

# Chairman's Letter to Shareholders

I am pleased to report that CITIC Pacific achieved excellent results in 2006. Net profit for the year was a historic high of HK\$8,272 million, a 107% increase compared with 2005. Earnings per share were HK\$3.77. In light of this good performance, our sufficient financial resources, and at the same time considering the need to further expand our businesses in the future, the board has recommended paying a special dividend of HK\$0.30 per share in addition to a final dividend of HK\$0.80 per share. Including the regular (HK\$0.30) and special (HK\$0.30) dividend per share already paid at the interim, total dividend per share for the year is HK\$1.70.

All of CITIC Pacific's businesses performed well in 2006, in particular the three core businesses, which made outstanding profit contribution. The Special Steel business recorded an impressive growth in profit of 65% compared to last year. Benefiting from the sale of Festival Walk, profit contribution from our property business rose 84% compared with last year. Also, in accordance with accounting standards, fair value gains on revaluation of the Group's investment properties were HK\$1.08 billion. Infrastructure businesses such as Aviation, Power Generation, Tunnels, and Environmental businesses all recorded growth in recurrent earnings. These businesses provide stable and recurring cash flows to the Group. The restructuring of the aviation industry in 2006 provided CITIC Pacific's shareholders a satisfactory return on investment. Cash realized from this transaction further strengthened the Group's financial position for future new investments.

## Special Steel

CITIC Pacific's special steel business had excellent performance in 2006. Through both organic growth and acquisitions, a plan implemented a few years ago, the Group has expanded its operations rapidly. In just a few years, CITIC Pacific's production capacity has reached over seven million tonnes, commanding a leading position in both product quantity and quality producing a variety of products such as bearing steel, gear steel, spring steel, and other alloy steel. Today, our special steel

business has become a highlight in the Group's profit growth and is expected to continue its rapid development in the foreseeable future.

Jiangyin Xingcheng's new production line, in partnership with Sumitomo Metals of Japan, is near completion, with the steel smelting section of the production line already completed and profitable. The steel rolling section is scheduled to complete and become fully operational in 2007. This production line, equipped with the most advanced technologies of similar types both domestically and internationally, is the foundation for the production of high quality and highly energy efficient special steel products in the future.

Through effective management and integration, the businesses of Hubei Xin Yegang (95%) and Daye Special Steel (56.6%), which the Group acquired in 2004 and 2005, improved greatly with significant increases in profitability. A newly built 900,000 tonne coking plant will be completed and become fully operational in 2007. This plant will not only satisfy demand at Xin Yegang and Daye Special Steel, but it can also supply coke to other sister plants within the Group. This will reduce costs and increase the Group's investment return.

Shijiazhuang Steel Mill officially became a member of the CITIC Pacific group in July 2006. Today, CITIC Pacific has three special steel manufacturing bases that are ideally located in Eastern (Jiangyin Xingcheng), Central (Xin Yegang/Daye Special Steel) and Northern (Shijiazhuang Steel) China. Our plants are positioned to take advantage of the high demand in these three industrial centres. The plants can also utilize the well developed transportation networks nearby to supply products to all regions in China. At the same time, these strategic locations are also beneficial in facilitating product realignment and centralizing purchasing, transportation and sales functions among the plants.

In 2006, the Group's steel plants sold a total of 5.9 million tonnes of special steel, a 60% increase from 2005. Even though prices of raw materials stayed at

high levels, profitability of the Group's steel business remained at a satisfactory level. CITIC Pacific is optimistic on the future development of this business. The above mentioned three locations will continue to support each other in the coming year to fully realize synergies, and to further strengthen our leading position in China's special steel industry.

### Iron Ore Mining

As previously reported, in March 2006, CITIC Pacific acquired mining rights to one billion tonnes of magnetite ore, and rights and options to a further five billion tonnes in the Western Pilbara region of Western Australia. Stage One, which includes the right to the first billion tonnes of reserves, received approval from the Australian government in June 2006. It will be capable of producing 12 million tonnes of concentrate annually once operational. Pre-construction design work is underway. We have signed a general construction contract with China Metallurgical Group Corporation ('MCC'). Work on the development of mining, beneficiation plant, pellet plant, desalination plant, power station and material handling system has begun. First shipment of product is expected to be in 2009.

Management and technical teams with Chinese, Australian and international experience have been assembled and will be strengthened step-by-step. The financing framework for the project has been signed, and the bank has undertaken to support the project by providing long-term project finance to shareholders and the project companies. Once completed, this mining project will provide a long-term stable supply of iron ore for the Group's steel plants.

### Property

Property development in mainland China is an important focus in the Group's businesses. We believe that with the rapid development of the Chinese economy and rising living standards, market demand for high quality commercial and residential properties will continue to be strong. From a long-term perspective, fundamentals of the Chinese property market remain positive. CITIC Pacific is confident in the long-term prospects of the property development business in China. We will continue to actively invest and increase

our land bank in order to establish a solid foundation for the Group's property development in the long-term.

CITIC Pacific's property development in mainland China is mainly in the Yangtze River Delta area centered around Shanghai, and large scale development projects in the coastal city of Wanning in Hainan Province.

The Shanghai Lu Jiazui Financial District Project will be one of the Group's most important development projects in the coming years. The design for Phase I has been finalized comprising of a top grade hotel and two landmark office towers. Government review of Phase I building scheme is in progress, and foundation work will then begin. Meanwhile, preparation work is underway.

Construction of 'CITIC Square' in Ningbo is progressing well and foundation work has been completed. Work has also begun on the Group's projects at Qingpu in Shanghai, Yangzhou, Wuxi and Jiangyin in Jiangsu Province. These development projects will be completed in the coming few years to provide the Group with satisfactory investment returns.

CITIC Pacific's large scale 'Shenzhou Peninsula' project, in the city of Wanning in Hainan is progressing well. A master plan for the development of about 2.5 million square metres in gross floor area received government approval. Infrastructure development related to the project has commenced. Design and commercial negotiation for Phase I, which includes four grade A hotels and auxiliary facilities, are in progress. Site work is expected to commence shortly as well as work on a world class golf course and other related facilities.

Our investment properties in Shanghai, CITIC Square and Royal Pavilion, remain well let and are providing the Group with satisfactory returns. The Group now wholly owns CITIC Square, a well-known building in Shanghai, after acquiring interests from two minority shareholders.

In 2006, the Hong Kong property market remained active with rentals rising steadily, in particular those of premium properties. As current market rates need to be paid by new tenants and renewals, returns on the Group's overall investment properties will continue to improve. Phase 13 (Chianti) of the Discovery Bay development was completed at the end of 2006 and to date, over half

of the units have been sold and delivered. The remaining units will be sold gradually in 2007. The project company has submitted an application to the Government on the development of the next phase. CITIC Pacific's properties in Kowloon Bay and Yuen Long all have re-development potential and we are exploring opportunities and discussing with the Government regarding the relevant approvals. We believe the re-development of these properties will increase their value and in turn bring better returns for the Group.

### Aviation

The restructuring of the aviation industry in the second half of 2006 resulted in a HK\$2 billion profit for CITIC Pacific, a satisfactory return on investment for our shareholders. At the same time, the Group realized over HK\$5 billion of cash from the transaction, further strengthening our financial position. After the restructuring, CITIC Pacific remains a major shareholder of Cathay Pacific, holding a 17.5% interest.

The business of HACTL performed well with an increase in annual profit.

### Power Generation

Ligang Phase III (2 x 600MW) passed testing and formally commenced commercial operation in the fourth quarter of 2006. Construction of Ligang Phase IV (2 x 600MW) is progressing well with commercial operation expected in 2007. As the flagship of CITIC Pacific's power generation business, the Ligang Power Station will have installed capacity of 3,800MW, making it one of the largest coal fired power stations in China.

Zhengzhou Phase III (2 x 200MW) also passed testing and entered commercial operation at the end of 2006. We anticipate that profit contribution from our power business will increase greatly in 2007. CITIC Pacific will continue to seek new investment opportunities to further expand the power business.

### Civil Infrastructure

The Group's environmental, water projects and tunnels also performed well in 2006. These infrastructure projects provide CITIC Pacific with stable income and cash contribution.

### Marketing and Distribution

The businesses of Dah Chong Hong and Sims performed well with increased market share in Hong Kong motor vehicles sales, while the distribution networks in mainland China improved. Profit from our joint venture with Shiseido increased substantially to reach yet another high.

### Looking to the Future

Looking ahead, we are confident in the future development of the Group. The continuing rapid and healthy growth of the Chinese economy created excellent investment opportunities and a favorable operating environment for us. CITIC Pacific will continue to leverage our expertise and capture business opportunities. We will also focus more on our core businesses such as Steel, Mining, Property in mainland China and infrastructure projects to achieve higher returns for our shareholders.

On behalf of all the directors, I would like to express my sincere thanks to everyone at CITIC Pacific for their hard work, and to our investors, bankers and everyone else for their continuing support.

Let me also take this opportunity to welcome Mr. Chang Zhenming's return to CITIC Pacific's board as a Director, effective August 2006. Mr. Chang resigned from CITIC Pacific in June 2005 as an Executive Director when he was appointed as President of China Construction Bank. Mr. Chang returned to CITIC Group in 2006 as Vice Chairman and President. His return to the board is an important asset to CITIC Pacific. In January 2007, Mr. Yuen Kee Tong resigned as Deputy Managing Director of CITIC Pacific to take on the position of CEO at CITIC 1616 Holdings Limited which is to be listed. I would like to thank Mr. Yuen Kee Tong for his valuable contribution to our company.

**Larry Yung Chi Kin**

*Chairman*

Hong Kong, 15 March 2007