Investment Manager's Discussion and Analysis

DR. HUANG DAZHAN
Chairman of the Board of the Investment Manager

OVERALL PERFORMANCE

China Merchants China Direct Investments Limited and its subsidiaries (the "Fund") recorded a profit attributable to shareholders of US$7.83 million for the year ended 31 December 2005, representing an increase of 610% over the year 2004. This was attributable to a significant increase in the fair value of financial assets at fair value through profit and loss (the "financial assets"). As of 31 December 2005, the net assets of the Fund were US$146.67 million (31 December 2004: US$139.03 million), with a net asset value per share of US$1.069 (31 December 2004: US$1.014).

Total turnover for the year increased by 17% to US$3.12 million (2004: US$2.67 million). This was due mainly to an increase in both dividend income from China Merchants Bank and interest income.

For the year 2005, the fair value of the financial assets increased by US$9.98 million (2004: US$0.19 million). The significant increase in the fair value was attributed to the favourable valuation of both China Merchants Bank and Industrial Bank whose values increased by US$9.68 million and US$2.86 million respectively against the end of 2004.

MATERIAL ACQUISITION OF INVESTMENT

In September 2004, the Fund entered into an agreement with Yong Cheng Mei Dian (Group) Limited to acquire a 6.8167% stake in China Credit Trust Co., Ltd. at a consideration of US$15.31 million. The acquisition was approved by the CBRC in May 2005 and the Fund then paid the acquisition price to the transferor in June 2005. The acquisition was then completed.

LIQUIDITY, FINANCIAL RESOURCES, GEARING AND CAPITAL COMMITMENTS

Net cash decreased by 48.8%, from US$33.88 million as of 31 December 2004 to US$17.35 million as of 31 December 2005, mainly due to a capital injection into an unlisted investment project and an increase in listed share investments.

As of 31 December 2005, the Fund had no outstanding bank loans (2004: Nil).

As of 31 December 2005, the Fund had no capital commitments (2004: US$15.31 million).

EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

Most of the Fund's investments are located in China, where the official currency is the Renminbi ("RMB"). The People's Bank of China announced the reform of the RMB exchange rate regime and simultaneously revalued the RMB against the US dollar by approximately 2% in July 2005. Such RMB revaluation has a positive impact on the Fund since the Fund holds a considerable amount of assets denominated in the RMB.

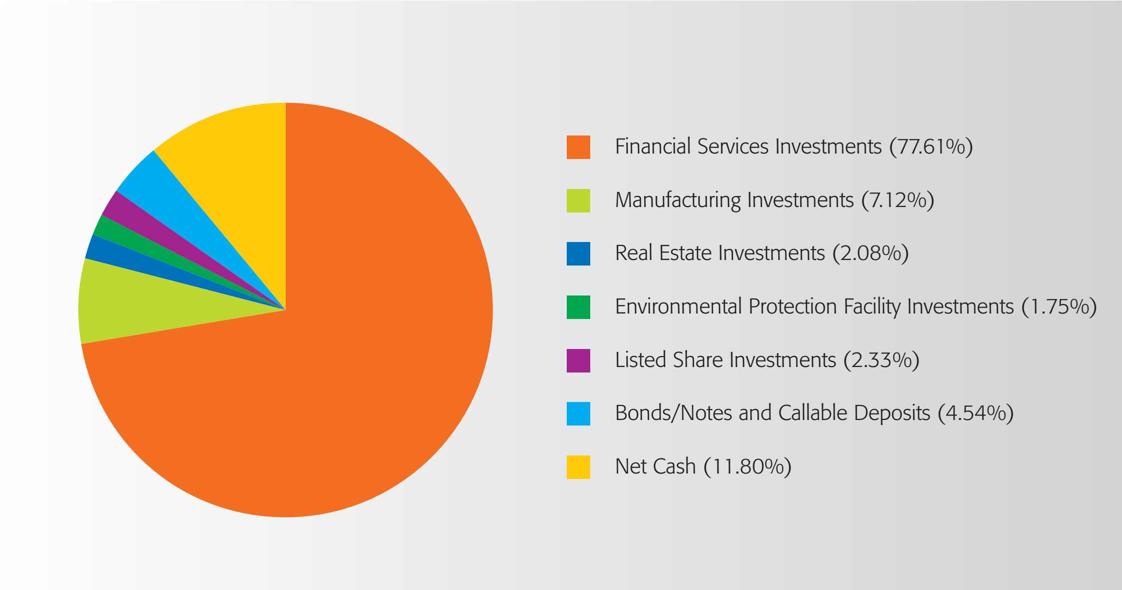
EMPLOYEES

Other than a qualified accountant whose remuneration packages are borne by the Investment Manager, the Fund has no salaried employees. The Investment Manager handles the portfolio and day-to-day administration of the Fund.

THE PORTFOLIO

As of 31 December 2005, the Fund had total investments of US$140.02 million – US$129.94 million in unlisted investments, US$3.41 million in listed investments, and US$6.67 million in bonds, notes and callable deposits. The major unlisted investment projects were in financial services (77.61% of net assets), manufacturing (7.12%), real estate (2.08%) and environmental protection facility (1.75%). In addition, the Fund had net cash of US$17.35 million, accounting for 11.80% of the Fund's net assets.

NET ASSET DISTRIBUTION *(As at 31 December 2005)*



MR. XIE KUIXING
Managing Director of the Investment Manager

REVIEW OF UNLISTED INVESTMENTS

The following table shows the major unlisted investment projects held by the Fund as at 31 December 2005:

	Name of Projects	Location	Business Nature	Net Book Value (US$ million)	Percentage of Net Assets
Financial Services:					
1.	China Merchants Bank Co., Ltd.	Shenzhen, Guangdong	Banking	64.96	44.29
2.	Industrial Bank Co., Ltd.	Fuzhou, Fujian	Banking	29.89	20.38
3.	China Credit Trust Co., Ltd.	Beijing	Trust management	16.18	11.03
4.	China Merchants Securities Co., Ltd.	Shenzhen, Guangdong	Securities	1.10	0.75
5.	Industrial Securities Co., Ltd.	Fuzhou, Fujian	Securities	–	–
6.	Jutian Securities Co., Ltd.	Shenzhen, Guangdong	Securities	–	–
7.	Houlder China Insurance Brokers Ltd.	Shenzhen, Guangdong	Insurance brokerage	0.65	0.44
8.	Jutian Fund Management Co., Ltd.	Shenzhen, Guangdong	Fund management	1.06	0.72
			Sub-total	113.84	77.61
Manufacturing:					
9.	Zhaoyuan Jinbao Electronics Co., Ltd.	Zhaoyuan, Shandong	Copper foil & laminates	10.44	7.12
			Sub-total	10.44	7.12
Real Estate:					
10.	Langfang Oriental Education Facilities Development Co., Ltd.	Langfang, Hebei	Student dormitory	3.05	2.08
11.	Shenzhen Man Kam Square	Shenzhen, Guangdong	Retail shops	–	–
			Sub-total	3.05	2.08
Environmental Protection Facility:					
12.	Chenzhou Heshang Environmental Protection Co., Ltd.	Chenzhou, Hunan	Landfill operation	2.57	1.75
			Sub-total	2.57	1.75
			Total	129.90	88.56

China Merchants Bank Company, Limited ("CMB"), a registered commercial bank in the PRC, is the first joint-stock commercial bank established by mainland enterprises and the shares of which were first listed on the Shanghai Stock Exchange in 2002. CMB now has over 400 branches and offices across the country. The Fund invested US$14.06 million and held a 1.18% stake in CMB at the balance sheet date. In 2005, CMB sustained its pace of growth with the revenue of RMB28.45 billion and a profit after taxation of RMB3.93 billion, which was increased by 26% and 25% respectively as compared with the same period of last year. The Fund received dividends for 2004 of RMB9.06 million in the year.

CMB proposed its Share Reform Plan on 29 December 2005, which was subsequently approved in a shareholders' meeting in early 2006 and was successfully implemented. After the completion of the Share Reform Plan in February 2006, the Fund's interest in CMB decreased from 1.18% to 0.998% (after taking into account the conversion of the convertible notes). The originally non-freely transferable shares held by the Fund will be available for trading two years from the date of completion of the Share Reform Plan. By the end of 2005, the Fund's interest in CMB was valued as US$64.96 million, which increased by 18% from the end of last year.

On 16 March 2006, CMB announced to hold a shareholders' meeting for the purpose of considering a proposal for issuing H Shares and listing in Hong Kong. According to the proposal, the H Shares to be issued will be 2.2 billion, representing no less than 15% of its enlarged share capital (excluding the over-allotment option). The proposal was duly approved by the shareholders' meeting on 17 April 2006. If the proposal for issuing H Shares and listing is successfully implemented, the Fund's interest in CMB should be diluted. Nevertheless, it is believed that the capital enlargement will help the business development of CMB. In turn, it will benefit the Fund as a whole.

Industrial Bank Company, Limited ("IBCL") is a joint-stock commercial bank registered in the PRC with over 300 branches and offices throughout the country. Since 1998, the Fund has cumulatively invested RMB146 million (equivalent to US$17.62 million) in IBCL and currently holds a 2.1% stake in IBCL. In 2005, IBCL recorded a revenue of RMB17.60 billion (unaudited) and a profit after taxation of RMB2.45 billion (unaudited), representing an increase of 43% and 47% as compared with the same period of last year respectively. The Fund received dividends for 2004 of RMB9.24 million during the reporting period.

In order to secure sufficient capital for sustainable development, it was approved by the Board of Directors and the shareholders' meeting that IBCL would actively pursue for various preparations for the listing of A Shares. Nevertheless, as there is still uncertainty in the progress on the Share Reform in the domestic securities market, the specific timetable for the issue of A Shares by IBCL in the coming year remains uncertain. At the same time, IBCL is actively expediting the issuance of hybrid capital bond and considering the alternatives of raising capital such as the issue of H Shares or private placement of equity whereas the concrete proposal is awaiting the final decision of its Board of Directors.

China Credit Trust Company, Limited ("CCT") was established in 1995 and formerly known as China Coal Trust Company, Limited. Its principal activities are trust management, fund management, investments and loan financing. After being approved by the CBRC, the Fund acquired a 6.8167% stake in CCT at a total consideration of US$15.31 million in June 2005. Registration regarding the change of shareholder was completed during year 2005.

In December 2005, CCT was approved by the People's Bank of China to issue credit asset-backed securities up to RMB4.30 billion in the domestic inter-bank bond market. It was one of the first batch trust companies in the PRC to obtain the qualification for issuing credit asset-backed securities. CCT achieved a profit after taxation of RMB77.27 million (unaudited) for the year, which was increased by 144% as compared to the same period of last year.

China Merchants Securities Company, Limited ("CMSC"), is a comprehensive securities company registered in the PRC. Its businesses include IPO sponsorship, securities underwriting, brokerage, proprietary trading and investment consulting. The Fund invested RMB13.05 million (equivalent to US$1.58 million) to acquire a 0.52% stake in CMSC in 2001.

During 2005, the domestic securities market fluctuated considerably and total turnover in securities declined substantially. As a result, incomes from various businesses of CMSC including income from brokerage business and net income from proprietary trading declined significantly. However, its investment incomes (including share of results of its associated companies under equity method, and incomes from holding treasury bills and dividends from securities etc.) increased substantially as compared with 2004. Therefore, CMSC's profit after taxation for 2005 amounted to RMB47.31 million (unaudited), which was increased by 11% as compared with the same period of 2004.

At the end of June 2005, CMSC was approved by the CSRC to acquire China Merchants Securities (HK) Company Limited which is a company incorporated in Hong Kong. This is an important step for CMSC to develop its international business.

Industrial Securities Company, Limited ("ISCL") is a comprehensive securities company registered in the PRC. Its businesses include IPO sponsorship, securities underwriting, brokerage, proprietary trading and investment consulting. The Fund totally invested RMB8.51 million (equivalent to US$1.03 million) to acquire a 0.74% stake in ISCL. There was a significant decline in income from brokerage business for ISCL as the total turnover of the domestic securities market declined near one-third in 2005 compared with 2004. As a result, ISCL sustained a loss of RMB67.09 million (unaudited) for 2005 compared with a net profit of RMB16.74 million for the same period of last year. In addition, the net asset value at the end of 2005 decreased by 16% to RMB520 million (unaudited) as compared with the net asset value at the end of last year.

It is expected that it will be difficult for ISCL to resume dividend-paying ability in the foreseeable future due to serious losses accumulated over years. At the same time, the China Securities Regulatory Commission ("CSRC") is now actively rationalising the domestic securities industry. As such, the minority equity interest in ISCL held by the Fund could hardly be sold in the short term. The Fund thus made a full provision on ISCL for the year for prudence purpose.

Jutian Securities Company, Limited ("Jutian Securities") is one of the earliest comprehensive securities companies established in the PRC. Jutian Securities has 17 offices throughout the country. In 2001, the Fund invested RMB35.36 million (equivalent to US$4.27 million) in Jutian Securities, representing an interest of 4.66%. As there was a significant decline in total turnover of the domestic securities market, income from brokerage business for the industry also decreased substantially. Jutian Securities sustained a loss of RMB52.08 million (unaudited) in 2005, compared to a profit after taxation of RMB0.74 million over the same period last year.

The CSRC requires all domestic securities companies to fully replenish any appropriated customers' deposits within specific deadlines. After making efforts through different ways, customers' deposits appropriated and not yet replenished by Jutian Securities at the expiry of the deadline (being at the end of February 2006) still amounted to RMB295 million. If Jutian Securities finally fails to comply with relevant regulations, the CSRC may, depending on the circumstances, take over Jutian Securities or suspend its business operations.

In addition, a company in Beijing has initiated legal action against Jutian Securities for alleged claim that Jutian Securities had disposed of its treasury bills (with face value of about RMB166 million) held in custody without its authorisation. Jutian Securities states that both the parties intend to resolve this litigation by agreement.

It is subject to the material risk factors as discussed above whether Jutian Securities will continue as a going concern in the future. Therefore, the Fund made a full provision on Jutian Securities for the year for prudence purpose.

Houlder China Insurance Brokers Limited ("Houlder"), set up in 2001, is an insurance broker authorised by the China Insurance Regulatory Commission to register in the PRC. The Fund invested RMB5 million (equivalent to US$0.6 million) to acquire an interest of 10%. During 2005, Houlder achieved good results through market expansion and costs saving. Turnover amounted to RMB13.23 million, which was increased by 47% compared with the same period of last year. Profit after taxation amounted to RMB1.30 million, which was increased by 16% compared with the same period of last year. In the coming year, Houlder will continue to reinforce its efforts in building up its core business team, and devote more efforts to business expansion activities.

Jutian Fund Management Company, Limited ("JFM"), a fund management company, was approved by the CSRC to register in the PRC with a registered capital of RMB100 million. JFM's scope of businesses includes fund management and promotion of equity funds, etc. The Fund invested RMB10 million (equivalent to US$1.21 million) in JFM to acquire an interest of 10%. In September 2005, JFM issued its second equity investment fund, Jutian Resources Selective Equity Investment Fund. In 2005, the domestic securities market remained sluggish. Amount of assets under the management of JFM declined continuously. At the end of 2005, the net asset value of funds managed by JFM was RMB1.06 billion, which was decreased by 38% as compared with the same period of last year. JFM sustained a loss of RMB5.92 million for the year, as compared to a loss of RMB5.97 million for the same period of last year.

Zhaoyuan Jinbao Electronics Company, Limited ("Jinbao") was set up in 1993 in Zhaoyuan City of Shandong Province as a manufacturer of copper-foil and laminates. The Fund owns a 30% interest in Jinbao and has made a cumulative investment of US$7.85 million. In 2005, as the sales of copper-foil and laminates were satisfactory, Jinbao's revenue amounted to RMB741 million, which was increased by 32% as compared with the same period of last year. Nonetheless, gross profit margin dropped due to surge in raw materials cost. Profit after taxation dropped by 5% to RMB17.47 million as compared with the same period of last year.

As to the reinvestment of dividends for both 2003 and 2004 by Jinbao, since two of shareholders of Jinbao are state-owned enterprises, and their applications for reinvestment of dividends had not been approved by the relevant authorities as yet, therefore Jinbao decided to withdraw the dividend declared for such reinvestment of 2003 and cancel the reinvestment plan of 2004. The interest of the Fund in Jinbao remains unchanged.

Langfang Oriental Education Facilities Development Company, Limited ("Oriental") is a Sino-foreign cooperative joint venture established in Langfang City of Hebei Province. The total project cost is US$20 million, with a 20-year contractual period. In June 2002, the Fund invested US$5 million for an equity stake of 25%. Oriental is engaged in the operation and management of the Phase 1 dormitories of Oriental University City of Langfang City. Current capacity of the Phase 1 dormitories is about 17,000 students. It accommodated 12,600 students in the school year of 2004/2005, an 8% decrease over last school year. Due to various reasons such as upward adjustment of property management fee and an unexpected tax expense, its profit after taxation decreased 31% to RMB4.35 million (unaudited) for 2005, and profit after taxation for 2004 was retrospectively restated to be RMB6.33 million.

Oriental had a dispute with the State Taxation Bureau of the Langfang Development Zone on issue concerning the income tax for 2002 to 2005. Although the State Taxation Bureau of Langfang City accepted an application for administrative review on such tax issue submitted by Oriental, it finally adjudicated to support the decision of the State Taxation Bureau of the Langfang Development Zone.

The Fund has urged Oriental to review any potential tax problem or risk, and take appropriate actions in a timely manner.

Shenzhen Mankam Square ("Mankam") is a 33-storey commercial complex on North Wen Jin Road, Shenzhen. In 1994, the Fund invested US$4.30 million through a 35% holding in Hansen Enterprises Limited ("Hansen") to purchase 5,262 square metres of retail space on the third floor of Mankam. The Fund capitalised its loan to Hansen of US$4.48 million in 2005. Hansen has had difficulty in selling or leasing the third floor because the first two floors of Mankam have not yet been brought into use due to the issue of ownership. Hansen made every effort to seek a feasible plan to exit, but in vain. Therefore, the Fund made a full provision on the property for prudence purpose in this year.

Chenzhou Heshang Environmental Protection Company, Limited ("Heshang") is a Sino foreign cooperative joint venture formed by the Fund and Shenzhen Harvest Environment Development Company Limited in November 2003. Total investment in the project is RMB70 million. The Fund invested US$2.54 million for an equity stake of 30%. Heshang owns the right to construct and operate a landfill for domestic waste in Chenzhou, Hunan Province for 10 years. The designed capacity of the landfill is 3.2 million cubic metres, with a daily waste handling capacity of 500 tons.

The construction work was completed at the end of February 2006. Various takeover procedures including inspection and acceptance were conducted forthwith. Trial operation commenced in early March 2006. It is operating smoothly at present. According to the terms of the concession agreement and shareholder's loan agreement, the Fund has so far received a fee prepayment of RMB4.80 million and repayment of shareholder's loan of US$127,000.

REVIEW OF LISTED INVESTMENTS

In 2005, Hong Kong stocks fluctuated but remained its upward moving trend. Hang Seng Index climbed to a four-year high in the third quarter of 2005, and reached 15509 points. Although New York crude oil price rose to a historical high of US$70 per barrel, the market generally considered that oil price was still at an acceptable level at that time, which supported the upward moving trend of Hong Kong stocks. The reform of the Renminbi exchange rate regime duly commenced in 2005, confirming the appreciation of the Renminbi against US dollar and lending strength to other Asian currencies. Consequent to persistent high oil price, there were significant interest rate increases and subsidy cuts of oil products in part of the Southeast Asian region. In the US, there was mounting pressure of inflation, increasing concerns that the US Federal Reserve would extend the interest-rate rise cycle or enlarge the rate increase margin. Those Hong Kong stocks that are sensitive to interest rate, affected by the rates rise, also descended from their highs, making the market even more volatile. The closing of the Hang Seng Index, China Enterprises Index and China-Affiliated Corporations Index at the end of 2005 increased by 5%, 12% and 24% against the opening of the year respectively.

For 2005, the profits from listed shares amounted to US$22,000, which included US$82,000 of dividends, US$262,000 of realised gains and US$322,000 of unrealised losses. At the end of December 2005, the value of listed shares held by the Fund was US$3.41 million.

As at 31 December 2005, the Fund's holdings in bank notes and corporate bonds amounted to US$6.67 million (2004: US$6.67 million). Details are listed below:

Issuer	Business Nature	Investment Amount (US$ million)	Net Book Value (US$ million)	Coupon	Yield to Maturity	Date of Maturity
Corporate Bonds:						
China Insurance International Holdings (BVI) Limited	Insurance Business	0.695	0.696	5.800%	5.887%	12 November 2013
Hutchison Whampoa International Limited	Property, ports , telecommunication and hospitality business	1.004	1.004	6.250%	6.193%	24 January 2014
Citic Ka Wah Bank	Banking	0.998	0.998	4.250%	4.290%	17 November 2009
Notes:						
Lloyds TSB Bank LIBOR Structured Note		1.000	0.969	Note 1	–	20 August 2013 if no early redemption
Hang Seng Bank Fixed Rate Callable Deposit		2.000	2.000	Note 2	–	9 December 2008 if not called
Hang Seng Bank Callable Deposit		1.000	1.000	Note 3	–	16 March 2009 if not called
		6.697	**6.667**			

Note 1: Coupon rate for the first year is 10.5% and for subsequent years is 10% – (2 x 6-month LIBOR) per annum. The note will automatically be redeemed at par when accumulative coupon reaches 13.7%, or on 20 August 2013, whichever is the earlier.

Note 2: Interest rate for the first, second, third and fourth year are 3.55%, 3.85%, 4.15% and 4.45% respectively.

Note 3: Interest rate for the first, second, third, fourth and fifth year are 3.50%, 4.00%, 4.00%, 3-month LIBOR + 4% and 3-month LIBOR + 5%, provided that 3-month LIBOR less than 6% for the first three years and 3-month LIBOR less than 7% for the last two years.

PROSPECTS

Following the deepening of reform and the widening of opening up, China economy will further gain momentum of growth and the economy is able to maintain to grow at a relatively faster pace. It is expected that China annual GDP growth rate will keep at 7.5% during the Eleventh Five-Year Plan. The further advancement on reform will help China economy continue its steady development. The further advancement on opening up will provide a broader market for the world economy, which will also help Hong Kong maintain as an international financial centre. It is believed that this will bring more opportunities to the Fund, but along with more challenges. With the resort of a fast and stable economic growth in China, coupling with the recovery of Hong Kong economy, the Fund will continue to explore investment opportunities so as to increase the shareholder value.

Xie Kuixing
Managing Director
China Merchants China Investment Management Limited

Hong Kong, 20 April 2006

DIRECTORS OF THE INVESTMENT MANAGER

front row from left: Mr. Xie Kuixing, Dr. Huang Dazhan and Ms. Kan Ka Yee, Elizabeth;
rear row from left: Mr. Tse Yue Kit and Mr. Wu Huifeng