

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.

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.

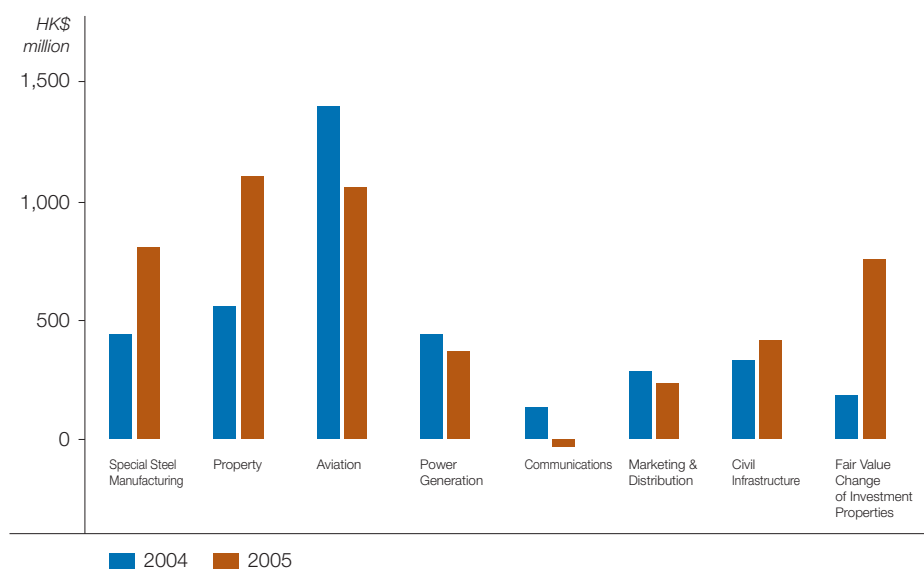
The Group applies all the relevant Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations (collectively referred to as the 'New HKFRSs') issued by the HKICPA that are effective for accounting periods beginning on or after 1 January 2005 set out in Note 2 to the summary financial statements.

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 2 to the summary financial statements on page 60. Within this section, 2004 figures have been adjusted in accordance with the accounting policies in force in 2005.

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



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.

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:

<i>HK\$ million</i>	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

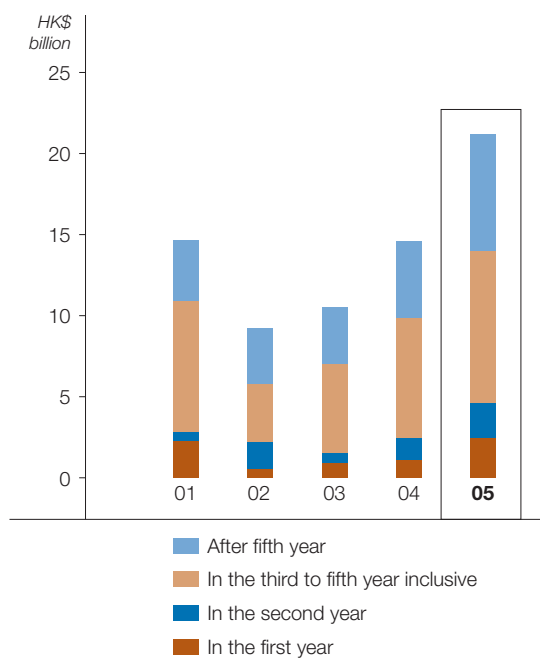
As shown above, cash contributions from most of the business segments increased compared to prior year. The significant increase from Communications was attributable to CITIC Telecom 1616 as a result of better management of account receivable. The Property sector also contributed strong cash flow because 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.

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.

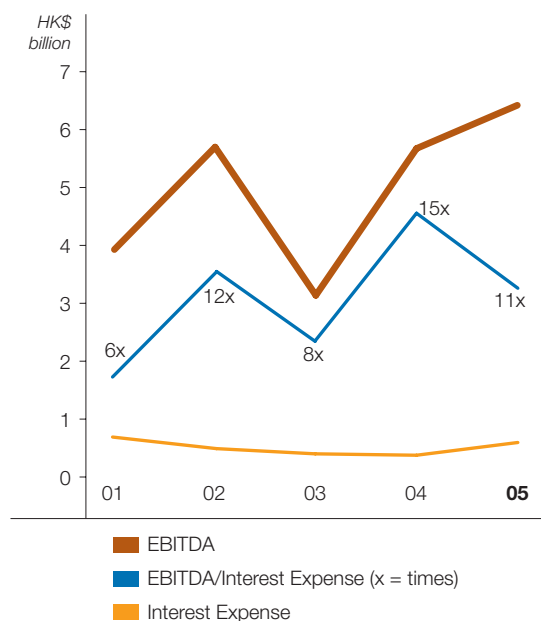
Total Debt



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



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.