



Dr. Huang Dazhan

Chairman of the Board of the Investment Manager

*“Greater understanding of the opportunities and challenges arising as a result of China’s accession into the WTO will help us gear up for the coming years and create greater value for the Fund.”*

## OVERALL PERFORMANCE

China Merchants China Direct Investments Limited and its subsidiaries (the "Fund") recorded a profit attributable to shareholders of US\$4.99 million for the year 2001, representing an increase of 37% over year 2000. This was attributable to the significant decrease in provisions for investments. As of 31 December 2001, the net assets of the Group were US\$125 million, with net asset value per share of US\$0.915, representing a 2.6% increase over year 2000.

Total turnover for the year fell by 40% to US\$3.69 million (2000: US\$6.18 million). Turnover included dividend income from unlisted investments which decreased 55%, as a result of the suspension of dividend distribution from one of the unlisted investments, China Merchants Bank, due to its preparation for initial public offering during the year. In addition, the US Federal Reserve cut interest rates during the year to a 40-year low, which caused the Fund's interest income to drop by 23%. To adapt to the changes in investment policies of China, the Fund has gradually reduced its holding in contractual investments with fixed returns. The impact was a drop of 49% in income from contractual joint ventures.

The net unrealized holding gain on unlisted investments for the year was US\$2.28 million, representing a decrease of 73% from 2000. This was because 2000 was the first year the Fund appointed an independent valuer to revalue the Fund's investment in China Merchants Bank, following the bank's announcement of a solid plan for IPO. Therefore, a significant amount of unrealized holding gain was recorded in 2000.

Despite the drop in both turnover and gain on investments, the Fund achieved a significant increase in net profit, as a result of a drop in provisions for diminution in value of investments and bad debts of 92% to US\$0.73 million (2000: US\$9.58 million).

## LIQUIDITY, FINANCIAL RESOURCES, GEARING AND CAPITAL COMMITMENTS

Working capital fell by 11% to US\$37.01 million as of 31 December 2001, mainly due to capital injections of US\$11.31 million to new investments, which was offset by the increase of US\$7.0 million in working capital from the disposals of an investment project and listed securities.

Although the Fund has consistently been in a very liquid position, during the year, it borrowed RMB53.40 million (equivalent to US\$6.45 million) from PRC banks for capital injections into new projects, aiming to hedge against the exchange rate risk of Yuan. As of 31 December 2001, the Fund's gearing ratio, measured on the basis of total borrowings as a percentage of shareholders' equity, was 5% (2000: 0%).

As of 31 December 2001, the Fund's capital commitment amounted to US\$1.0 million (2000: nil); this sum is dedicated to an investment, which has been authorized but not yet contracted for.

# INVESTMENT MANAGER'S DISCUSSION AND ANALYSIS

## CHARGES ON ASSETS

The Fund's short-term bank loans of RMB22.40 million (equivalent to US\$2.71 million) and RMB31.00 million (equivalent to US\$3.75 million) were respectively secured by a pledge of its time deposits of US\$2.80 million and 12.47 million shares of China Merchants Bank.

## EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

Most of the Fund's investments are located in China where the official currency is Yuan, which remained stable in the reporting period. To hedge against some currency exchange-rate risk, the Fund has arranged loans in Yuan, for injections to Yuan-denominated investments.

## EMPLOYEES

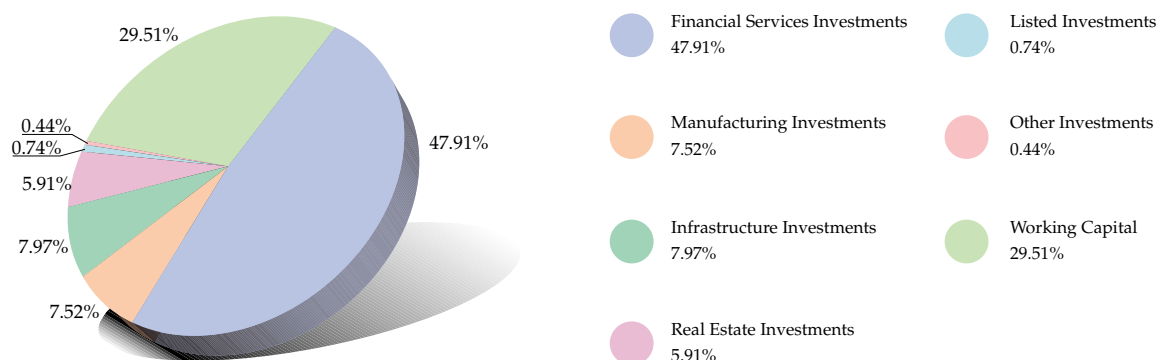
The Fund does not employ any employees, because its portfolio and day-to-day administration is handled by the Investment Manager.

## THE PORTFOLIO

As of 31 December 2001, the Fund had total investments of US\$88.42 million, of which US\$87.49 million was in unlisted investments and US\$0.93 million in listed investments. The major unlisted investment projects cover sectors of financial services (accounting for 47.91% of the Fund's net assets), manufacturing (7.52%), infrastructure (7.97%), and real estate (5.91%). Additionally, the fund had working capital of US\$37.01 million, accounting for 29.51% of the Fund's net assets.

### NET ASSET DISTRIBUTION

*As at 31 December 2001*





Linda L. Zhou

Managing Director of the Investment Manager

*“The Fund recorded a profit attributable to shareholders of US\$4.99 million for the year 2001, representing an increase of 37% over year 2000.”*

# INVESTMENT MANAGER'S DISCUSSION AND ANALYSIS

## REVIEW OF UNLISTED INVESTMENTS

The following table shows the major unlisted investment projects held by the Fund as at 31 December 2001:

Name of Projects	Location	Business Nature	Net Book Value US\$ million	Percentage of Net Assets
<i>Financial Services:</i>				
1. China Merchants Bank Co., Ltd.	Shenzhen, Guangdong	Banking	32.33	25.78
2. Fujian Industrial Bank Co., Ltd.	Fuzhou, Fujian	Banking	19.89	15.86
3. Industrial Securities Co., Ltd.	Fuzhou, Fujian	Securities	1.19	0.95
4. China Communication Securities Co., Ltd.	Shenzhen, Guangdong	Securities	1.65	1.31
5. Shenzhen Economic Special Zone Securities Co., Ltd.	Shenzhen, Guangdong	Securities	4.44	3.54
6. Houlder China Insurance Brokers Ltd.	Shenzhen, Guangdong	Insurance brokerage	0.60	0.47
<b>Sub-total</b>			60.10	47.91
<i>Manufacturing:</i>				
7. Zhaoyuan Jinbao Electronics Co., Ltd.	Zhaoyuan, Shandong	Copper foil & laminates	9.43	7.52
<b>Sub-total</b>			9.43	7.52
<i>Infrastructure:</i>				
8. Maoming Tongfa Highway Co., Ltd.	Maoming, Guangdong	Toll road	10.00	7.97
<b>Sub-total</b>			10.00	7.97
<i>Real Estate:</i>				
9. Beijing Longbao Mansion	Beijing	Office & Apartments	4.98	3.97
10. Shenzhen Man Kam Square	Shenzhen, Guangdong	Retails shops	2.43	1.94
<b>Sub-total</b>			7.41	5.91
<b>Total</b>			86.94	69.31

## Financial Services Investments

Financial services is one of the core investment sectors of the Fund. This sector brings stable cash flow and significant capital appreciation to the Fund. With China's entrance into the World Trade Organization ("WTO"), this sector will enter into a new era, which will create more business opportunities. For the year 2001, the Fund has acquired additional shares of a commercial bank, and invested in two more securities companies and an insurance brokerage company. The Fund will continue to explore investment opportunities, aiming to tap into this growing sector.

The Fund's financial services investments are concentrated in the banking, securities and insurance brokerage industries.

**China Merchants Bank Company, Limited ("CMB")**, a registered commercial bank in China, is the first joint-stock commercial bank established by mainland enterprises. CMB has over 280 branches and offices across the country. The Fund invested US\$13.77 million to acquire a 1.62% stake in CMB. CMB recorded a profit after taxation of RMB913 million for 2001. In preparation for its IPO, no dividends were distributed for the year 2000. According to an independent valuation, the Fund's investment value in CMB had increased US\$2.05 million for the year 2001. CMB became the fourth mainland bank to go public when it issued 1.5 billion A shares at RMB7.30 per share on the Shanghai Stock Exchanges on 9 April 2002. The share price rose by 46% upon its debut. In the second-largest A-share IPO in China, CMB raised over RMB10 billion. The IPO was well received and over RMB350 billion funds were then frozen from the subscriptions.

**Fujian Industrial Bank Company, Limited ("FIB")** is a commercial bank registered in China, with over 252 offices throughout the country. The Fund, in cooperation with the China Merchants Group, first invested in FIB in 1998. In 2001, the Fund acquired an additional 20,000,000 shares, bringing its cumulative stake in FIB to US\$17.60 million, or 2.8%. FIB recorded a profit after taxation of RMB510 million, representing a 39% increase over 2000. The Fund received dividends for 2000 in the amount of US\$0.81 million. FIB's Board of Directors studied the feasibility of an IPO, and had prepared to proceed with an application for listing. With the increase of FIB's net assets, the investment value of the Fund in FIB increase to US\$19.89 million at the end of 2001. Contribution from this investment amounted to US\$0.96 million for 2001.

**Industrial Securities Company, Limited ("ISCL")** is a comprehensive securities company registered in China, with business in securities underwriting, brokering and investment, and investment consulting. It has over 16 offices located in major cities throughout the country, including Beijing, Shanghai, Shenzhen, Wuhan, Fuzhou and Xiamen. The Fund invested US\$1.03 million to acquire a 0.74% stake in ISCL. Due to significant drop in the volume of stock trading, as a result of depressed market condition in 2001, the overall performance of securities companies was unsatisfactory. ISCL recorded a profit after taxation of RMB17.1 million for the year 2001, representing a 91.5% decrease over 2000. At the end of 2001, the total assets and net assets of ISCL were RMB8.77 billion and RMB1.36 billion, respectively. The Fund received 2000 dividends of approximately US\$0.12 million.



**China Communication Securities Company, Limited ("CCSC")**, with RMB2.4 billion paid-up capital, is a comprehensive securities company registered in China. Its businesses include securities underwriting, brokering and investment, and investment consulting. The Fund invested US\$1.57 million to acquire 12.43 million shares, or a 0.52% stake in CCSC in 2001. At the end of 2001, the total assets and net assets of CCSC were RMB10.6 billion and RMB2.66 billion, respectively. For the year 2001, CCSC recorded a profit after taxation of RMB260 million. CCSC's board of directors has planned to list its shares on the domestic stock exchange. When realized, it will result in significant capital gain for the Fund.

**Shenzhen Economic Special Zone Securities Company, Limited ("Shenzhen Securities")**, the first professional securities firm in China, was set up in 1987 and approved by China Securities Regulatory Commission to be a lead underwriter and sponsor for IPOs. The headquarter of Shenzhen Securities is located in Shenzhen, with 16 operation outlets all over the country. At the end of 2001, the total assets and the net assets of Shenzhen Securities were RMB4,852 million and RMB664 million, respectively. The profit after taxation for the year was RMB13.42 million. The Fund invested US\$4.26 million in Shenzhen Securities in 2001, holding an interest of 4.66%.

**Houlder China Insurance Brokers Limited ("Houlder")**, founded in 2001, was one of the second-lot insurance brokers approved by the China Insurance Regulatory Commission. Led by the China Merchants Group, the company has registered capital of RMB50 million. The Fund invested US\$0.6 million in Houlder to acquire a stake of 10%. Since the company didn't start its operation until the second half of the year, it recorded a net loss of RMB0.73 million for 2001.

### Manufacturing Investments

**Due to changes of investment strategy, the proportion of manufacturing investment in the Fund's portfolio was reduced to 7.5% of the net asset value. The steel tube project was successfully disposed of, with a satisfactory return for the shareholders of the Fund.**

**Zhaoyuan Jinbao Electronics Company Limited ("Jinbao")**, a core manufacturing investment of the Fund, was established in 1993 to manufacture and market copper foils and copper-clad laminates. The company achieved outstanding results in 2001, largely attributed to effective cost controls and writing-back of expense provisions. The net profit for 2001 reached RMB32.25 million, representing an increase of 99.6% over the previous year. The Fund received a dividend for the year of 2000 of US\$0.5 million. During 2001, Bank of China Fund, a minority shareholder, sold its entire stake of 15% to Shandong High-Tech Investment Corporation, which is a wholly owned enterprise of the provincial government of Shandong.

## Infrastructure Investments

**Infrastructure investments generate stable cash flow for the Fund. Although the Fund sold its toll road investment, the Fund will continue to explore the investment opportunities in this sector.**

**Maoming Tongfa Highway Company Limited ("Tongfa")** is a contractual joint venture. The total investment and paid-up capital of Tongfa were US\$28.8 million and US\$10 million, respectively. The contracted cooperation period was 24 years. Tongfa was engaged in the building and operation of Provincial Highway No. 1987, which links Maoming City and Huazhou City. The Fund invested US\$10 million to acquire a 34.7% stake in Tongfa. The traffic flow of the Highway has been decreasing due to keen competition from the newly built toll roads within the same region, hence the toll revenue of the Highway has declined significantly. Tongfa had been experiencing difficulty in meeting payments of the agreed return. Therefore, the Fund has decided to dispose of the investment. On 5 February 2002, the Fund signed a share transfer agreement with Maoming Guomao Traffic Development Limited to dispose of its entire interest in Tongfa. The Fund received proceeds of US\$10.67 million. The project's internal rate of return was 12.2%.

## Real Estate Investments

**Investment returns in the real estates sector have not been satisfactory. The Fund has reviewed its investment strategies in this sector, and will adopt a more conservative attitude towards property investment in the 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 Fund invested US\$4.98 million in 1997 for a 35% interest under an agreement with the developer to jointly manage the property. According to a joint-management agreement, the developer should have paid a fixed investment return semi-annually to the Fund during the three-year contractual period. However, the developer failed to pay further return after making the first year's payments. The Fund has taken steps, including sale and lease arrangements, to recover its investment cost as soon as possible. According to an independent surveyor's report, the market value of the property at the end of 2001 was higher than the Fund's investment cost.

**Shenzhen Mankam Square ("Mankam")** is a 33-storey commercial complex on North Wen Jin Road, Shenzhen. In 1994, the Fund 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. In 2001, Hansen took possession of the property and launched sale and lease programs in order to recover investment cost as quickly as possible. The project's carrying value at the end of 2001 was close to its market value given by a professional valuer.

## Other Investments

Investments, which were fully provided in previous years, include Tangshan Kintil Ceramics Company Limited, Weifang Yin Yuan Aviation Industry Company Limited, Weifang Zhaoyin Real Estate Development Limited and China Merchants Plaza (Shanghai) Property Company Limited. With the efforts of the Investment Manager, certain progress has been made on these projects. The Group received US\$0.25 million from the two Weifang projects and reached repayment agreements with the relevant PRC parties. Settlement for these two projects has been included in the provincial government's annual working programs.



## Disposal of an Investment

**Chengde Wanli Steel Tubes Company Limited (Wanli)** was set up in 1996 to produce and market seamless-like steel tubes. The Fund invested US\$5 million in Wanli in 1996. Because of delays in installation and trial production, Wanli was not able to launch its marketing program as planned. As a result, Wanli could not pay returns to the Fund as stipulated in the joint-cooperative contract. To resolve the difficulty, the Investment Manager initiated several talks with the Chinese party last year, in order to dispose of the Fund's stake in Wanli. A disposal agreement was finally signed with the Chinese party on 23 July 2001. According to the agreement, the Chinese party agreed to pay a consideration of US\$4.76 million in three installments, of which the first and second installment totaling US\$2.41 million have been received. Upon the receipt of balance payment of US\$2.35 million due on or before the end of May 2002, the Fund will achieve an internal rate of return of 12% from the investment.

## REVIEW OF LISTED INVESTMENTS

Due to the economic slowdown and the 9-11 incident in the U.S., the Hong Kong stock market continued to adjust downward in 2001. Hang Seng Index, Growth Enterprise Index and Hang Seng China-Affiliated Corporations Index shrunk by 24%, 36% and 18% respectively. However, thanks to the stable economic growth of China, Hang Seng China Enterprises Index increased by 8%, outperforming the above-mentioned indexes. In 2001, the Fund recorded a realized gain of US\$0.08 million, dividend income of US\$0.14 million and unrealized losses of US\$0.14 million. At the end of 2001, the Fund had listed shares valued at US\$0.93 million.

## PROSPECTS

Year 2002 will be challenging for China's economy. China has revised down its GDP growth rate forecast for 2002 from 7.8% to 7.0%. China no doubt will emerge to be one of a few countries to benefit from the development of globalisation. Given its low cost of technology, huge potential market and growth capacity, China will be well positioned during the transition of the global economy. Further opening up of China's markets, brought about by its WTO membership, will create more investment opportunities for the Fund, which we will continue to explore and capitalize. We expect to complete the investment process of an intelligent transportation-ticketing system project in Shenzhen this year. Meanwhile, we will also continue actively to seek opportunities to dispose of the real estate investments and increase efforts on assisting investee companies in preparing for IPOs, aiming to create value for the Fund.

**Linda L. Zhou**

*Managing Director*

**China Merchants China**

**Investment Management Limited**

Hong Kong, 22 April 2002



*Directors of the  
Investment Manager*

front row from left: Dr. Huang Dazhan, Ms. Kan Ka Yee, Elizabeth and Ms. Linda L. Zhou;  
rear row from left: Mr. Wu Hui Feng, Mr. Lee York Wo and Mr. Tse Yue Kit

*“We will continue to explore and capitalize investment opportunities, to seek opportunities to dispose of the real estate investments and increase efforts on assisting investee companies in preparing for IPOs.”*