containers Terminals (Phase II) Company Limited (“SCT2”) at a total consideration of HK\$3,168 million.
- On the same date, the Company entered into a rationalisation agreement with MTL, pursuant to which the Company and MTL will form a joint venture to hold their entire 100% interests in SCT1, SCT2, Shekou Containers Terminals (Phase III) Company Limited (“SCT3”) and An Yun Jie Port and Warehouse Services (Shenzhen) Company Limited (“Land Co”). MTL is a substantial shareholder of MTL Chiwan Holdings Limited, a subsidiary of the Company, and hence is a connected person of the Company.
- (e) Details of the continuing connected transactions of the Group for the year ended 31 December 2006 are set out below:

Name of party	Nature of transaction	Note	Income/ (expenses) HK\$'000
Hempel A/S and its fellow subsidiaries	Royalties charged to the Group	(i), (ii)	(58,216)
	Sales of paint products by the Group	(i), (iii)	169,818
	Sourcing services charged to the Group	(i), (iv)	(2,175)
China Merchants Godown Wharf and Transportation Company Limited (“CMGW”)	Rental of use of nine vessels charged to the Group	(v)	(3,024)
China Merchants Property Development Company Limited (“CMPD”)	Rental of properties and plant and equipment charged to the Group	(vi)	(10,341)
CMSIZ	Rental of properties in Shekou charged to the Group	(vii)	(30,611)
Euroasia Dockyard Enterprise and Development Limited (“Euroasia”)	Rental of properties at Tsing Yi Terminal charged to the Group	(viii)	(20,285)
Hoi Tung Marine Machinery Suppliers Limited (“Hoi Tung”)	Rental of warehouse charged to the Group and cargo management service fee charged to the Group	(ix)	(2,448)
	Rental of properties charged by the Group	(xii)	3,111



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Name of party	Nature of transaction	Note	Income/ (expenses) HK\$'000
Yiu Lian Dockyards Limited ("Yiu Lian")	Rental of properties at Tsing Yi Terminal charged to the Group	(x)	(5,589)
	Ship berthing service fee charged to the Group	(xi)	(4,908)
CMHK	Rental of properties charged by the Group	(xii)	16,058
Hong Kong Ming Wah Shipping Company Limited ("Ming Wah")	Rental of properties charged by the Group	(xii)	7,854
Shenzhen Chiwan Logistics Limited ("SCL")	Port-zone container horizontal transportation and related services charged to the Group	(xiii)	(7,632)

## Notes:

- (i) Hempel A/S (also known as I.C.H. Industrial and Commercial Holding ApS, which is registered as a secondary name) is a substantial shareholder of Hempel-Hai Hong (China) Limited ("Hempel-Hai Hong"), a non wholly-owned subsidiary of the Group, and hence a connected person of the Company.
- (ii) Royalties were paid by Hempel-Hai Hong (China) Limited, a 64%-owned subsidiary of the Group, to Hempel A/S pursuant to the joint venture agreement dated 9 October 1991 (as amended) and the Technology and Trademark Licence Agreement dated 15 February 1996 between Hempel A/S, Hai Hong Industry (Shenzhen) Co. Ltd. and Hempel-Hai Hong (China) Limited. Hai Hong Industry (Shenzhen) Co. Ltd. is a wholly-owned subsidiary of the Group and Hempel-Hai Hong (China) Limited is a joint venture company which is owned as to 64% by the Group and 36% by Hempel A/S. Royalties were based on percentages of the net sales of paints and negotiated on an arms-length basis.
- (iii) Hempel-Hai Hong entered into a master purchase agreement with Hempel A/S for a term of two years with effect from 1 January 2005. Under the master purchase agreement, Hempel-Hai Hong sold to Hempel A/S and its subsidiaries finished marine paint products. Sales of paints were determined by Hempel-Hai Hong on the basis of its total production costs for the products plus a mark-up and the selling prices in general were no less favourable to Hempel-Hai Hong than the prices Hempel-Hai Hong would obtain from independent third parties on similar terms. The parties have further agreed to extend the transactions contemplated under the master purchase agreement for another 2 years (commencing from 1 January 2007) by entering into a supplemental agreement on 27 November 2006.
- (iv) Hempel-Hai Hong entered into a master sourcing agreement with Hempel A/S for a term of two years commencing on 1 January 2005. Pursuant to the master sourcing agreement, Hempel A/S and its subsidiaries acted as buying agents of Hempel-Hai Hong to source unfinished paint products from third party suppliers. Such sourcing services were charged at a rate of 4% of the purchase price payable Hempel-Hai Hong for the unfinished paint products. The parties have further agreed to extend the transactions contemplated under the master purchase agreement for another 2 years (commencing from 1 January 2007) by entering into a supplemental agreement on 27 November 2006.
- (v) China Merchants Container Services Limited ("CMCS"), a wholly-owned subsidiary of the Company, entered into various ship leasing agreements with CMGW, a subsidiary of CMG and hence is a connected person of the Company, on 1 November 2005 for a term of commencing on 1 November 2005 and ending on 31 December 2007. Pursuant to these agreements, CMGW agreed to lease to CMCS the use of several vessels. The rental paid by CMCS was based on the depreciation charges of the vessels.

- (vi) China Merchants Port Services (Shenzhen) Company Limited ("SCMPS"), a wholly-owned subsidiary of the Group, entered into an agreement with CMPD on 8 December 2005 in relation to the lease by SCMPS from CMPD of certain properties and plants and equipment for the operation of the port of Shekou, Shenzhen. The agreement was for a term of 12 months commencing on 1 January 2006 and ending on 31 December 2006. CMPD is an associate (as defined in the Listing Rules) of CMG and hence is a connected person of the Company. The rental paid by SCMPS was based on the market value of the properties and depreciation charges of the plants and equipment. The rental agreement was extended for a term of 1 year commencing from 1 January 2007 at annual rental of approximately RMB10,620,000 in accordance with a renewal agreement executed on 15 January 2007.
- (vii) SCMPS entered into a lease agreement with CMSIZ on 14 December 2005 pursuant to which SCMPS agreed to lease from CMSIZ certain properties in Shekou for a term of 2 years commencing from 1 January 2006 at annual rental of RMB31,550,000.
- (viii) CMCS entered into a rental agreement with Euroasia on 1 November 2001 for the use of certain properties owned by Euroasia in connection with the operation of the business of CMCS at Tsing Yi Terminal. Pursuant to a supplemental agreement entered into on 1 November 2004, the rental agreement has been amended to have a term of two years commencing on 1 November 2004 at annual rental of HK\$20,285,000. The rental agreement was further extended for a term of 1 year commencing from 1 November 2006 with identical terms in accordance with a further supplemental agreement executed on 27 November 2006.
- (ix) Hempel-Hai Hong entered into a rental and service agreement with Hoi Tung on 1 November 2005 for the rental of warehouse space from Hoi Tung and the provision of cargo management service by Hoi Tung. The agreement was initially for a term of one year commencing on 1 November 2005 and was further extended for a term of one year commencing on 1 November 2006 pursuant to a supplemental agreement. The rental and the cargo management service fee were charged at negotiated prices based on market rates. Hoi Tung is a subsidiary of CMG and therefore is a connected person of the Company.
- (x) CMCS entered into a rental agreement with Yiu Lian, a wholly-owned subsidiary of CMG and hence is a connected person of the Company, on 8 November 2001 for the use by CMCS of certain properties owned by Yiu Lian in connection with the operation of the business of CMCS at Tsing Yi Terminal. Pursuant to a supplemental agreement entered into on 1 November 2004, the rental agreement was extended for a term of two years commencing on 1 November 2004 at a rental charge of HK\$5,589,000 per annum. The rental agreement was further extended for a period of 6 months commencing from 1 November 2006 at a rental charge of HK\$2,800,000 for the 6-month period pursuant to a further supplemental agreement executed on 27 November 2006.
- (xi) CMCS entered into a ship berthing services agreement with Yiu Lian on 1 November 2005 for a term of 1 year commencing from 1 November 2005 pursuant to which Yiu Lian provided barges to bring ships into a port. The arrangement was extended for a term of one year commencing from 1 November 2006 pursuant to a supplemental agreement executed on 27 November 2006. The ship berthing services charged were by reference to market rates.
- (xii) Universal Sheen Investment Limited ("Universal Sheen"), a wholly-owned subsidiary of the Group, entered into 3 tenancy agreements with CMHK, Ming Wah and Hoi Tung on 2 April 2004, respectively, for the rental of 3 properties for a term of 2 years (commencing on 1 February 2004 for the leases to CMHK and Ming Wah and on 1 March 2004 for the lease of Hoi Tung) at rentals of HK\$1,338,168, HK\$465,030 and HK\$229,536 per month, respectively. The tenancy agreements were further extended for a term of 2 years (subject to early termination by mutual agreement) at rentals of HK\$1,338,168, HK\$671,710 and HK\$331,552 per month, respectively. The lease to Hoi Tung was terminated by mutual agreement on 15 October 2006.

## REPORT OF THE DIRECTORS

- (xiii) Shenzhen Mawan Port Services Company Limited (“Mawan Port Services”) and Mawan Terminals (together, the “Mawan Companies”) entered into a services agreement with SCL pursuant to which the Mawan Companies appointed SCT as a contractor in relation to the Mawan Companies’ port-zone container horizontal transportation and other related services for a term commencing from 1 July 2006 to 31 December 2007 at RMB30,000,000 per annum.
- (f) The Independent Non-executive Directors have reviewed the continuing connected transactions set out in paragraph (e) of this section above. In their opinion, these transactions were:
- (i) in the ordinary and usual course of business of the Group;
  - (ii) on normal commercial terms; and
  - (iii) in accordance with the relevant agreements governing such transactions and on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.
- The Independent Non-executive Directors further opined that:
- (i) in respect of the use of the technology, management knowhow and trademarks of Hempel A/S by Hempel Hai-Hong which is referred to in note (ii) to paragraph (e) of this section, the aggregate royalty fee charged to the Group has not exceeded HK\$64,000,000, the annual cap for the year ended 31 December 2006;
  - (ii) in respect of the sale of paint products to Hempel A/S, which is referred to in note (iii) to paragraph (e) of this section, the aggregate amount of sales has not exceeded HK\$210,000,000, the annual cap for the year ended 31 December 2006;
  - (iii) in respect of the sourcing services provided by Hempel A/S, which is referred to in note (iv) of paragraph (e) of this section, the aggregate amount of service fees has not exceeded HK\$5,087,000, the annual cap for the year ended 31 December 2006;
  - (iv) in respect of the leasing of the nine vessels by CMGW to CMCS, which details are set out in note (v) to paragraph (e) of this section, the aggregate rental has not exceeded HK\$3,024,000, the cap for the year ended 31 December 2006;
  - (v) in respect of the lease by SCMPS from CMPD of certain properties and plants and equipment for the operation of the port of Shekou, Shenzhen, which details are set out in note (vi) to paragraph (e) of this section, the aggregate rental has not exceeded HK\$15,000,000, the annual cap for the year ended 31 December 2006;
  - (vi) in respect of the lease by SCMPS from CMSIZ of certain properties in Shekou, which details of which are set out in note (vii) to paragraph (e) of this section, the aggregate rental has not exceeded RMB31,550,000, the annual cap for the year ended 31 December 2006;
  - (vii) in respect of the use of certain properties owned by Euroasia in connection with the operation of the business of CMCS at Tsing Yi Terminal, which details are set out in note (viii) to paragraph (e) of this section, the aggregate rental has not exceeded HK\$20,285,000, the annual cap for the year ended 31 December 2006;
  - (viii) in respect of the rentals of warehouse and the cargo management services provided by Hoi Tung, which details are set out in note (ix) to paragraph (e) of this section, the aggregate amount of rentals and service fees has not exceeded HK\$2,900,000, the annual cap for the year ended 31 December 2006;

- (ix) in respect of the use of certain properties owned by Yiu Lian in connection with the operation of the business of CMCS at Tsing Yi Terminal, which details are set out in note (x) to paragraph (e) of this section, the aggregate rental has not exceeded HK\$5,591,000, the annual cap for the year ended 31 December 2006;
- (x) in respect of the ship berthing services provided by Yiu Lian, which details are set out in note (xi) to paragraph (e) of this section, the aggregate amount of service fees has not exceeded HK\$5,900,000, the annual cap for the year ended 31 December 2006;
- (xi) in respect of the leases provided by Universal Sheen, which details are set out in note (xii) to paragraph (e) of this section, the aggregate rentals paid under the tenancy renewal agreements executed on 29 March 2006, has not exceeded HK\$25,424,178, the relevant cap for the year ended 31 December 2006; and
- (xii) in respect of the use of port-zone container horizontal transport and other related services, which details are set out in note (xiii) to paragraph (e) of this section, the aggregate amount of service fees has not exceeded RMB15,000,000, the annual cap for the year ended 31 December 2006.

The Board of Directors has received a letter from the auditors of the Company stating that the continuing connected transactions set out in paragraph (e) of this section:

- (A) have received the approval of the Company's Board of Directors;
- (B) were in accordance with the pricing policies of the Group if the transactions involve the provision of goods or services by the Group;
- (C) have been entered into in accordance with the terms of the relevant agreements governing the transactions; and

- (D) where applicable, have not exceeded the caps as disclosed in previous announcements.

### Management contracts

No contract concerning the management and administration of the whole or any substantial part of the business of the Company had been entered into or existed during the year.

### Major customers and suppliers

The aggregate amount of sales and purchases attributable to the Group's five largest customers and suppliers represented less than 30% of the Group's total sales and purchases in 2006 respectively.

At no time during the year had the Directors, their associates or any shareholder (whom to the knowledge of the Directors own(s) more than 5% of the Company's share capital) had any interest in these major customers and suppliers.

### Public float

Based on the information that is publicly available to the Company and within the knowledge of its Directors, as at the date of this report, there is sufficient public float of not less than 25% of the Company's issued shares as required under the Listing Rules.

### Audit Committee

The revised written terms of reference which describe the authority and duties of the Audit Committee were prepared and adapted with reference to "A Guide for Effective Audit Committee" published by the Hong Kong Institute of Certified Public Accountants. On 3 January 2005, the Company has adopted further revised terms of reference for its Audit Committee to comply with the Code on Corporate Governance as set out in Appendix 14 to the Listing Rules.



## REPORT OF THE DIRECTORS

The Audit Committee provides an important link between the Board and the Company's auditors in matters coming within the scope of the Group's audit. It also reviews the effectiveness of both the external and internal audit and of internal controls and risk evaluation. The Committee comprises all four Independent Non-executive Directors, namely Mr. Tsang Kam Lan, Mr. Kut Ying Hay, Mr. Lee Yip Wah Peter and Mr. Li Kwok Heem John. Five meetings were held during the year.

### **Subsequent event**

Details of subsequent event of the Company are set out in note 39 to the financial statements.

### **Auditors**

The financial statements have been audited by PricewaterhouseCoopers who retired and, being eligible, offer themselves for re-appointment at the forthcoming annual general meeting.

On behalf of the Board

Dr. Fu Yuning  
*Chairman*

Hong Kong, 12 April 2007