Chairman's Letter to Shareholders

CITIC Pacific's net profit for the first six months of 2006 was HK$3,440 million, a 24% increase compared with the same period last year. The contribution from our special steel manufacturing business rose 28% compared with the same period a year ago due to continued strong demand for our products and the addition of Daye Special Steel. On the property front, sales and rentals increased the contribution from this business by 120%. In light of the satisfactory performance and the Group's strong cash position, the board has recommended paying a special dividend of HK$0.30 per share in addition to an interim dividend of HK$0.30 per share.

Much has been achieved in the first six months of 2006 in better positioning the Group for the future. As we increase our investments in mainland China, we are at the same time focusing on the core businesses we manage, divesting those that we do not, as well as those that do not provide satisfactory returns.

Special Steel Manufacturing

Driven by strong demand for our products from key industries such as auto, industrial machinery manufacturing, power generation and oil industries among others which are experiencing tremendous growth, our special steel business grew substantially in the first half of 2006 over the same period last year. The addition of Daye Special Steel is another factor. The price of our products also rebounded from the end of 2005 due to the increase in steel consumption in mainland China and the export market as well as our effort to produce a greater proportion of higher quality products. This not only mitigated the rise in the cost of raw materials in particular iron ore, but also led to increased profit margin.

The acquisition of Shijiazhuang Steel Mill is nearing completion. Steel making of the new production line in Jiangyin in cooperation with Sumitomo Metals is operating and is profitable. CITIC Pacific Special Steel, which brings *Jiangyin Xingcheng Special Steel*, *Xin Yegang*, *Daye Special Steel* and *Shijiazhuang Steel Mill* under one management, will surely reinforce our leadership in the manufacturing of special steel in China.

Iron Ore Mining

To provide mainland China in general and our special steel business in particular with a secure, stable and long-term supply of essential raw material, in March this year, CITIC Pacific acquired the mining rights to one billion tonnes of magnetite ore with options to another five billion tonnes in the Pilbara region of Western Australia. The development of the first one billion tonnes of ore reserve, capable of producing up to twelve million tonnes of product a year, received Australian government approval in July. Work on this is progressing well. The second one billion tonnes of reserve is now in the final testing and confirmation stage.

CP Mining Management Pty Ltd. has been incorporated in Australia to manage and coordinate the construction and operation of the project. Key personnel, including chief executive officer, financial controller and project director with extensive knowledge and experience in the mining industry have been recruited. They are working closely with consultants and main contractors on various aspects of the project including geological survey, planning for mining, beneficiation plant, pellet plant, desalination plant, power plant, transportation, port and other related works. A detailed development proposal will be presented at the end of August. CITIC Pacific's shareholding in the entire project is 50% and the other 50% will be held by other Chinese government designated steel groups to jointly develop the project. CITIC Pacific will assume a leading role in the management of the project.

Property

In Shanghai, Phase I of our *New Westgate Garden* was completed in June. Substantial progress was made in realizing a landmark development at the *Lu Jia Zui New Financial District* in Shanghai, the last significant site located in Pudong directly on the Huangpu River. A design for the first phase has been selected which will include a hotel and two office towers, and foundation work is expected to start as early as the end of this year. These buildings will become a feature of the Shanghai skyline by 2010. In June, the JV agreement with China State Shipbuilding Corporation on the third phase was formalized. The property development project on *Shenzhou Peninsula* in Hainan Province is progressing well. The master plan has received government approval and work has already begun on roads and bridges. A station at Shenzhou Peninsula has already been confirmed for the high speed railway to be built on the east coast of Hainan Island. This will be beneficial to the development of Shenzhou Peninsula. The Group's other property projects are also progressing well.

A strategic decision was made to sell our 50% passive interest in Festival Walk in Hong Kong to our partner. A profit of approximately HK$1.3 billion was recorded and cash of about HK$6 billion was received thus strengthening the Group's financial position for expansion in the mainland.

Power Generation

Electricity generated in the first six months of 2006 by all power plants in which CITIC Pacific has an interest totalled 39 billion kwh, an increase of 5% from the same period last year. Even with the increase in the cost of coal, our power plants performed better than the first half of last year. In July, CITIC Pacific decided to dispose of its entire 60% interests in the Jilin Power Station which had been incurring losses. With the disposal and the raising of on-grid tariffs by the government beginning July, we expect performance to be better in the second half of this year. *Ligang Power Station Phase III (2 x 600MW)* will begin operation at the end of this year. *Phase IV (2 x 600MW)* is progressing on schedule.

Aviation

CITIC Pacific has long been an advocate of greater co-operation between Cathay Pacific and Dragonair, the two Hong Kong airlines, in order to strengthen Hong Kong's position as the premier Asian hub. On 8 June, Air China, CNAC, Cathay Pacific, CITIC Pacific and Swire Pacific entered into an agreement to restructure the parties' shareholdings in Cathay and Dragonair. Dragonair will become a wholly owned subsidiary of Cathay Pacific, permitting Cathay Pacific to market a network including mainland China to strengthen its ability to compete in the world markets. CITIC Pacific's shareholding in Cathay will be reduced to 17.5% in the combined group. This transaction will result in the creation of one of the most powerful airline groups in the world, providing Cathay with greater access to mainland China and customers of all airlines greater convenience and better choices. It will also, when completed, allow CITIC Pacific to realize cash of approximately HK$5 billion for further developing our core businesses. A profit of approximately HK$2 billion will also be recorded.

The Future

As the growth of the mainland economy continues and the Hong Kong economy revives, we are optimistic that our Group's businesses will perform better in the second half of 2006. We are committed to focusing on our core businesses and will continue to seek investment opportunities therein. Our financial position remains strong.

On behalf of our directors, I would like to thank all the employees at CITIC Pacific for their hard work.

Larry Yung Chi Kin
Chairman
Hong Kong, 21 August 2006