

MANAGEMENT DISCUSSION AND ANALYSIS

For the six months ended 30 June 2001, the turnover of China Merchants China Direct Investments Limited and its subsidiaries (the "Group") was US\$2.88 million, representing a 25% decrease against the same period of 2000. The Group achieved profit attributable to shareholders of US\$2.82 million for the period, representing a 35% increase over the same period last year. The drop in turnover was due to the decrease in dividend income from unlisted investments in securities. The decrease in loss on and provisions for investments contributed to the Group's growing net profit for the period. As of 30 June 2001, the net assets of the Group were US\$124 million, with net asset value per share of US\$0.904.

As of 30 June 2001, the Group had total investments of approximately US\$89.19 million, including US\$86.95 million of unlisted investments and US\$2.24 million of listed investments. The major unlisted investment projects are spread through the sectors of financial services (accounting for 41.3% of the Group's net assets); manufacturing (10.7%); infrastructure (8.1%); and real estate (6.0%). The Group had cash and bank balances of US\$34.69 million, accounting for 28.0% of the Group's net assets.

Most of the Group's investments are located in China where the official currency is RMB, which remained stable in the reporting period.

REVIEW OF UNLISTED INVESTMENTS

Financial Services Investments

Financial Services is one of the core investment sectors of the Group. This sector brings stable cash flow and significant capital appreciation to the Group. Since this sector in China is a developing industry with high growth potential, the Group will continue to explore investment opportunities and will likely increase its presence in this sector.

The Group's Financial Services investments are concentrated in the banking and securities industries.

China Merchants Bank Company, Limited ("CMB"), a registered commercial bank in the PRC, is the first joint-stock commercial bank established by mainland enterprises. CMB has over 230 branches and offices across the country. The Group invested US\$13.77 million to acquire a 1.62% stake in CMB. In the first half of 2001, CMB recorded a profit before taxation of RMB780 million, in line with the corresponding period of 2000. CMB has accelerated steps toward an IPO. In order to satisfy all regulations governing the IPO, CMB has started to restructure its business and expects to complete this effort in the near future. We expect an IPO to result in significant capital appreciation. No dividends were distributed for the year 2000, due to a resolution of the 2001 Annual General Meeting.

Fujian Industrial Bank Company, Limited (“FIB”) is a commercial bank registered in the PRC, with over 230 offices throughout the country. The Group first invested in FIB in 1998, in cooperation with the China Merchants Group. In the first half of 2001, the Group acquired an additional 20,000,000 shares, bringing its cumulative stake in FIB to US\$17.6 million, or 2.8%. For the first half of 2001, FIB recorded a profit before taxation of RMB500 million, representing an 87% increase over the same period of 2000. FIB is expanding its business and studying the feasibility of listing its shares. The Group received dividends for 2000 in the amount of US \$0.81 million.

Industrial Securities Company, Limited (“ISCL”) is a comprehensive securities company registered in the PRC. It has 16 offices located in major cities throughout the country, including Beijing, Shanghai, Shenzhen, Wuhan, Fuzhou and Xiamen. The Group invested US\$1.03 million to acquire a 0.74% stake in ISCL. For the first six months of this year, ISCL recorded a profit after taxation of RMB56 million, representing a 67% decrease over the same period of 2000. The Group received dividends for the year 2000 of approximately US\$120,000.

Transportation and Infrastructure Investments

Transportation and Infrastructure is another core investment sector of the Group. These investments continued to generate stable cash flow. As a long-term investment strategy, the Group will continue to explore investment opportunities in this sector, and will invest in projects with strong potential for profit growth and capital appreciation.

Maoming Tongfa Highway Company Limited (“Tongfa”) is a contractual joint venture. The Group invested US\$ 10 million to acquire a 35% stake in Tongfa. In the past few years, Tongfa has generated stable cash flow for the Group. Return on investment has reached 15%.

Manufacturing Investments

Official sources revealed that China experienced GDP growth of 7.8% in the first half of 2001. Although this figure declined slightly from the previous year, it remained much more favorable than for many other countries. The Group's industrial projects benefited from China's continuing strong economic growth.

Zhaoyuan Jinbao Electronics Company Limited (“Jinbao”) recorded a turnover of RMB160 million for the first half of 2001, an increase of 2.6% over the same period last year. Profit after taxation was RMB13.25 million, representing year-to-year growth of 11.3%. This improvement was attributed primarily to a combination of increasing turnover and effective cost controls. Also during this period, BOC China Fund, a minor shareholder, sold its entire stake of 15% to Shandong High-Tech Investment Corporation. However, the Group's stake in Jinbao remains unchanged.

Chengde Wanli Steel Tubes Company Limited (“Wanli”) is another manufacturing holding of the Group. Under the co-operative joint venture contract, the Chinese party was obligated to make payments of US\$5.5 million to the Group through 2001. However, due to financial hardship, the Chinese party had made payments of only US\$3.47 million. Efforts to collect the overdue amount were not successful, and in October 2000, the Investment Manager initiated talks with the Chinese party in order to dispose of the Group's stake in Wanli. An agreement was reached in July 2001, and the Chinese party consented to buy back the Group's entire stake in the joint venture for US\$4.76 million-to be paid in three installments-representing an internal rate of return of approximately 12%. The first installment of US\$1.18 million was received on 14 September.

Real Estate Investments

Real Estate is another investment sector of the Group, with holdings distributed among Beijing, Shanghai, Shenzhen and Shandong.

In the first half of 2001, Real Estate has trailed the performance of the Group's other investment sectors. Although all of the Group's investments are located in developed and prosperous regions of the PRC, they have lost significant value due to the sluggish real estate market over the past few years. Therefore, the Group has decided to divest from this sector, and to adopt a more conservative approach to potential real estate investments in future.

Beijing Longbao Mansion (“Longbao”) is situated near the Third Ring of Chaoyang District in Beijing. It comprises two 17-storey apartment buildings and an office complex. The Group invested US\$4.98 million for a 35% interest under an agreement with the developer to jointly manage the property. The Group has taken steps, including sale and lease arrangements, to recover its investment cost as soon as possible, but progress has been slow. We expect Beijing's real estate market to improve since the government will be making large investments in the city in preparation for the 2008 Olympic Games. According to an independent surveyor's report, the market value of the property at the end of 2000 was higher than the Group's investment cost.

Shenzhen Mankam Square (“Mankam”) is a 33-storey commercial complex on North Wen Jin Road, Shenzhen. The Group invested US\$4.3 million through a 35% holding in Hansen Enterprises Limited (“Hansen”) to purchase 5,262 sq. m. of retail space on the third floor of Mankam Square. Hansen has taken possession of the property. The Group has already launched a series of sale and lease programs in order to recover its investment cost as soon as possible.

REVIEW OF LISTED INVESTMENTS

Driven by the opening of the B-share market and improvements in corporate earnings, the China Enterprise Index and the Red Chip Index rose by 42% and 12%, respectively, while Hang Seng Index decreased 14% in the first half of 2001. The Group continued to adopt a conservative investment posture and disposed of some China-concept shares during this period. For the first half of the year, the Group recorded a profit of US\$0.83 million from listed investments. In the second half of the year, the Group sees no quick recovery for the local stock market since Hong Kong relies heavily on exports to the U.S., where the economy remains weak. However, China’s anticipated entry into the WTO and its sustained economic growth will help Red Chips and the stocks of some Chinese enterprises outperform the market. As of 30 June 2001, the Group had listed investments valued at US\$2.24 million.

PROSPECTS

In the first half of the year 2001, the global economy has been slowing, the stock market fluctuated, and most industries faced difficulties and challenges. Therefore, the Group adopted a more conservative strategy to new investment projects. The Group will consolidate its investments to improve profitability. Meanwhile, China will enter into the WTO, which will vigorously increase China’s economic activity and initiate a new era of economic development. During this period, we believe that Financial Services, Biotech, Communications and Infrastructure will experience the most rapid growth. We will therefore actively seek investment opportunities in the above sectors. With the China Merchants Group’s full support and assistance, the Group has committed to invest in two securities companies and a newly established insurance brokerage company. Meanwhile, the Group also plans to participate in an intelligent transportation ticketing system project. The above investments are in the approval process of the relevant authorities in the PRC. The total investment amount is about US\$8 million.

We anticipate that the second half of year 2001 will see an even more fluctuating economy worldwide. We will adopt a more active, though conservative, attitude in seeking new investment opportunities that will emphasize higher growth industries that are well positioned to take full advantage of China’s entry into the WTO.

INTERIM DIVIDEND

The Board of Directors has declared an interim dividend of US¢0.5 or HK¢3.9 (2000: US¢0.5) per share for the year ending 31 December 2001, which will be paid on 2 November 2001 to shareholders whose names appear on the Register of Members on 12 October 2001.

Shareholders who wish to receive the interim dividend in Hong Kong Dollars have to complete a Hong Kong Dollar dividend election form, a copy of which will be despatched with the interim report to shareholders, and return the same to the Share Registrars on or before 22 October 2001. Shareholders who have previously submitted a dividend election form do not need to re-submit this form.

BOOK CLOSURE

The Register of Members of the Company will be closed from Wednesday, 10 October 2001 to Friday, 12 October 2001 (both dates inclusive), during which period no transfer of shares will be registered. In order to qualify for the interim dividend, all transfer of shares accompanied by the relevant share certificates and transfer forms must be lodged with the Company's Share Registrars, Central Registration Hong Kong Limited, Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong no later than 4:00 p.m. on Tuesday, 9 October 2001.

PURCHASE, SALE OR REDEMPTION OF SHARES OF THE COMPANY

During the period ended 30 June 2001, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN SHARES

None of the directors or chief executives, or their associates, had any interests in any securities of the Company or any of its associated corporations as defined in the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance") as at 30 June 2001, and none of the directors or chief executives, or their spouses or children under the age of 18, had any right to subscribe for the securities of the Company, or had exercised any such right during the period ended 30 June 2001.

SUBSTANTIAL SHAREHOLDERS

As at 30 June 2001, the register of substantial shareholders maintained under Section 16(1) of the SDI Ordinance showed that the following shareholders had an interest of 10% or more in the share capital of the Company.

Name	Number of ordinary shares
HKSCC Nominees Limited	47,477,760
HSBC Nominees (Hong Kong) Limited	31,301,040
China Merchants Holdings Company Limited <i>(Note)</i>	33,989,760
China Merchants Steam Navigation Company Limited <i>(Note)</i>	33,989,760
China Merchants Holdings (Hong Kong) Company Limited <i>(Note)</i>	33,989,760
China Merchants Finance Holdings Company Limited <i>(Note)</i>	33,989,760
China Merchants Financial Services Limited <i>(Note)</i>	33,989,760
Good Image Limited	33,989,760

Note: The Company is deemed to have interests in the shares opposite to its name by virtue of its controlling shareholding in the Company whose name is set out immediately under it.

CODE OF BEST PRACTICE

The Company has complied throughout the period from 1 January 2001 to 30 June 2001 with those paragraphs of the Code of Best Practice, as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited except that non-executive directors are not appointed for specific term(s).

By order of the Board
Zhang Yun Kun
Executive Director

Hong Kong, 20 September 2001