Economic Review

Despite earlier fears of a sharp decline in the US Dollar and rising protectionism, the global economy proved resilient in 2006, even in the face of rising oil prices and interest rates. Global growth became less dependent on the US economy as other economies strengthened. In Europe and Japan, past restructuring began to yield benefits, while emerging economies, notably China and India, continued their impressive expansion and their growing global significance as economic engines. This very positive environment fed into regional and international equities markets.

The Chinese economy grew by 10.5% during the year – the fastest pace in a decade – especially because of continued strong export performance and construction and investment. To give an example of how this affects the country as a market, per capita disposable income among residents in both urban and rural areas increased during 2006 at double-digit rates. The current growth rate is considered to be at the top end, and policymakers have taken action to cool the economy down somewhat.

Hong Kong enjoyed its third consecutive year of strong growth, with GDP increasing by a very impressive 6.5%. Much of Hong Kong's strength was due to domestic demand as confidence continued to grow among consumers and investors. Unemployment declined to a six-year low of 4.4%, further encouraging consumption. At the same time, Hong Kong remained a generally low-inflation environment, with consumer prices rising by a relatively modest 2.0%. It is useful to put Hong Kong's recent trends into perspective. Average annual growth for the last three years has been 7.6%. The combination of positive external and internal factors fed into the local markets, which in turn encouraged particular growth in the financial services sector and the consolidation of Hong Kong as an international centre.

Results Announcement

Including the exceptional earnings arising from the gain on disposal of Asia Commercial Bank ("ACB") in the first half of the year, Asia Financial Group's profit attributable to equity holders of the Company for 2006 was HK$3,092.4 million, 1,575.4% above that of 2005. The sale of ACB naturally has a very significant impact on the Group's bottom line, accounting for HK$2,628.3 million, or 85.0% of the total net profit. Although outweighed by this exceptional item, the Group's continuing investments and insurance operations performed very well, with their profit attributable to equity holders of the Company of HK$415.1 million representing a 310.3% rise on 2005.

Good Investment Returns, and a Steady Operating Environment

Apart from exceptional earnings, the driver for both Asia Financial Holdings' ("Holding Company") and Asia Insurance Company, Limited's ("Asia Insurance"'s) profit growth last year was the strong performance of the stock markets in which we invested, particularly Hong Kong and the United States. The Hang Seng Index climbed 34.2%, while the Dow rose 16.3%.

Our corporate investment recorded a net profit rise 1,060.9% in 2006 to HK$154.7 million. The majority of this increase was due to both the realized and unrealized year-on-year gains in the value of our investments, which were mainly in blue chip stocks on the Hong Kong and New York markets. This reflects the overall strength of the markets last year and our generally prudent but decisive approach to picking investments. A significant minority of the increase came from interest income from the funds arising from the proceeds from the sale of ACB in the first half of the year. Much of the rise in operating expenses was related to the sale, including fees and the transfer of some bank personnel to AFH.

On the operational level, Asia Insurance maintained its stable performance and its reputation and status as one of the leaders in the Hong Kong general insurance market. Its 196.4% rise in net profit to HK$260.4 million was mainly due to gains in blue chip investments, along with the interest income generated after an injection of additional capital into the company from the proceeds of the sale of ACB. The relatively minor year-on-year changes in turnover and underwriting profit reflect management's decision to limit exposure to extremely competitive parts of the Hong Kong general insurance market during the year. The company ended the year with strong levels of reserves and provisions. More details of the performance and prospects of Asia Insurance appear in the management discussion and analysis.

ACB contributed to the group for the first four months of the year up to the completion of its sale. Its net profit for that period was HK$49.0 million.

Staff

The Group had a total of 239 employees at the end of 2006, a decrease of 58% compared with the end of 2005. While remaining conscious of the need to manage costs carefully, we also sought to ensure that our salaries and conditions remained in line with the market and with the need to be able to attract and retain good quality people. We also continued to ensure that adequate resources were made available for training. The directors and I wish to take the opportunity to thank all our staff within the group for their dedication and hard work during 2006.

Management Strategy During the Year

The positive results of our investment and underwriting activities during the year reflect our longstanding management strategy to preserve shareholder value during bad times and capture additional value during good times, through a consistently prudent approach to risk. Examples of this approach in 2006 include the overweighting of investments in blue chips and the minimization of exposure to certain insurance market segments. These basic principles also guided management thinking on the subject of ACB. Management decided during 2005 that the time was right to renew the Group's strategic direction by reallocating resources into activities where it has its greatest strengths and prospects for growth. Following the sale of the bank for HK$4.58 billion, part of the proceeds were injected as additional capital into insurance activities, part was placed in the Holding Company's direct investment projects and trading portfolio, while the remainder was declared as special dividends and put on deposit to await future investment opportunities.

Outlook and Strategy for the Future

The outlook for the Group in 2007 is generally good. The only possible clouds on the horizon in the year ahead are a serious slowdown in the US economy and volatility in the markets. Either of these possibilities would have at least some effect on the Group, and we will manage our investment portfolios with due caution.

Following the sale of ACB, we will use some of the proceeds to invest in the expansion of our existing insurance interests, and additional capital has been injected into Asia Insurance in Hong Kong (HK$1.2 billion). We are also exploring possible new investments in insurance and health care – complementary areas in which we have relevant experience and which offer possible synergies and very attractive long-term growth prospects in this region. Given the scale of the possible opportunities that lie ahead, we are prepared to exercise patience in considering and selecting new investments. Our intention is to use this money to put the Group on the path to higher long-term returns.

In conclusion, I believe Asia Financial Group will enjoy another successful year in 2007 and I hope to report satisfactory interim results in six months' time.

Robin Y.H. Chan
Chairman

Hong Kong
27th March, 2007