Financial Review

Introduction

CITIC Pacific's 2006 Annual Report includes a letter from the Chairman to shareholders, the final 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 74 to 82 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 83 to 134 of the Annual Report, are Notes that further explain certain figures presented in the statements.

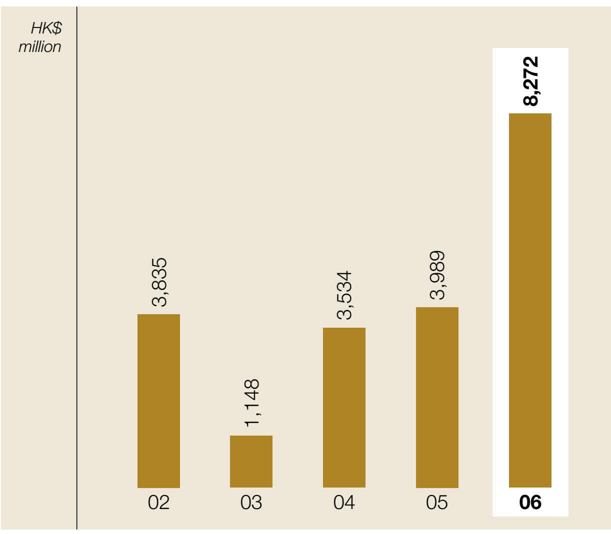
On pages 135 is the report of CITIC Pacific's auditor – PricewaterhouseCoopers – of their independent audit of CITIC Pacific's Annual Accounts.

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') which have been converged with International Financial Reporting Standards.

Profit Attributable to Shareholders

The net profit attributable to shareholders for the year ended 31 December 2006 was HK$8,272 million, an increase of 107% compared with HK$3,989 million in 2005. The reasons for the increase in profit are described below.



Business Segments Contribution

The Contribution (Note) made by major business segments in 2006, compared with 2005, were:

HK$ million	actual **2006**	2005	change 2006 – 2005
Special Steel	**1,333**	808	525
Property	**2,035**	1,106	929
Aviation	**3,288**	1,058	2,230
Power Generation	**268**	368	(100)
Civil Infrastructure	**469**	413	56
Marketing & Distribution	**275**	232	43
Communications	**367**	(31)	398
Fair Value change of Investment Properties	***1,077***	*755*	*322*

Note: Please refer to Definition of Terms on Page 140.

Compared the contribution for the year 2006 with last year:

- Special Steel: Turnover of Special Steel increased from HK$12 billion in 2005 to HK$15 billion in 2006. Contribution increased significantly due to continuing good performance of Jiangyin Steel Plant and Xin Yegang Steel Plant including the contribution from Daye Special Steel which was acquired in November 2005. Shijiazhuang Steel Plant acquired during the year contributed HK$119 million.

- Property: Excluding the revaluation surplus of investment properties in both year, contribution increased by 84% mainly due to the profit from the sale of 50% interest in Festival Walk, and profit recognized on completion of Shanghai Westgate Garden and Chianti at Discovery Bay in 2006. In 2005, there were also profits from the sales of properties including a piece of land at Hung Shui Kui in the New Territories. Excluding the effect due to the disposal of Festival Walk, rental income recorded good growth.

- Aviation: Cathay Pacific reported 24% increase in net profit for the year. Despite the fact the Group reduced its shareholding in Cathay Pacific from 25.4% to 17.5% and disposed all of its 28.5% interest in Dragonair during the year in connection with the restructuring of aviation business, recurring contribution in 2006 almost levelled that of 2005. In addition, profit of HK$2.2 billion was recognised from the restructuring of aviation business.

- Power Generation: Excluding the impairment loss of HK$152 million of Jilin Power Station and a loss of HK$56 million arose from the share reform plan of a mainland listed company under North United Power Group, contribution increased by 29% in 2006.

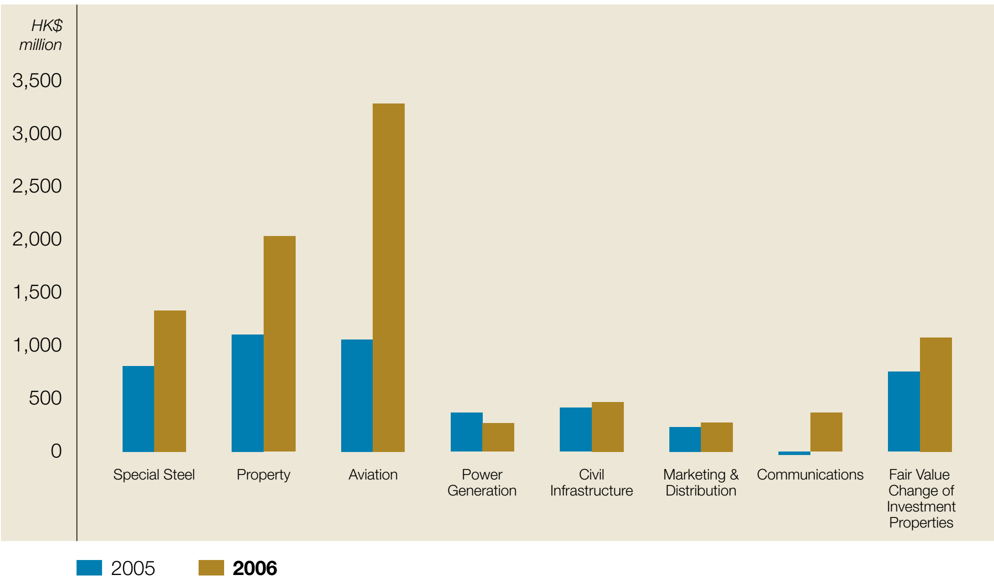
- Civil Infrastructure: Contribution from both vehicular tunnels increased. Toll charges of Eastern Harbour Tunnel have been increased since May 2005.

- Marketing & Distribution: Turnover increased by 20% to HK$13 billion in 2006 with contribution increased by 19%. The contribution from motor business in both Hong Kong and the PRC improved. The performance of non-motor businesses during the year was affected by the challenging market and project development costs.

- Communications: Profit of CITIC 1616's telecom operations increased by 93% in 2006 but was partly offset by the costs of the Group's other developing businesses. The result of CTM was relatively stable. A profit of approximately HK$170 million arose from the share placement by Guoan Information in 2006. There was a loss of approximately HK$190 million in 2005 as a result of Guoan Information's share reform plan.

- Fair value change of investment properties: Increase in fair value of investment properties as a result of a revaluation reflecting the current market condition.

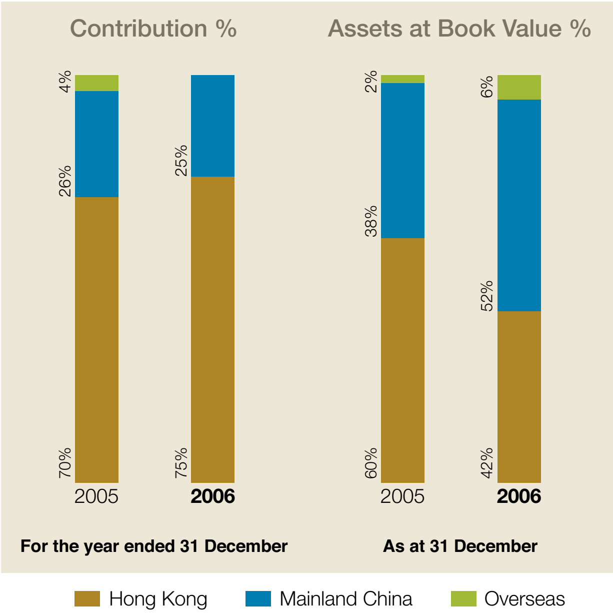
Contribution



Page 92 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.



Interest Expense

The Group's interest expense net of amount capitalised decreased from HK$596 million to HK$590 million mainly due to the increase in capitalised interest related mainly to various PRC property projects while weighted amount of borrowings increased. The weighted average cost of debt in 2006 was 5.2% compared to 4.3% last year.

Taxation

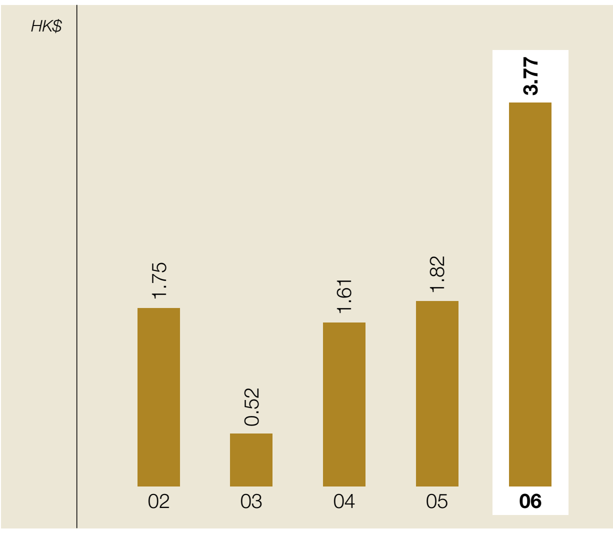
Taxation increased from HK$345 million in 2005 to HK$644 million in 2006 mainly due to increased profit from PRC operations.

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.

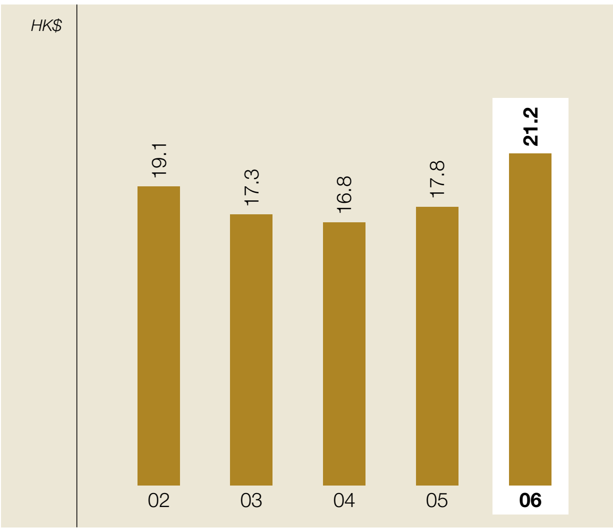
Earnings per Share

Earnings per Share was HK$3.77 for 2006, an increase of 107% compared with HK$1.82 in 2005. The increases in Earnings per Share was mainly attributable to the increase in profit as the number of shares outstanding in the two years was substantially the same.



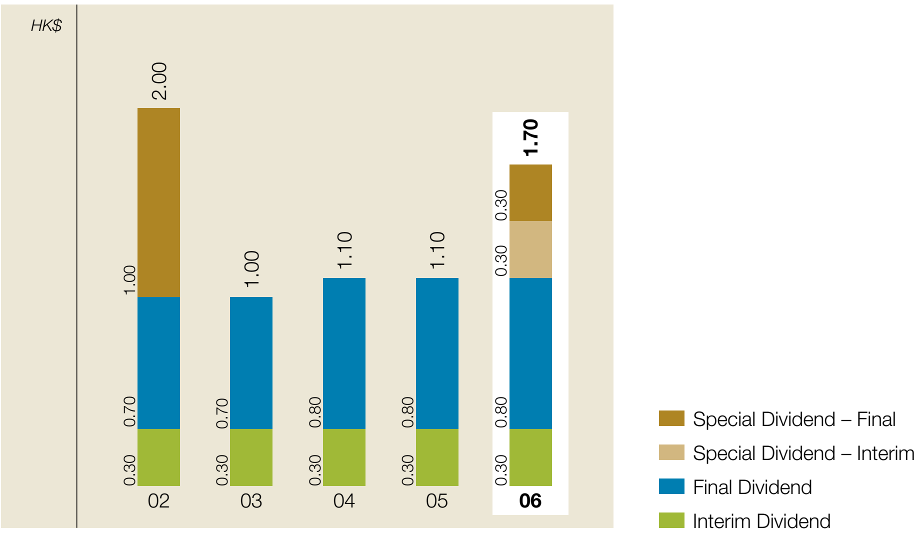
Shareholders' Funds per Share

Shareholders' Funds per share at 31 December 2006 was HK$21.2. The increase was due to profit during the year less dividend paid.



Dividend per Share

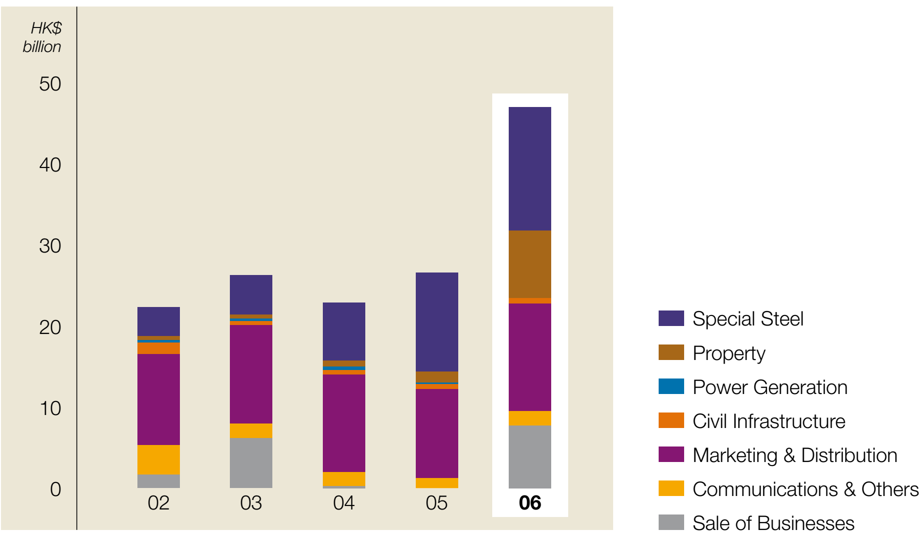
A final dividend of HK$0.8 per share and a special dividend – final of HK$0.3 are proposed for 2006.



Turnover

Turnover in 2006 increased substantially compared to last year mainly attributable to the followings:

- Special Steel turnover increased by 26% mainly due to turnover of Daye Special Steel which was only acquired in November 2005.
- The proceeds on disposal of 50% interest in Festival Walk amounted to approximately HK$6.1 billion.
- The proceeds on disposal of Dragonair and Cathay Pacific related to the restructuring of aviation business amounted to HK$7.7 billion.
- Marketing & Distribution turnover increased by 20% mainly due to increased sales in mainland China particularly for the motor business.



Capital Expenditure

The acquisition of Shijiazhuang Steel Plant at HK$1.3 billion was completed in July 2006. Jiangyin Steel Plants, Xin Yegang Steel and Daye Special Steel made significant investment in their production facilities during the year. Further HK$0.7 billion investment in Jiangyin Phase II was made in 2006.

The property development projects in the Mainland, including Shanghai Lu Jaizui New Financial District project, Qingpu, Ningbo and Yangzhou, are continuing. The first phase of New Westgate Garden was completed in the first half of 2006.

A mining right of magnetite iron ore in Western Australia was acquired in 2006 at US$215 million and the development is still at the initial stage.

Further capital contribution was made to Zhengzhou Power during the year. The construction of the new power generators, Ligang Power III and Zhengzhou Power III, had been completed and commenced operations before the year end.

Others of 2006 includes investment in the listed shares of Industrial and Commercial Bank and China Coal Energy. The Group also invested in China Shenhua Energy in 2005.

HK$ million	**2006**	2005
Special Steel	**3,674**	2,063
Iron Ore Mining	**1,754**	–
Property	**2,873**	2,526
Power Generation	**197**	1,518
Civil Infrastructure	**196**	225
Marketing & Distribution	**294**	200
Communications	**170**	134
Others	**1,004**	554

Treasury Policy and Risk Management

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.

Foreign Currency Exposure

CITIC Pacific conducts business mainly in Hong Kong and mainland China, therefore it is subject to the market risk of 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 and thus the RMB exchange swap market is not readily available or efficient at this time. 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 dollars. As the Group's investment in mainland China is expanding, CITIC Pacific has an increasing exposure to the Renminbi. As at 31 December 2006, around HK$35 billion or 52% of the Group's total assets were based in mainland China (2005: HK$23 billion, or 38%).

The underlying cash flow of the Group's businesses is mainly in HK dollars or in Renminbi. CITIC Pacific entered into foreign currency forward contracts to minimise potential exposure to US dollar denominated debt principal and interest payments. As at 31 December 2006, such contracts outstanding amounted to US$747 million (2005: US$641 million). In addition, foreign exchange forward contracts were employed by our trading business to hedge currency fluctuations. As at 31 December 2006, such contracts outstanding amounted to HK$707 million (2005: HK$657 million).

Interest Rate Exposure

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 uses interest rate swaps, forward rate agreements, interest rate option contracts and other instruments to hedge exposures or to modify the interest rate characteristics of its borrowings. As at 31 December 2006, CITIC Pacific had outstanding interest rate swap / forward rate contracts with a notional amount of HK$11.1 billion. After the swaps, HK$7.4 billion or 40% of the Group's total borrowings were effectively paying fixed rate and the remaining were effectively paying floating rate of interest. During the current interest cycle, the US Federal Reserve increased interest rate 17 times from 1% in June 2004 to 5.25% as at end of June 2006 and since then, the Fed maintained the Fed funds rate unchanged. Due to active hedging program, the Group's cost of borrowings increased at a slower pace relative to the market rate of increase. For the year ended 31 December 2006, the Group's overall weighted average all-in cost of borrowings (including fees and hedging costs) was about 5.2%, compared with 4.3% for the last year.

Employment of Derivative Products

The Group employs a combination of financial instruments, including derivative products, to manage its exposure to fluctuations in interest and currency rates. Derivative transactions are only used 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.

Following the adoption of HKAS 32 and HKAS 39 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 strategies, may not qualify for hedge accounting treatment under the specific rules of the accounting standards. The changes in the fair value of such kind of derivative transactions are recognised in the profit and loss account. The fair market value of outstanding derivative transactions is calculated at least semi-annually based on the price quotations obtained from major financial institutions or the Group's own calculation where applicable.

Cash Flow

By design, majority of the Group's debt is raised at the holding company level (except for project based financing or arrangement limited by regulation such as RMB borrowings). As such, the actual net amount of cash flow from each business to the Group is an important indicator as to the Group's ability to service its debts. Following is a summary of cash contributions by each business segment in the year 2006 compared to the year 2005:

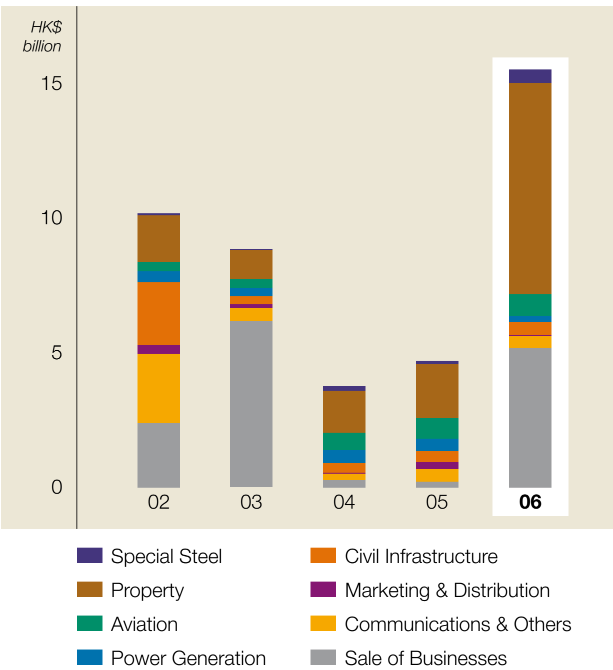
HK$ million	**2006**	2005
Special Steel	**500**	143
Property	**7,821**	1,996
Aviation	**5,975**	767
Power Generation	**213**	449
Civil Infrastructure	**476**	407
Marketing & Distribution	**57**	256
Communications	**347**	413
Others	**79**	57
Total	**15,468**	4,488

For the year ended 31 December 2006, the Group's cash flow was very strong. Special Steel sector contributed higher cash flow as prior years retained profits were distributed during the year. Property sector continued to generate strong cash flow from both recurring rental income and property sale. In addition, disposal of 50% interest in Festival Walk also contributed HK$6.1 billion. Cash contribution from Aviation sector was stable. In addition, HK$5.2 billion was received from aviation restructuring. Cash contribution from Power Generation sector decreased as the 2005 final dividend declared by Ligang Power Station was retained for reinvestment in Ligang Phase IV. Civil Infrastructure sector also contributed higher cash flow mainly attributable to the strong performance of tunnel operations. Cash contribution to the Group from Marketing & Distribution decreased for the year as cash generated from operations was utilised by the business unit to invest in new project.

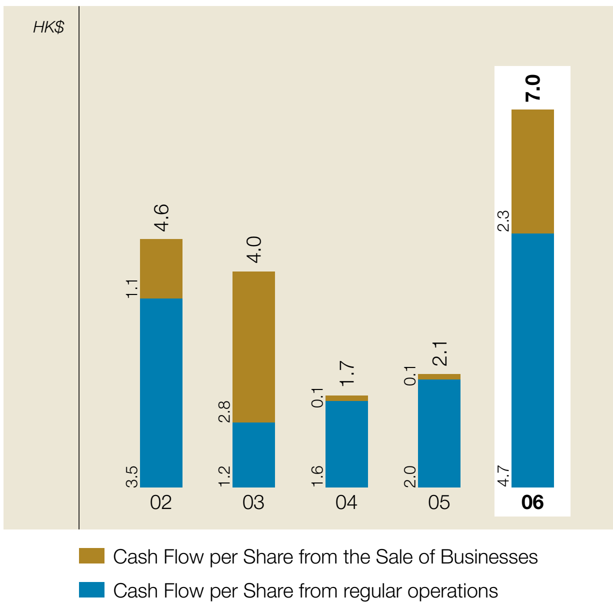
Summary of Consolidated Cash Flow Statement

HK$ million	**2006**	2005
Net Cash generated from / (invested in)		
consolidated activities	**4,302**	2,063
jointly controlled entities	**220**	(59)
associated companies	**1,132**	1,504
other financial assets	**11**	1
Sale of business interests and marketable securities	**12,313**	481
Capital expenditure and investment in new businesses	**(9,451)**	(5,971)
Tax	**(315)**	(227)
Net interest paid	**(751)**	(601)
	7,461	(2,809)
Dividends paid	**(3,072)**	(2,412)
(Decrease) / Increase in borrowings	**(3,376)**	5,330
Repurchase of shares	**(35)**	–
Share options exercised	**87**	16
	(6,396)	2,934
Increase in cash and cash equivalents	**1,065**	125

Cash Flow from Operations



Cash Flow per Share



Group Debt and Liquidity

The financial position of the Group as at 31 December 2006, as compared to 31 December 2005, is summarised as follows:

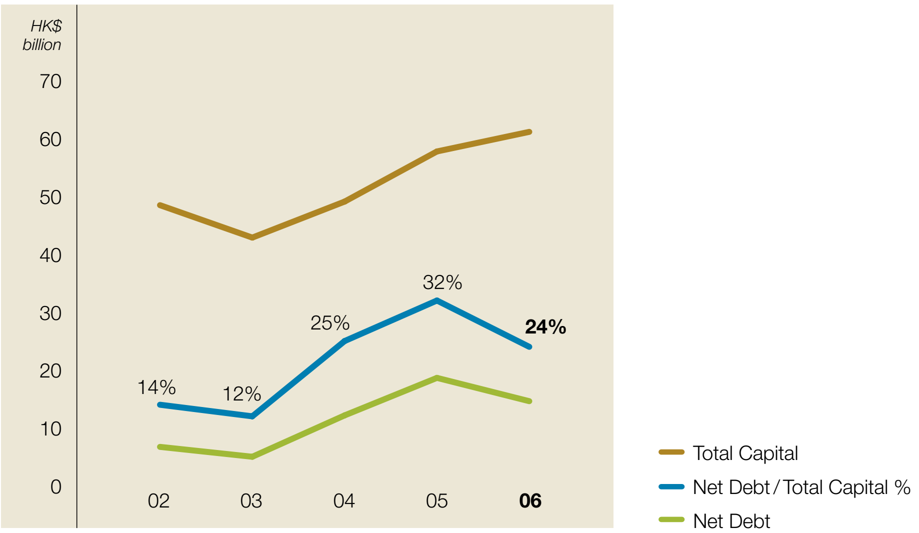
HK$ million	**2006**	2005
Total debt	**18,293**	21,218
Cash and bank deposits	**3,679**	2,579
Net debt	**14,614**	18,639

The original denomination of the Group's borrowings as well as cash and deposit balances by currencies as at 31 December 2006 is summarised as follows:

	denomination					
HK$ million equivalent	HK$	US$	Renminbi	Yen	other	total
Total debt in original currency	8,147	5,348	3,684	1,016	98	18,293
Total debt after hedging	13,901	0	3,684	610	98	18,293
Cash and bank deposits	162	1,021	2,269	112	115	3,679
Net debt / (cash) after hedging	13,739	(1,021)	1,415	498	(17)	14,614

Leverage

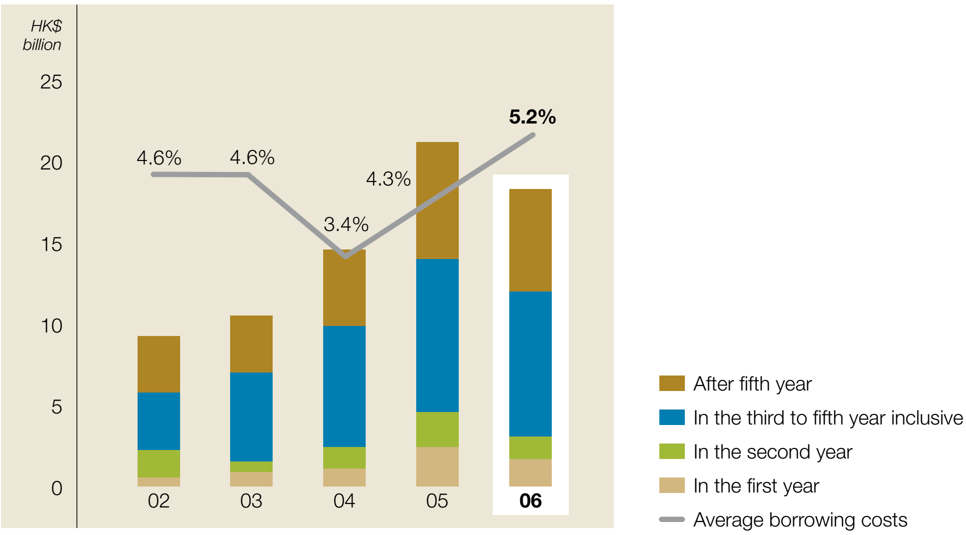
Net debt divided by total capital was 24% at 31 December 2006 compared with 32% at the end of 2005.



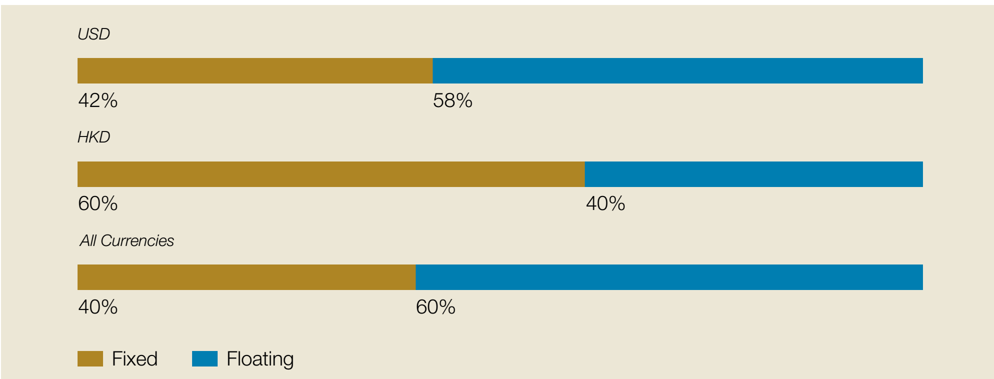
Total Debt

Total debt decreased mainly due to strong cash flow. As at 31 December 2006, outstanding loans maturing within one year amounted to HK$1.7 billion or 9% of the total debt. On the other hand, the Group had cash and deposits with banks of HK$3.7 billion on that date.

For the year ended 31 December 2006, the Group's average borrowing costs was about 5.2% compared with 4.3% for the last year. For the description on the Group's average borrowing costs, please refer to 'Interest Rate Exposure'.



As described under 'Interest Rate Exposure', the Group maintains a suitable mixture of fixed and floating rate base in order to stabilise interest costs. As at 31 December 2006, 40% of the Group's total debt was effectively paying fixed rate of interest.



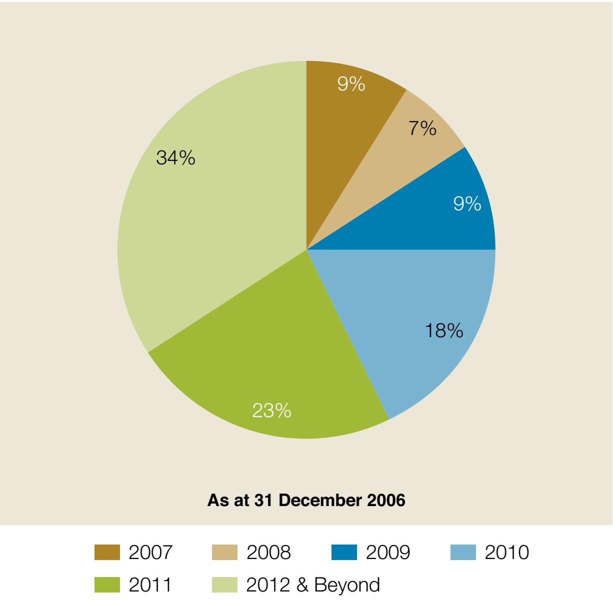
Maturity Profile of Outstanding Debt

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.

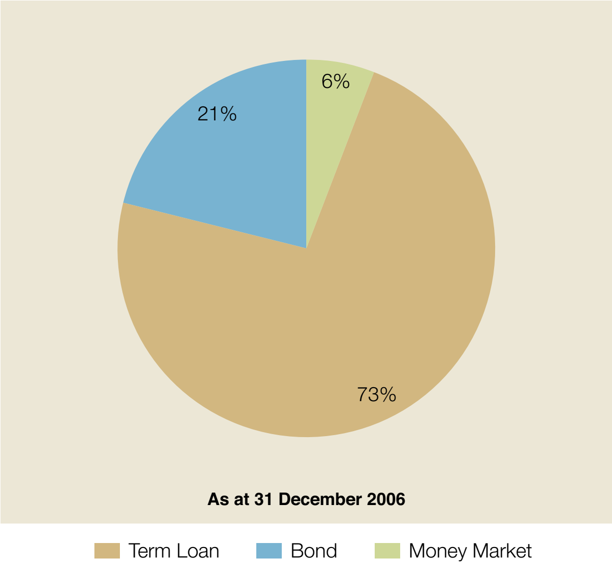
HK$ million	2007	2008	2009	2010	2011	2012 and beyond	total	percentage
Parent Company	27	8	624	3,052	3,510[1]	6,294[2]	13,515	74%
Subsidiaries	1,662	1,351	958	249	558	0	4,778	26%
Total Maturing Debt	1,689	1,359	1,582	3,301	4,068	6,294	18,293	100%

1. *Including a US$450 million global bond due in 2011 which was issued by a wholly owned special purposes vehicle.*
2. *Including a JPY8.1 billion floating rate note due in 2035 which was issued by a wholly owned special purposes vehicle.*

Outstanding Debt by Maturity



Outstanding Debt by Type



	2006	2005
Weighted average term of debt	**5.2 years**	4.0 years

Analysis on the Group's Financial Obligations

category	description	2006 *HK$ million*	2005 *HK$ million*
Borrowings of Holding Company	Include bond and notes issued by wholly owned special purposes vehicles.	**13,515**	16,813
Borrowings of Subsidiaries	Mainly related to the RMB borrowings of steel subsidiaries and Dah Chong Hong. According to PRC regulations, RMB borrowings must be raised at the operating subsidiary level.	**4,778**	4,405
Borrowings of Jointly Controlled Entities and Associated Companies	Share of net debt of jointly controlled entities and associated companies. All the debts are non-recourse to the Company and its subsidiaries.	**16,465**	14,131

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 at 31 December 2006 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
Special Steel	2,404	1,923
Property	(98)	(38)
Aviation	17,178	3,065
Power Generation	34,930	9,081
Civil Infrastructure	2,035	694
Marketing & Distribution	1,101	487
Communications	1,891	946
Others	593	307
Total	60,034	16,465

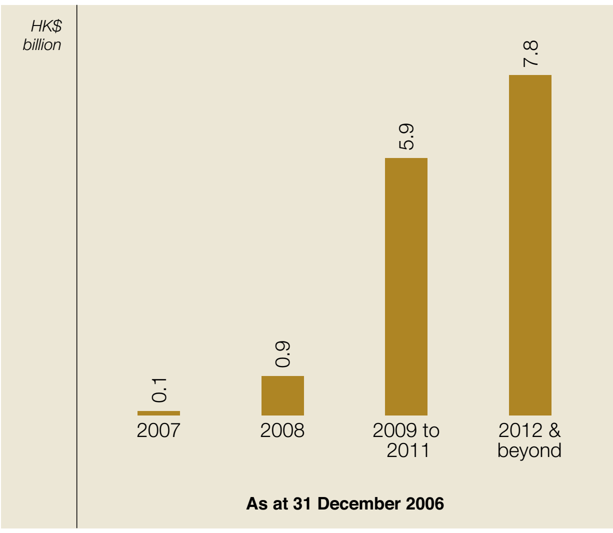
The debt amounts shown in the above table were arranged by jointly controlled entities and associated companies without recourse to their shareholders. None of these debts is guaranteed by CITIC Pacific or its subsidiaries. Certain Group's investments, such as Discovery Bay, are 100% financed by their shareholders and do not have any external borrowings.

Available Sources of Financing

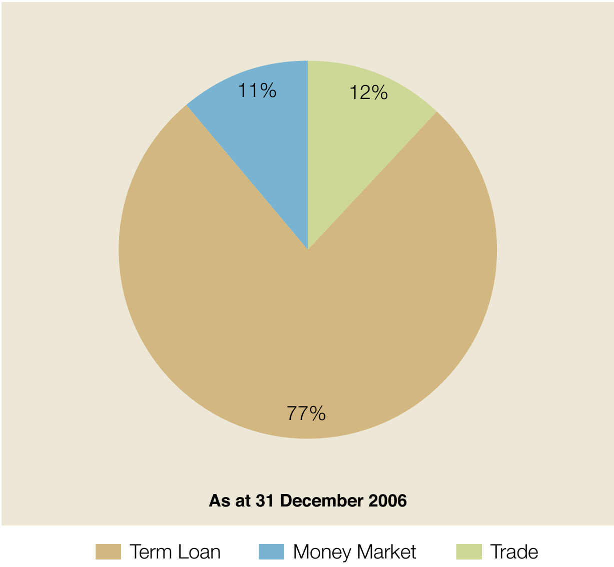
In addition to cash and deposits balance of HK$3.7 billion as at 31 December 2006, the Group had undrawn available loan facilities totaling HK$16.8 billion, of which HK$14.7 billion was in committed long term loans and HK$2.1 billion of money market lines. Besides, available trade facilities amounted to HK$2.2 billion. Borrowings by sources of financing as at 31 December 2006 is summarised as follows:

HK$ million	total facilities	outstandings	available facilities
Committed Facilities			
Term Loans	28,020	13,328	14,692
Global Bonds	3,510	3,510	0
Private Placement	406	406	0
Total Committed	31,936	17,244	14,692
Uncommitted Facilities			
Money Market Lines and Short Term Facilities	3,134	1,027	2,107
Trade Facilities	2,766	591	2,175

Undrawn Available Committed Facilities by Maturity (Total HK$14.7 billion)



Undrawn Available Facilities by Type (Total HK$19 billion)



In addition to the above summarised facilities, the Company established Cooperative Agreements with major PRC banks. Under such agreements, general credit limits have been granted to us to support the Group's funding requirements. Utilisation of these facilities will be subject to the banks' approval on a project-by-project basis in accordance with PRC banking regulations. As at 31 December 2006, total of around RMB66 billion credit limit under such arrangements remained available, of which RMB30 billion have been specifically allocated to Iron Ore Mining, Special Steel, Hainan property projects, and various other projects in the mainland.

Financing Activities

During the year, CITIC Pacific successfully completed a HK$7.2 billion syndicated loan facility. In addition, newly established, renewed or extended bilateral loan facilities amounted to HK$4.1 billion. The Company also established cooperative agreements with 3 major PRC banks during the year. Under these agreements, substantial amount of credit limit have been made available to further support the Group's expansion strategy in the mainland.

Pledged Assets

As at 31 December 2006, subsidiaries' assets of HK$696 million (2005: HK$585 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 2006 was stated under Note 29 to the Accounts.

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 has been in compliance with all of its loan covenants.

	covenant limits	actual 2006
Minimum Consolidated Net Worth:		
Consolidated Net Worth	≥ HK$25 billion	HK$49 billion
Gearing:		
Consolidated Borrowing / Consolidated Net Worth	≤ 1.5	0.37
Negative Pledge:		
Pledged Assets / Consolidated Total Assets	≤ 30%	1%

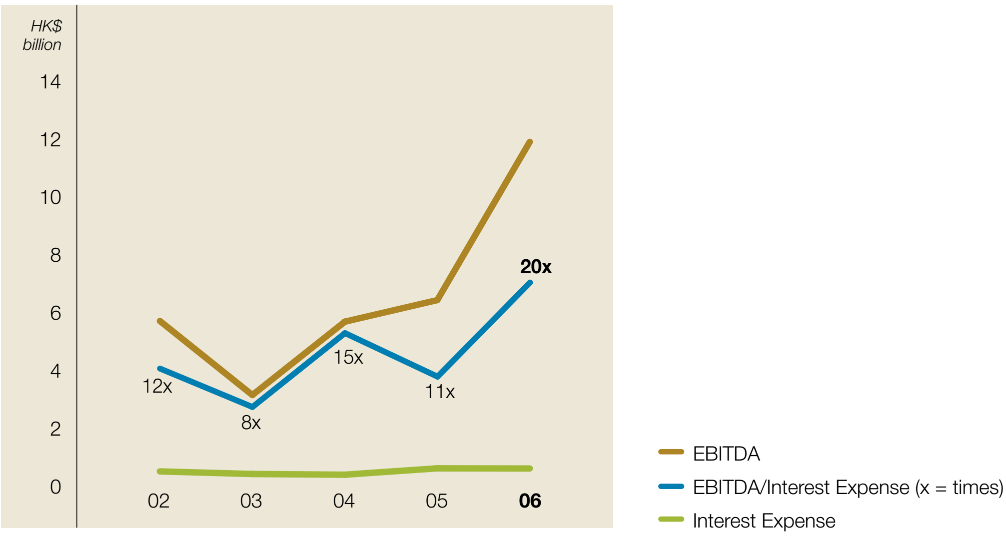
For the purpose of the above covenant limits, as defined in the relevant borrowing agreements:

'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.

Interest Cover

EBITDA divided by interest expense for year ended 31 December 2006 was 20 compared to 11 in 2005, due to the 85% increase in EBITDA and a 1% decrease of interest expenses.



Credit Ratings

The current long term credit ratings of the Company are Ba1 by Moody's Investor Service and BB+ by Standard & Poor's. For both ratings, the credit outlook is stable. The Group's new investments, which focus mainly in the 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. The credit profile of the Group will be improved in due course. The Group's objective is to maintain its financial discipline when expanding its businesses.

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 know 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.