Financial Review

Introduction

CITIC Pacific's 2005 Annual Report includes a letter from the Chairman to shareholders, the annual accounts and other information required by accounting standards, legislation, and the Hong Kong Stock Exchange. This Financial Review is designed to assist the reader in understanding the statutory information by discussing the contribution of each business segment, and the financial position of the company as a whole.

Pages 76 to 84 of the Annual Report contain the Consolidated Profit and Loss Account, Balance Sheet, Cash Flow Statement and Statement of Changes in Equity. Following these financial statements, on pages 85 to 142 of the Annual Report, are Notes that further explain certain figures presented in the statements.

On page 143 is the report of CITIC Pacific's auditor – PricewaterhouseCoopers – of their independent audit of CITIC Pacific's Annual Report.

Basis of Accounting

CITIC Pacific prepares its financial statements in accordance with generally accepted accounting standards issued by the Hong Kong Institute of Certified Public Accountants ('HKICPA') and have been converged with International Financial Reporting Standards.

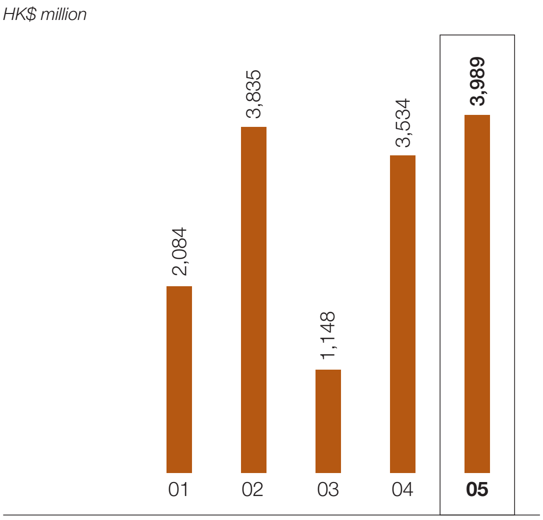
The Group applies all the relevant Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations (collectively referred to as the 'New HKFRSs') issued by the HKICPA that are effective for accounting periods beginning on or after 1 January 2005 set out in Note 1 to the annual accounts.

The application of the New HKFRSs has resulted in changes to the Group's accounting policies. As a result of these changes, the profit attributable to shareholders for the year 2004 decreased by HK$47 million and the equity attributable to the shareholders' of CITIC Pacific as at 1 January 2005 decreased by HK$1,009 million. Details of the major changes to the accounting policies and their financial impact on the Group are summarized in Note 1 to the annual accounts on page 85. Within this section, 2004 figures have been adjusted in accordance with the accounting policies in force in 2005.

Profit Attributable to Shareholders

The net profit attributable to shareholders for the year ended 2005 was HK$3,989 million, an increase of 13% compared with HK$3,534 million for the same period in 2004 (as restated). The reasons for the increase in profit are described below.

Profit Attributable to Shareholders



Business Segments Contribution

The contribution (Note) made by major business segments in the year of 2005, compared with the year of 2004, were:

Contribution

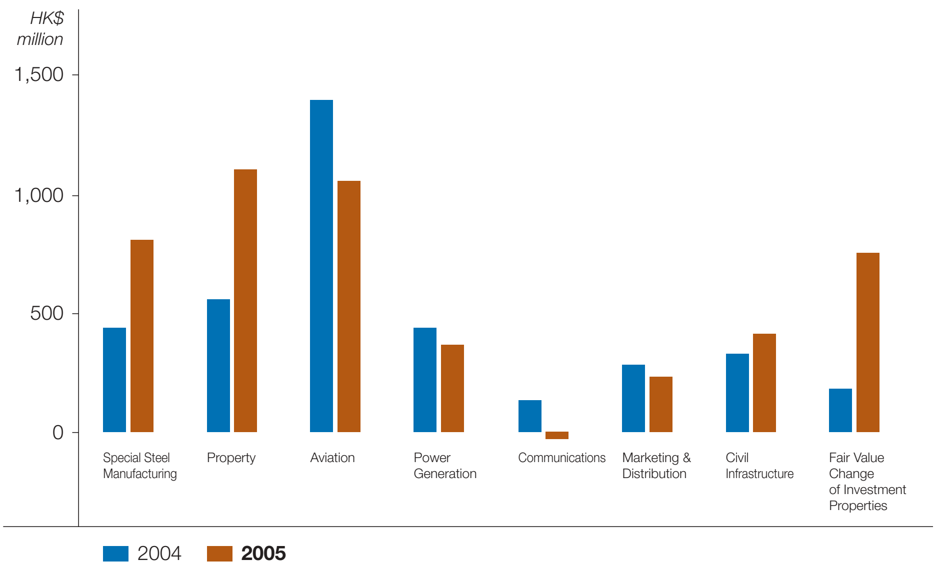
HK$ million	**2005**	(As restated) 2004	2005 – 2004
Special Steel Manufacturing	**808**	438	370
Property	**1,106**	559	547
Aviation	**1,058**	1,398	(340)
Power Generation	**368**	439	(71)
Communications	**(31)**	133	(164)
Marketing & Distribution	**232**	284	(52)
Civil Infrastructure	**413**	329	84
Fair Value change of Investment Properties	***755***	*181*	*574*

Note: Please refer to Definition of Terms on page 148 of the Annual Report.

Compared with the contribution for the year ended 2004:

- Special Steel Manufacturing: Contribution increased by 84% in 2005 mainly due to continuing strong performance from Jiangyin Steel Plant and the contribution from Xin Yegang Steel Plant which was acquired in late 2004.
- Property: Excluding the revaluation surplus of investment properties, contribution increased by 98% mainly due to the profits from the sale of properties in 2005, including the sale of a piece of land at Hung Shui Kiu in the New Territories. Rental income grew steadily.
- Aviation: While the load factor for both Cathay Pacific and Dragonair remained high, contributions decreased in 2005 due to the significant increase in fuel costs.
- Power Generation: The business had been affected by the continuing high coal prices in 2005 which were only partially offset by the increase in tariff during the year.
- Communications: Contribution from CTM was improved while the results of CITIC Telecom 1616 was stable. A loss of approximately HK$ 190 million was recognised in 2005 as a result of the share reform plan of Guoan.
- Marketing & Distribution: Despite the improved results in Hong Kong motor business, overall contribution decreased mainly due to the challenging motor market in the Mainland, the animal diseases that affected the food trading business, and the development costs for China business.
- Civil Infrastructure: Higher toll changes at both the Eastern (May 2005) and Western (August 2004) harbour tunnels resulted in higher profit.
- Fair Value Change of Investment Properties: Increase in fair value of investment properties as a result of the improved business environment and market demand.

Contribution

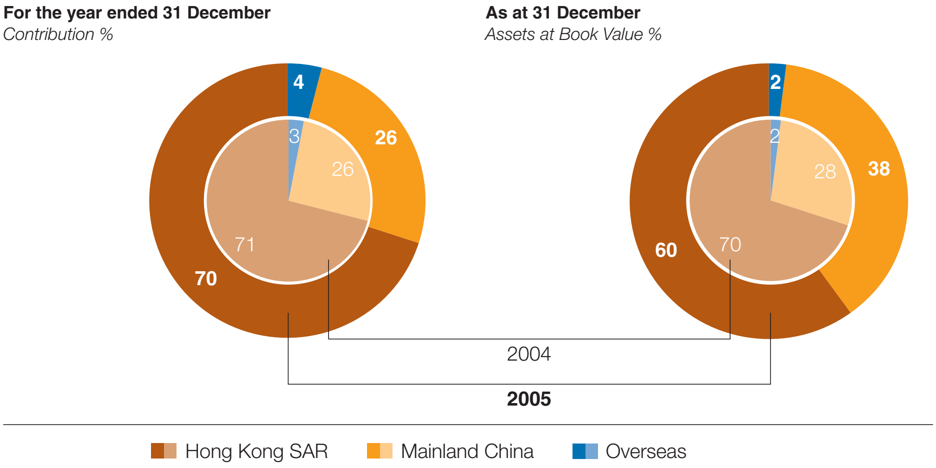


Page 96 of the Annual Report contains business segment information for turnover and profit before net finance charges and taxation for consolidated activities, jointly controlled entities and associated companies.

Geographical Distribution

The division of contribution and assets between Hong Kong, mainland China and overseas is shown below based on the location of the base of each business's operations.

Geographical Distribution



Interest Expense

The Group's interest expense net of amount capitalised increased from HK$376 million to HK$596 million mainly due to the increase in the amount of borrowings and the increase in the weighted average cost of debt from 3.4% to 4.3%.

Taxation

Taxation decreased from HK$413 million in 2004 to HK$345 million in 2005 mainly due to additional provisons made in 2004 for prior years.

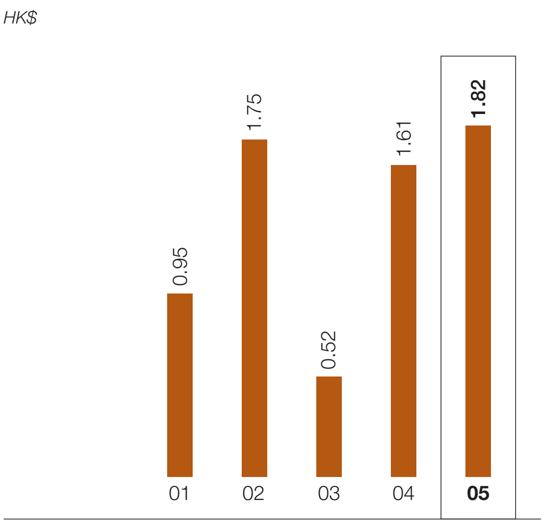
Shareholders' Returns

CITIC Pacific's primary objective is to increase shareholder value for which it has used earnings per share as a proxy. The Company expects its businesses to provide returns on investment over their lives that will provide shareholders with an adequate return on equity.

Earnings per Share

Earnings per Share was HK$1.82 for 2005, an increase of 13% compared with HK$1.61 in 2004. All the increases in Earnings per Share was attributable to the increase in profit as the number of shares outstanding in the two years was substantially the same.

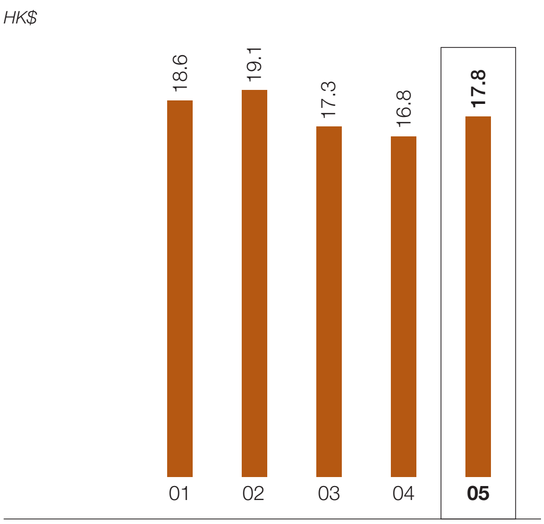
Earnings per Share



Shareholders' Funds per Share

Shareholders' Funds per share at 31 December 2005 was HK$17.8. The adoption of New HKFRSs decreased 2005's opening Shareholders' Funds by approximately HK$1,009 million. This was partially offset by the 2005 profit less dividends paid in the year.

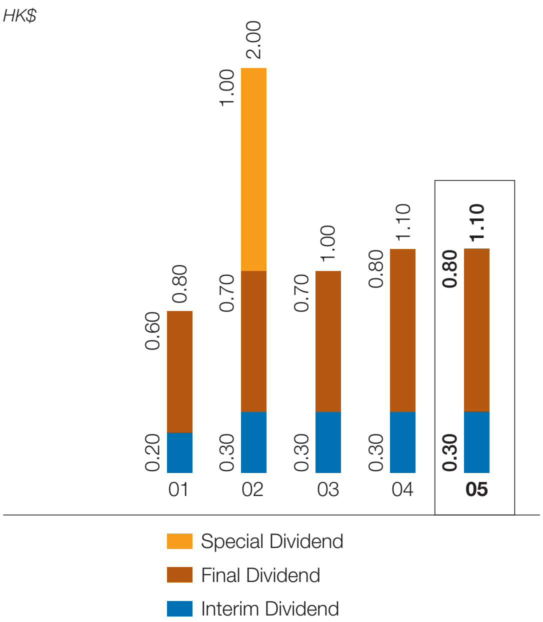
Shareholders's Funds per Share



Dividend per Share

A final dividend of HK$0.80 per share is proposed for 2005, giving shareholders a total dividend for 2005 of HK$1.1.

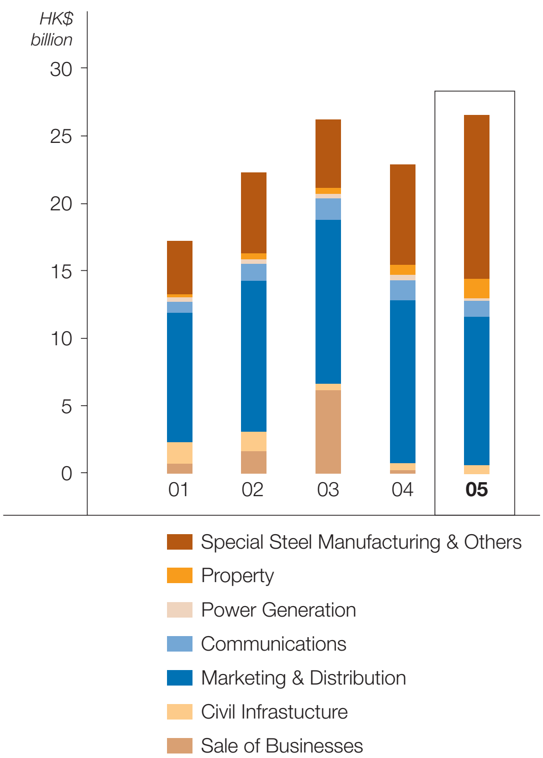
Dividend per Share



Turnover

Marketing & Distribution turnover decreased by 9% due to reduced sales in mainland China particularly for the motor business, Special Steel Manufacturing turnover increased by 69% mainly due to turnover of Xin Yegang which was acquired in late 2004.

Turnover



Capital Expenditure

During the year ended 31 December 2005, the Company increased its land bank in the mainland. The development of the first phase of New Westgate Garden continued during the year and is expected to be completed in mid 2006.

The acquisition of 95% interest in the Xin Yegang steel plant and related assets were completed in 2004 while the acquisition of 38.86% interest in Daye Special Steel was completed in the last quarter of 2005. Further additions and upgrading of steel production facilities is continuing.

The construction of new power generators by Ligang Power and Zhengzhou Power are on schedule while an additional capital contribution to North United Power was made.

Others includes an investment of the listed shares in China Shenhua Energy.

Capital Expenditure

HK$ million	**2005**	2004
Property	**2,526**	1,291
Special Steel Manufacturing	**2,063**	3,417
Power Generation	**1,518**	2,739
Others	**554**	394
Civil Infrastructure	**225**	61
Marketing & Distribution	**200**	203
Communications	**134**	177
Aviation	**–**	518

Group Liquidity and Capital Resources

General Policies

The Group's policy is to maintain a high degree of financial control and transparency. Financing and cash management activities are centralised at head office level to enhance risk management, control and the best utilisation of financial resources of the Group.

We aim to diversify our funding sources through utilisation of both banking and capital markets. To the extent it is possible, financing is arranged to match business characteristics and cash flows. Limited or non-recourse project finance is employed when it is available and appropriate.

CITIC Pacific conducts business mainly in Hong Kong and mainland China, therefore it is subject to the market risk of the foreign exchange rates of the HK Dollar, US Dollar and Renminbi. To minimise currency exposure, non Hong Kong dollar assets are usually financed in the same currency as the asset or cash flow from it, either by borrowing or using foreign exchange contracts. Achieving this objective is not always possible due to limitation in financial markets and regulatory constraints, particularly on investment into mainland China as the Renminbi is currently not a free convertible currency. In addition, 'Registered Capital', which usually accounts for no less than 25% of the total investment amount for projects in mainland China, is required to be paid in US or HK Dollars. As a result, CITIC Pacific has an increasing exposure to the Renminbi. As of 31 December 2005, around 38% (around HK$23 billion) of the Group's total assets were based in mainland China.

The Group aims to maintain a suitable mixture of fixed and floating rate borrowings in order to stabilise interest costs despite rate movements. Interest rate hedging ratio is determined after taking into consideration of the general market trend, the Group's cash flow pattern, interest coverage ratio and etc. The Group actively employs various interest rate instruments to manage long term interest risk.

The Group only uses derivative transactions for interest rate and currency hedging purposes, speculative trading is prohibited. Counterparties' credit risks are carefully reviewed and in general, the Group only deals with financial institutions with investment grade credit rating. The amount of counterparties' lending exposure to the Group is also an important consideration as a means to control credit risk.

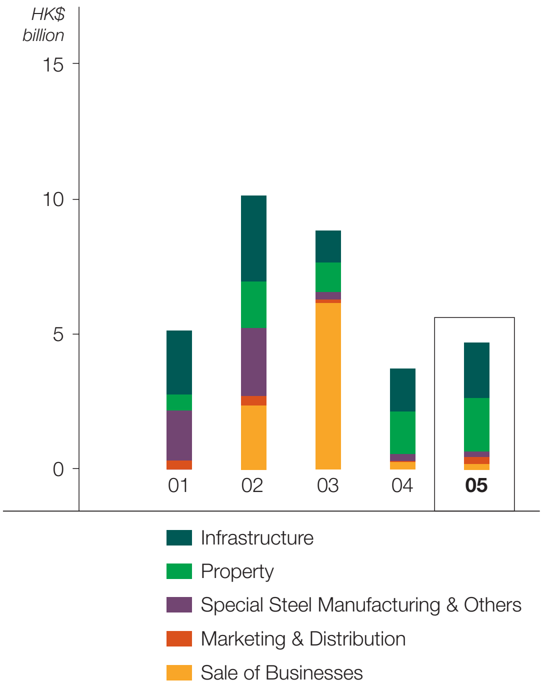
Cash Flow

By design, most of the Group's debt is raised at the holding company level. As such, the net amount of cash flow from each business to the Company is an important indicator as to the Company's ability to service its debts. For the year ended 31 December 2005, cash flow to the Company remained strong. Following is a summary of the cash contributions by each business segment:

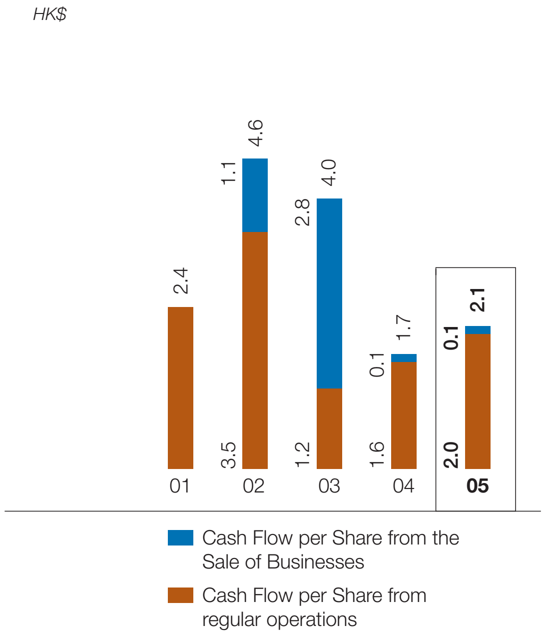
HK$ million	**2005**	2004
Infrastructure		
Aviation	**767**	649
Civil Infrastructure	**407**	362
Power Generation	**449**	469
Communications	**413**	111
Property	**1,996**	1,573
Special Steel Manufacturing	**143**	153
Marketing & Distribution	**256**	35
Others	**57**	50
Total	**4,488**	3,402

As shown above, cash contributions from most of the business segments increased compared to prior year. The significant increase from Communications was attributable to CITIC Telecom 1616 as a result of better management of account receivable. The Property sector also contributed strong cash flow because of the successful pre-sale of New Westgate Garden in Shanghai and the sale of two pieces of land in the New Territories. The cash contribution to the Group from Marketing & Distribution was relatively low in 2004 because in that year, Dah Chong Hong reinvested most of its operating cash flow to new projects in the mainland. In 2005, however, the expansion was mostly funded by increase in borrowings at Dah Chong Hong level.

Cash Flow from Operations



Cash Flow per Share



Summary of Consolidated Cash Flow Statement

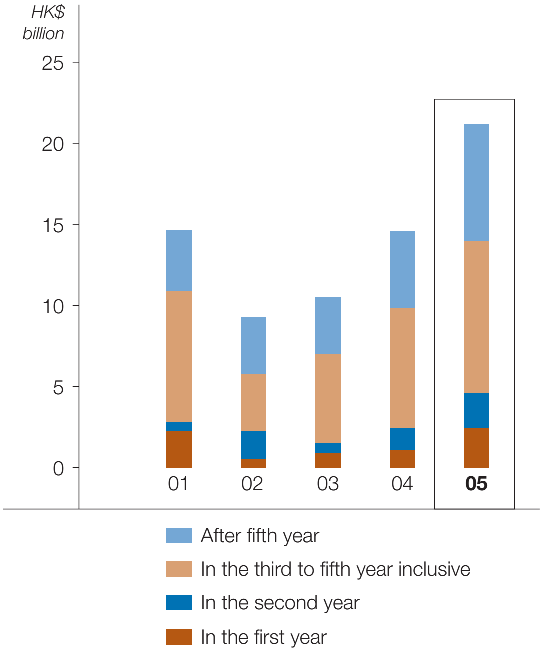
HK$ million	**2005**	2004
Net Cash generated from / (invested in)		
consolidated activities	**2,063**	1,204
jointly controlled entities	**(59)**	49
associated companies	**1,504**	1,526
other financial assets	**1**	393
Sale of business interests and marketable securities	**481**	109
Capital expenditure and investment in new businesses	**(5,971)**	(7,460)
Tax	**(227)**	(178)
Net interest paid	**(601)**	(310)
	(2,809)	(4,667)
Dividends paid	**(2,412)**	(2,189)
Increase in borrowings	**5,330**	3,698
Share options exercised	**16**	68
	2,934	1,577
Increase / (Decrease) in cash and cash equivalents	**125**	(3,090)

Group Debt and Liquidity

As of 31 December 2005, the Group's total outstanding debt was HK$21.2 billion (31 December 2004: HK$14.6 billion), cash and deposits with banks were HK$2.6 billion (31 December 2004: HK$2.4 billion) giving a net debt of HK$18.6 billion compared to HK$12.2 billion at 31 December 2004. The increase in net debt was mainly due to various new investments made during the year as described under capital expenditure section. Leverage, measured by the Group's net debt to total capital, was 32% (31 December 2004: 25%).

Total debt increased due to capital expenditure and new investments of HK$6 billion in 2005. As at 31 December 2005, total debt including outstanding short term loans that will mature to the end of 2006 amounted to HK$2.4 billion or 11% of the total debt. On the other hand, the Group had deposits with banks of HK$2.6 billion on that date, exceeding the loans due for repayment in 2006.

Total Debt



The denomination of the Group's borrowings as well as cash and deposit balances by currencies as of 31 December 2005 is summarised as follows:

Denomination

HK$ million Equivalent	HK$	US$	Renminbi	Yen	Other	**Total**
Borrowings	12,745	4,519	3,351	504	99	**21,218**
Cash and Deposits	195	554	1,680	100	50	**2,579**
Net Borrowings	12,550	3,965	1,671	404	49	**18,639**

The exchange exposure of US Dollar borrowings are hedged by foreign exchange forward and option contracts. Details see descriptions under 'Derivative Transactions'.

Available Sources of Financing

In addition to cash and deposits balance of HK$2.6 billion as of 31 December 2005, the Group had undrawn available facilities totaling HK$10.2 billion, of which HK$8.5 billion was in committed long term loans and HK$1.7 billion of money market lines. Besides, available trade facilities amounted to HK$2.4 billion. Borrowings by sources of financing is summarized as follows:

HK$ million	Total Facilities	Outstandings	Available Facilities
Committed Borrowings			
Bank Loans	23,791	15,305	8,486
Global Bonds	3,510	3,510	0
Private Placements*	1,199	1,199	0
Total Committed	**28,500**	**20,014**	**8,486**
Uncommitted Facilities			
Money Market Lines and Short Term Facilities	2,856	1,185	1,671
Trade Facilities	2,787	384	2,403

**Including a US$100 million Note which was repaid on 15 February, 2006 upon maturity.*

Maturity Profile of Outstanding Debt

The Group actively manages and extends its debt maturity profile to ensure that the Group's maturing debt each year will not exceed the anticipated cash flow and the Group' s ability to refinance the debt in that year. During 2005, CITIC Pacific successfully completed a HK$5.2 billion 7-year syndicated loan transaction. The Group also issued a JPY8.1 billion 30-year floating rate note (with a put option in the 10th year), the exchange risk was hedged through cross currency swap for the duration of the note. In addition, substantial amount of bilateral facilities were newly established, renewed or extended, further improved the Group's maturity profile.

HK$ million	**2006**	**2007**	**2008**	**2009**	**2010**	2011 and Beyond	Total	Percentage
Parent Company[1]	810[2]	527	2,572	2,593	3,082	7,229	16,813	79%
Subsidiaries	1,596	1,640	621	471	77	0	4,405	21%
Total Maturing Debt	2,406	2,167	3,193	3,064	3,159	7,229	21,218	100%
Percentage	11%	10%	15%	15%	15%	34%	100%	
Available Facilities[3]	96	78	1,292	1,832	1,138	4,050	8,486	

1. Including a US$450 million global bond due in 2011 and a JPY8.1 billion floating rate note due in 2035 which were issued by wholly owned special purposes vehicles.

2. Including a US$100 million Note which was repaid on 15 February, 2006 upon maturity.

3. The maturity years of the relevant committed facilities are shown for reference.

Financial Position at a Glance

The charts below show the type, interest rate, maturity and currency profiles of borrowings of the Group as at 31 December 2005:

1. Available Facilities by Type

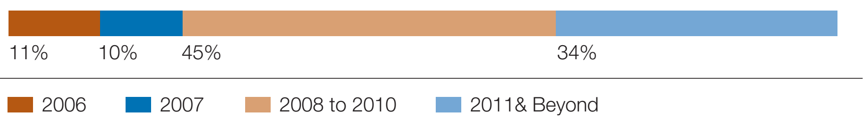
Total HK$12.6 billion

2. Outstanding Debt by Type

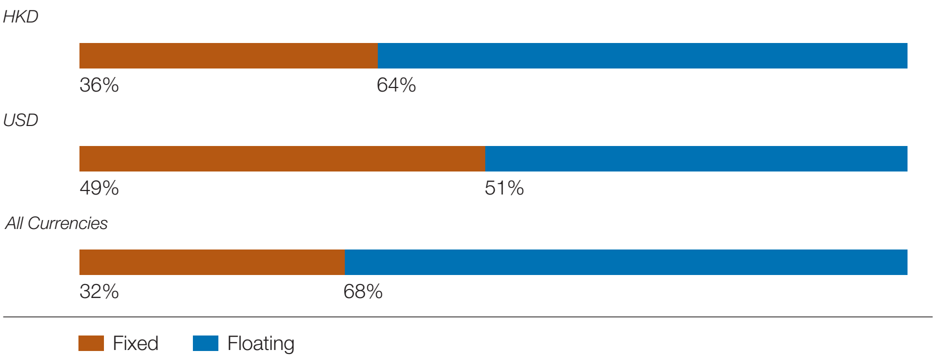
Total HK$21.2 billion

3. Outstanding Debt by Currency

4. Outstanding Debt by Maturity



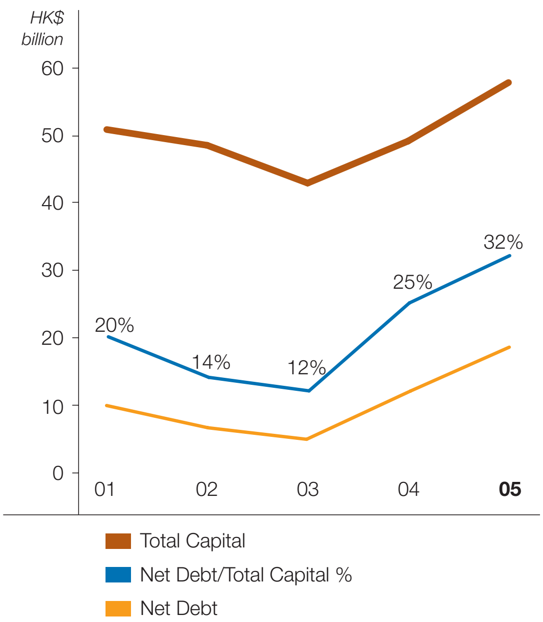
5. Interest Rate Base



Leverage

Net debt divided by total capital was 32% at 31 December 2005 compared with 25% at the end of 2004.

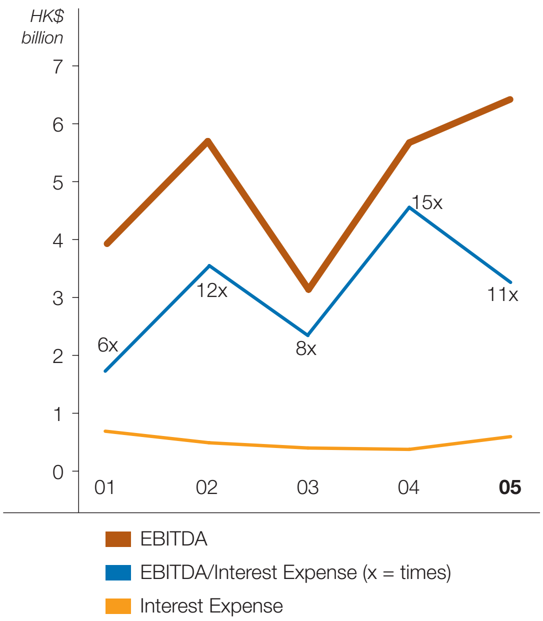
Leverage



Interest Cover

EBITDA divided by interest expense for year ended 31 December 2005 was 11 compared to 15 in 2004, due to the 13% increase in EBITDA and a 59% increase of interest expenses.

Interest Cover



Debt / Cash in Jointly Controlled Entities and Associated Companies

For accounting purposes, some of the Group's businesses are classified as jointly controlled entities and associated companies. The following table shows the debt / cash position of jointly controlled entities and associated companies by business sector as of 31 December 2005 which, under Hong Kong generally accepted accounting standards, are not consolidated into the Group's accounts.

Business Sector

HK$ million	Total Net Debt/ (Cash)	Proportion of Net Debt/(Cash) attributable to CITIC Pacific	Amount of debt guaranteed by CITIC Pacific or its subsidiaries
Infrastructure			
Aviation	15,741	3,531	
Civil Infrastructure	2,562	922	
Power Generation	33,683	8,483	610
Communications	1,124	693	
Property	(476)	(207)	
Special Steel Manufacturing	(38)	(29)	
Marketing & Distribution	902	430	
Others	588	308	
Total	54,086	14,131	610

Except for the guarantee related to Jilin Power Station as described under Financial Guarantees, the debt amount shown in the above table were arranged by jointly controlled entities and associated companies without recourse to their shareholders. Certain Group's investments, such as Festival Walk (disposed in early 2006) and Discovery Bay, are 100% financed by their shareholders and do not have external borrowings.

Financial Guarantees and Pledged Assets

In a limited number of cases, financial guarantees were given by the Company or its subsidiaries for loan facilities which were not included in the consolidated borrowings. As of 31 December 2005, CITIC Pacific provided guarantees to support its share of loan facilities totaling RMB635 million at Jilin Power Station. CITIC Pacific also provided a guarantee to support loan facilities of RMB400 million to a subsidiary of Shijiazhuang Iron & Steel Co., Ltd. ('Shijiazhuang Steel'). CITIC Pacific has entered into acquisition agreement to acquire Shijiazhuang Steel and the transaction is pending for regulatory approval. Hubei Xin Yegang Co., Ltd. ('Xin Yegang'), a 95% owned subsidiary of the Company, provided guarantees to support the bank borrowings up to RMB33 million of Daye Steel Group Corporation. Daye Steel Group Corporation was the original holding company of Xin Yegang. These arrangements were incurred prior to CITIC Pacific's acquisition of Xin Yegang and the guarantee obligations will be released in due course according to the acquisition agreement.

As at 31 December 2005, subsidiaries' assets of HK$585 million (2004: HK$538 million) were pledged to secure banking facilities, these arrangements mainly related to Daye Special Steel Co., Ltd. and Dah Chong Hong's business overseas.

Contingent Liabilities

Details of the Group's contingent liabilities as at 31 December 2005 was stated under Note 32 to the Accounts.

Derivative Transactions

CITIC Pacific employs a combination of financial instruments, including derivative products, to manage its exposure to fluctuations in interest and currency rates. Following the adoption of HKAS32 and HKAS39 as described under 'Significant accounting policies', all derivatives are stated at fair market value. Certain derivative transactions, while the objective is for hedging purposes under the Group's risk management policies, may not qualify for hedge accounting treatment under the specific rules of the new accounting standards. The changes in the fair value of such kind of derivative transactions are recognized in the profit and loss account. The fair market value of outstanding derivative transactions is calculated at least semi-annually based on the Group's own calculation where applicable, or price quotations obtained from major financial institutions.

The Company uses interest rate swaps, forward rate agreements and interest rate option contracts to hedge exposures or to modify the interest rate characteristics of its borrowings. As of 31 December 2005, the Company had outstanding interest rate swap / option contracts with a notional amount of HK$12.0 billion. After the swaps, HK$14.4 billion or 68% of the Group's total borrowings were effectively paying floating rate and the remaining were effectively paying fixed rate of interest. CITIC Pacific has also entered into a cross currency swap contract to hedge the JPY8.1 billion floating rate note so as to limit foreign currency exposure. The overall weighted average all-in cost of debt (including fees and hedging costs) in 2005 was about 4.3%, compared with 3.4% in 2004.

The underlying cash flow of the Group's businesses is mainly in HK dollars or in Renminbi. To minimise potential exposure to US dollar denominated debt principal and interest payments, the Company entered into forward and option contracts. As of 31 December 2005, such contracts outstanding amounted to US$641 million. In addition, foreign exchange forward contracts were also employed by our trading business to hedge currency fluctuations. As of 31 December 2005, such contracts outstanding amounted to HK$657 million.

Loan Covenants

Over the years, CITIC Pacific has developed a set of standard loan covenants to facilitate the management of its loan portfolio and debt compliance. The financial covenants are generally limited to three major categories, namely, a minimum net worth undertaking, a maximum ratio of total borrowings to net worth and a limit on the amount of pledged assets as a percentage of the Group's total assets. CITIC Pacific is in compliance with all of its loan covenants.

	Covenant Limits	Actual 2005
Minimum Consolidated Net Worth:		
Consolidated Net Worth	≥ HK$25 billion	HK$42 billion
Gearing:		
Consolidated Borrowing / Consolidated Net Worth	≤ 1.5	0.53
Negative Pledge:		
Pledged Assets / Consolidated Total Assets	≤ 30%	1%

For the purpose of the above covenant limits, as defined in the relevant borrowing agreements:

'Consolidated Net Worth' means the aggregate of shareholders' funds and goodwill from acquisitions and developments having been written off against reserves or profit and loss account.

'Consolidated Borrowing' means the aggregate of all consolidated indebtedness for borrowed money and all contingent obligations in respect of indebtedness for borrowed money other than aforesaid consolidated indebtedness for borrowed money.

Credit Ratings

The Company has been assigned an investment grade foreign currency long term credit rating from major rating agencies. Standard & Poor's assigned BBB- with stable rating outlook. Moody's Investor Service ('Moody's') assigned a credit rating of Baa3. In January 2006, Moody's changed the outlook on credit rating of CITIC Pacific from stable to negative siting the Agency's concerns over CITIC Pacific's shift in business focus from Hong Kong to mainland China.

The Company's objective is to maintain its financial discipline when expanding its businesses. The new investments, which focus mainly in areas where CITIC Pacific has greatest expertise, are expected to contribute significantly in both profit and cash flow to the Group in the coming years. For the year ended 31 December 2005, the Group's leverage, measured by the net debt to total capital, was 32%. The Group's leverage will be lowered after the disposal of Festival Walk in March 2006 which generated in cash proceeds of over HK$6 billion. Interest cover, defined as EBITDA divided by interest expense, was 11 times for the year ended 31 December 2005. Cash contributed from all the business amounted to HK$4.5 billion. Solid interest cover and stable cash flow demonstrated CITIC Pacific's strong financial standing.

Forward Looking Statements

This Annual Report contains certain forward looking statements with respect to the financial condition, results of operations and business of the Group. These forward looking statements represent the Company's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements.

Forward looking statements involve inherent risks and uncertainties. Readers should be cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward looking statement.