招商銀行
CHINA MERCHANTS BANK

招商銀行股份有限公司
CHINA MERCHANTS BANK CO., LTD.

(a joint stock company incorporated in the People's Republic of China with limited liability)
(stock code: 3968)

2006 ANNUAL RESULTS ANNOUNCEMENT

The Board of Directors (the "Board") of China Merchants Bank Co., Ltd. is pleased to announce the audited annual results, which have been prepared in accordance with International Financial Reporting Standards ("IFRS") promulgated by the International Accounting Standards Board, of the Bank and its subsidiary (hereinafter called "the Company", "the Bank" or "the Group") for the year ended 31 December 2006. The Board and the Audit and Related Party Transactions Control Committee of the Board of the Company have reviewed and confirmed the audited annual results.

1 CORPORATE INFORMATION

1.1	Share listing:	
	A Share	: Shanghai Stock Exchange
	Abbreviated Name of Share	: CMB
	Stock Code	: 600036
	H Share	: The Stock Exchange of Hong Kong Limited ("SEHK")
	Abbreviated Name of Share	: CMB
	Stock Code	: 3968
	Convertible Bond	: Shanghai Stock Exchange
	Abbreviation of Convertible Bonds	: CMB Convertible Bonds
	Code of Convertible Bonds	: 110036
1.2	Registered Address	: No. 7088 Shennan Boulevard, Futian District, Shenzhen, Guangdong Province, China
	Mailing Address	: No. 7088 Shennan Boulevard, Futian District, Shenzhen, Guangdong Province, China
	Postcode	: 518040
	Telephone	: 86755-83198888
	Fax	: 86755-83195109
	E-mail	: cmb@cmbchina.com
	Website	: www.cmbchina.com
	Principal Place of Business in Hong Kong	: 21st Floor, Bank of America Tower, 12 Harcourt Road, Hong Kong
1.3	Legal Representative	: Qin Xiao
	Authorized Representatives	: Ma Weihua, Lan Qi
	Secretary of Board Of Directors	: Lan Qi
	Joint Company Secretaries	: Lan Qi, Seng Sze Ka Mee (FCIS, FCS, FHKIOD)
	Qualified Accountant	: Cheng Ting Nan (CPA, FCCA)
	Securities Representative	: Wu Jianbing

2 FINANCIAL HIGHLIGHTS

2.1 Financial Highlights

	2006	2005	Change
Results for the year	*(in millions of RMB)*		*+/(-)%*
Operating income	**24,866**	19,214	29.42
Profit before tax	**10,084**	6,462	56.05
Net profit attributable to the bank's equity holders	**6,794**	3,749	81.22
Per share	*(in RMB)*		*+/(-)%*
Dividend[1]	**0.12**	0.08	50.00
Basic earnings	**0.53**	0.34	55.88
Diluted earnings	**0.53**	0.33	60.61
Year-end net assets value	**3.75**	2.51	49.40
Year end (as at 31 December)	*(in millions of RMB)*		*+/(-)%*
Total shareholders' equity	**55,160**	25,998	112.17
Share capital	**14,703**	10,374	41.73
Total assets	**934,102**	734,613	27.16
Risk-weighted assets	**551,503**	423,312	30.28
Financial Ratios	*(%)*		*+/(-)*
Profitability ratios			
Return on average assets (after tax)	**0.81**	0.57	0.24
Return on average equity (after tax)	**16.74**	15.64	1.10
Net interest spread	**2.69**	2.67	0.02
Net interest margin	**2.72**	2.69	0.03
Percentage of operating income			
– Net interest income	**86.50**	86.61	(0.11)
– Non-interest income	**13.50**	13.39	0.11
Cost-to-income ratio[2]	**38.28**	41.10	(2.82)
Capital adequacy ratio			
Core capital adequacy ratio	**9.58**	5.57	4.01
Capital adequacy ratio	**11.40**	9.01	2.39
Total equity to total assets	**5.91**	3.54	2.37
Asset quality ratios			
Non-performing loan ratio[3]	**2.12**	2.58	(0.46)
Allowance for loan impairment losses to non-performing loans	**135.61**	111.04	24.57
Allowance for loan impairment losses to total loans and advances to customers	**2.88**	2.86	0.02

[1] Dividend per share of RMB0.12 in 2006 will be submitted to the general meeting of shareholders. The RMB0.08 dividend per share in 2005 did not include special dividend (RMB1.8 per 10 shares).

[2] Cost-to-income ratio is the operating expenses minus business tax and surcharge, and then divided by the operating income.

[3] Non-performing loan ratio is total non-performing loans divided by total loans and advances to customers.

2.2 Five-year Financial Summary

	2006	2005	2004	2003	2002(3)
Results for the year			*(in millions of RMB)*		
Operating income	**24,866**	19,214	15,676	11,169	8,154
Operating expenses	**11,091**	9,115	7,432	5,516	4,369
Provision for impairment losses	**3,691**	3,637	3,066	2,236	1,083
Profit before tax	**10,084**	6,462	5,178	3,417	2,703
Net profit attributable to the bank's equity holders	**6,794**	3,749	3,276	2,211	1,847
Per share			*(in RMB)*		
Dividend	**0.12**	0.08	0.11	0.09	0.12
Basic earnings	**0.53**	0.34	0.29	0.20	0.35
Diluted earnings	**0.53**	0.33	0.29	0.20	0.35
Year-end net assets value	**3.75**	2.51	3.21	3.22	2.95
Year end (as at 31 December)			*(in millions of RMB)*		
Share capital	**14,703**	10,374	6,848	5,707	5,707
Total shareholders' equity	**55,160**	25,998	21,958	18,354	16,829
Total liabilities	**878,942**	708,615	564,757	475,663	349,362
Deposits from customers	**773,757**	634,404	512,586	406,886	304,295
Total assets	**934,102**	734,613	586,715	494,017	366,191
Loans and advances to customers(1)	**549,420**	458,675	363,097	298,960	200,111
Key financial ratios			*(%)*		
Return on average assets (after tax)	**0.81**	0.57	0.61	0.51	0.59
Return on average equity (after tax)	**16.74**	15.64	16.25	12.57	16.99
Cost-to-income ratio	**38.28**	41.10	41.18	43.62	46.97
Non-performing loan ratio	**2.12**	2.58	2.88	3.15	5.99
Core capital adequacy ratio(2)	**9.58**	5.57	5.41	6.17	8.42
Capital adequacy ratio(2)	**11.40**	9.01	9.47	9.49	12.57

(1) Loans and advances to customers represent gross loans and advances to customers less allowance for loan impairment losses.

(2) The capital adequacy ratio as at 31 December 2003 is calculated based on the financial information prepared in accordance with the Accounting Standards for Business Enterprises issued by the Ministry of Finance (the "MOF"), the Accounting Regulations for Financial Enterprises (2001), and other relevant regulations issued by the MOF (collectively "PRC GAAP") and related guidelines of the People's Bank of China ("PBOC"). The capital adequacy ratios of the year 2004 and the years afterwards were calculated based on the related guidelines of China Banking Regulatory Commission ("CBRC").

(3) The applicable accounting policies adopted in the preparation of the financial statements for the year 2002 are differed from that of the year 2003, the Company considers the changes in those accounting policies will not result in material impact on the financial ratios.

3 FINANCIAL REPORT

(Expressed in millions of RMB unless otherwise stated)

3.1 Consolidated Income Statement

For the year ended 31 December

	2006	2005
Interest income	**33,990**	25,877
Interest expense	**(12,481)**	(9,235)
Net interest income	**21,509**	16,642
Fee and commission income	**2,988**	1,856
Fee and commission expense	**(474)**	(289)
Net fee and commission income	**2,514**	1,567
Other net income	**843**	1,005
Operating income	**24,866**	19,214
Operating expenses	**(11,091)**	(9,115)
Operating profit before provision	**13,775**	10,099
Provision for impairment losses	**(3,691)**	(3,637)
Profit before tax	**10,084**	6,462
Income tax	**(3,290)**	(2,713)
Net profit attributable to equity holders of the Bank	**6,794**	3,749
Dividends		
Declared and paid	**3,193**	753
Proposed in respect of current year	**1,764**	830
	4,957	1,583
	RMB	*RMB*
Earnings per share		
Basic	**0.53**	0.34
Diluted	**0.53**	0.33

3.2 Consolidated Balance Sheet

As at 31 December

	2006	2005
Assets		
Cash and balances with banks and other financial institutions	**20,861**	22,491
Balances with central bank	**82,372**	62,102
Placements with banks and other financial institutions	**88,171**	46,982
Loans and advances to customers	**549,420**	458,675
Investments	**178,885**	131,902
Fixed assets	**7,376**	6,777
Deferred tax assets	**2,260**	2,166
Other assets	**4,757**	3,518
Total assets	**934,102**	734,613
Liabilities		
Deposits from banks and other financial institutions	**68,854**	39,673
Placements from banks and other financial institutions	**7,749**	3,574
Deposits from customers	**773,757**	634,404
Financial liabilities at fair value through profit or loss	**106**	86
Certificates of deposit issued	**1,170**	1,211
Convertible bonds issued	**22**	5,184
Other debts issued	**9,987**	9,982
Current taxation	**2,652**	2,715
Other liabilities	**11,145**	8,286
Subordinated notes issued	**3,500**	3,500
Total liabilities	**878,942**	708,615
Shareholders' equity		
Share capital	**14,703**	10,374
Capital reserve	**27,536**	6,095
Surplus reserve	**2,377**	1,591
Investment revaluation reserve	**195**	404
Regulatory general reserve	**6,500**	3,000
Retained profits	**1,374**	2,918
Proposed profit appropriations	**2,475**	1,616
Total shareholders' equity	**55,160**	25,998
Total shareholders' equity and liabilities	**934,102**	734,613

3.3 Consolidated Statement of Changes in Equity

For the year ended 31 December

	2006							
	Share Capital	Capital Reserve	Surplus Reserve	Investment Revaluation Reserve	Regulatory General Reserve	Retained Profits	Proposed Profit Appropriations	Total
At 1 January 2006	10,374	6,095	1,591	404	3,000	2,918	1,616	25,998
Net profit for the year	–	–	–	–	–	6,794	–	6,794
H-Shares issued	2,420	–	–	–	–	–	–	2,420
Share premium arising from H-Shares issued	–	18,085	–	–	–	–	–	18,085
Appropriations to statutory surplus reserve and statutory public welfare fund for the year 2005	–	–	786	–	–	·	(786)	–
Proposed dividends:								
– for the year 2005	–	–	–	–	–	(153)	153	–
– for the year 2006	–	–	–	–	–	(1,764)	1,764	–
– special	–	–	–	–	–	(2,210)	2,210	–
Dividends for the year 2005 and special dividend paid	–	–	–	–	–	–	(3,193)	(3,193)
Transfer of retained profits to regulatory general reserve	–	–	–	–	3,500	(3,500)	–	–
Capital reserve transferred to share capital upon issue of A-Shares	971	(971)	–	–	–	–	–	–
Conversion of convertible bonds	938	4,327	–	–	–	–	–	5,265
Realised on disposal of available-for-sale financial assets	–	–	–	(42)	–	–	–	(42)
Changes in fair value of available-for-sale financial assets	–	–	–	(167)	–	–	–	(167)
Proposed appropriations to statutory surplus reserve for the year 2006	–	–	–	–	–	(711)	711	–
At 31 December 2006	14,703	27,536	2,377	195	6,500	1,374	2,475	55,160

	2005							
	Share Capital	Capital Reserve	Surplus Reserve	Investment Revaluation Reserve	Regulatory General Reserve	Retained Profits	Proposed Profit Appropriations	Total
At 1 January 2005	6,848	9,046	962	(65)	–	3,785	1,382	21,958
Net profit for the year	–	–	–	–	–	3,749	–	3,749
Appropriations to statutory surplus reserve and statutory public welfare fund for the year 2004	–	–	629	–	–	–	(629)	–
Dividends paid for the year 2004	–	–	–	–	–	–	(753)	(753)
Transfer of retained profits to regulatory general reserve	–	–	–	–	3,000	(3,000)	–	–
Capital reserve transferred to share capital upon issue of A-Shares	3,424	(3,424)	–	–	–	–	–	–
Conversion of convertible bonds	102	473	–	–	–	–	–	575
Realised on disposal of available-for-sale financial assets	–	–	–	110	–	–	–	110
Changes in fair value of available-for-sale financial assets	–	–	–	359	–	–	–	359
Proposed appropriations to statutory surplus reserve and statutory public welfare fund for the year 2005	–	–	–	–	–	(786)	786	–
Proposed dividends for the year 2005	–	–	–	–	–	(830)	830	–
At 31 December 2005	10,374	6,095	1,591	404	3,000	2,918	1,616	25,998

3.4 Consolidated cash flow statement

for the year ended 31 December 2006

	2006	2005
Operating activities		
Profit before tax	**10,084**	6,462
Adjustments for:		
– Impairment losses charged on loans and advances	**3,537**	3,575
– Impairment losses (released)/charged on deposits and placements with banks and other financial institutions	**(91)**	62
– Impairment losses charged on other assets	**245**	–
– Unwind of interest income on impaired loans	**(222)**	(244)
– Depreciation	**910**	854
– Amortisation of discount and premium of debt investments	**(267)**	152
– Amortisation of discount and premium of bonds issued	**7**	194
– Write-off of loans and advances, net of recoveries	**(270)**	(661)
– Net gain on debt investments	**(335)**	(276)
– Net gain on disposal of fixed assets	**(1)**	(4)
– Interest income on debt investments	**(3,652)**	(3,133)
– Interest expense on issued debts	**474**	407
Changes in operating assets and liabilities:		
Increase in balances and placements with banks and other financial institutions with original maturity over 3 months	**(6,910)**	(8,266)
Increase in discounted bills	**(4,309)**	(38,641)
Increase in loans and advances to customers	**(89,208)**	(59,605)
Decrease in other assets	**7,362**	379
Increase in deposits from customers	**139,353**	121,818
Increase in deposits and placements from banks and other financial institutions	**33,356**	10,251
Increase in other liabilities	**2,812**	1,408
Net cash inflow from operating activities	**92,875**	34,732
Income tax paid	**(3,410)**	(2,405)
Investing activities		
Payment for purchase of debt investments	**(157,403)**	(132,115)
Proceeds from redemption or disposal of debt investments	**104,685**	113,998
Interest received from debt investments	**3,526**	3,116
Payment for purchase of fixed assets	**(1,768)**	(1,256)
Proceeds from sale of fixed assets	**260**	43
Net cash outflow from investing activities	**(50,700)**	(16,214)
Net cash inflow before financing activities	**38,765**	16,113

	2006	2005
Financing activities		
Proceeds from H-Shares issuance	21,049	–
Cost of issuing shares, net of interest income	(544)	–
Payment of issuing expenses on other debts	–	(19)
Proceeds from issue of other debts	–	10,000
Dividends paid	(3,160)	(742)
Interest paid on issued debts	(465)	(257)
Net cash inflow from financing activities	16,880	8,982
Net increase in cash and cash equivalents	55,645	25,095
Cash and cash equivalents at 1 January	120,609	95,952
Effect of foreign exchange rate changes	(644)	(438)
Cash and cash equivalents at 31 December	175,610	120,609
Cash flows from operating activities include:		
Interest received	30,552	22,507
Interest paid	11,291	8,075

3.5 NOTES TO THE FINANCIAL STATEMENTS

1 Significant accounting policies

(a) Statement of compliance and basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") and its interpretations promulgated by the International Accounting Standards Board ("IASB"), and the disclosure requirements of the Hong Kong Companies Ordinance. These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on the SEHK. A summary of the significant accounting policies adopted by the Group is set out below.

All IFRSs in issue which are effective for the accounting period beginning on 1 January 2006 and which are relevant to the Group have been applied. IFRS 7 Financial Instruments: Disclosures ("IFRS 7") and Amendment to International Accounting Standard 1 Presentation of Financial Statements: Capital Disclosures, both of which were issued in August 2005 and which are effective for the period beginning on 1 January 2007, have not been adopted in these financial statements. IFRS 7 requires more detailed qualitative and quantitative disclosure primarily on fair value information and risk management. The Group has assessed the impact of IFRS 7 and concluded that IFRS 7 would only affect the level of details in the disclosure of the financial statements, and would not have an impact on the Group's results or the state of affairs of the Group or the Bank.

(b) Basis of measurement

Unless stated otherwise, the financial statements are presented in Renminbi ("RMB"), which is the Group's functional and presentation currency, rounded to the nearest million.

The financial statements are prepared using the historical cost basis except that financial assets and liabilities at fair value through profit or loss including derivatives, and available-for-sale assets are stated at their fair value; and certain non-financial assets are stated at deemed cost.

2 Income tax

(a) Income tax in the consolidated income statement represents:

	2006	2005
Current tax	**3,347**	3,025
Deferred tax	**(57)**	(312)
	3,290	2,713

(b) A reconciliation of income tax in the consolidated income statement and that calculated at the applicable tax rate is as follows:

	2006	2005
Profit before tax	**10,084**	6,462
Notional tax on profit before tax, calculated at the statutory tax rate of 33%	**3,328**	2,133
Add/(less) the tax effect of the following items:		
Non-deductible expenses	**198**	861
Non-taxable income	**(209)**	(237)
Different income tax rates in other areas	**(331)**	(133)
Others	**304**	89
Income tax expense	**3,290**	2,713

Note: The income tax rates applicable to the Bank's operations in certain areas such as Shenzhen Special Economic Zone and Urumqi are 15% and 16.5% respectively during the year.

3 Earnings per share

(a) Basic earnings per share

The calculation of basic earnings per share is based on the net profit attributable to the Bank's equity holders and the weighted average number of shares in issue, calculated as follows.

	2006	2005
Net profit	**6,794**	3,749
Weighted average number of shares in issue *(in millions of shares)*	**12,833**	11,166
Basic earnings per share *(in RMB)*	**0.53**	0.34

(b) ***Diluted earnings per share***

The calculation of diluted earnings per share is based on the diluted net profit and the weighted average number of shares in issue after adjusting for the effect of all dilutive potential shares, calculated as follows.

	2006	2005
Net profit	**6,794**	3,749
Interest expense on convertible bonds issued	**9**	282
Diluted net profit	**6,803**	4,031
Weighted average number of shares in issue *(in millions of shares)*	**12,833**	11,166
Effect of deemed conversion of convertible bonds *(in millions of shares)*	**60**	1,122
Weighted average number of shares in issue after dilution *(in millions of shares)*	**12,893**	12,288
Diluted earnings per share *(in RMB)*	**0.53**	0.33

4 Loans and advances to customers

Analysed by legal form of borrowers:

	2006	2005
Domestic enterprises:		
State-owned enterprises	**142,804**	111,779
Joint-stock enterprises	**42,642**	48,576
Other limited liability enterprises	**72,608**	47,619
Others	**44,783**	43,803
	302,837	251,777
Foreign-invested enterprises	**52,391**	43,418
Enterprises operating in the Mainland	**355,228**	295,195
Enterprises operating outside the Mainland	**4,655**	3,427
Corporate loans	**359,883**	298,622
Discounted bills	**103,836**	99,527
Retail loans	**101,983**	74,036
Gross loans and advances to customers	**565,702**	472,185

5 Proposed profit appropriations

	2006	2005
Statutory surplus reserve	**711**	393
Statutory public welfare fund	**–**	393
Dividends of RMB1.2 (2005: RMB0.8) per every 10 shares	**1,764**	830
Total	**2,475**	1,616

6 Segmental reporting

The Group's principal activities are commercial lending and deposits taking. The funding of existing retail and corporate loans are mainly from customer deposits.

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format as it is more relevant to the Group's operating activities.

For the purposes of segmental analysis, external net interest income/expense represents the net interest income earned or expenses incurred on banking business originated by these segments. Internal net interest income/expense represents the allocation of revenue to reflect the benefits of funding sources allocated to the business segments by way of internal funds transfer pricing mechanism. The internal funds transfer pricing mechanism has taken into account the structure and market returns of the assets and liabilities portfolio. Cost allocation is based on the direct cost incurred by the respective business segments and apportionment of management overheads. Inter-segment interest income and expenses recognised through the internal funds transfer pricing mechanism are eliminated in the consolidated results of the operations.

(a) Business segments

	Year ended 31 December 2006				
	Corporate banking	**Retail banking**	**Treasury business**	**Others and unallocated**	**Total**
External net interest income	**14,348**	**812**	**6,349**	**–**	**21,509**
Internal net interest (expense)/income	**(814)**	**4,086**	**(3,272)**	**–**	**–**
Net interest income	**13,534**	**4,898**	**3,077**	**–**	**21,509**
Net fee and commission income	**854**	**1,531**	**14**	**115**	**2,514**
Other net income/(expense)	**501**	**158**	**357**	**(173)**	**843**
Operating income/ (expense)	**14,889**	**6,587**	**3,448**	**(58)**	**24,866**
Operating expenses					
– depreciation	**(502)**	**(378)**	**(30)**	**–**	**(910)**
– others	**(5,380)**	**(4,129)**	**(667)**	**(5)**	**(10,181)**
	(5,882)	**(4,507)**	**(697)**	**(5)**	**(11,091)**
Provision for impairment losses	**(3,241)**	**(533)**	**83**	**–**	**(3,691)**
Total expenses	**(9,123)**	**(5,040)**	**(614)**	**(5)**	**(14,782)**
Profit/(loss) before tax	**5,766**	**1,547**	**2,834**	**(63)**	**10,084**
Capital expenditure	**975**	**735**	**58**	**–**	**1,768**
	31 December 2006				
Segment assets	**451,882**	**105,045**	**370,578**	**6,597**	**934,102**
Segment liabilities	**461,797**	**311,960**	**91,399**	**13,786**	**878,942**

	Year ended 31 December 2005				
	Corporate banking	Retail banking	Treasury business	Others and unallocated	Total
External net interest income	12,309	526	3,807	–	16,642
Internal net interest (expense)/income	(74)	3,488	(3,414)	–	–
Net interest income	12,235	4,014	393	–	16,642
Net fee and commission income	681	777	19	90	1,567
Other net income	379	107	418	101	1,005
Operating income	13,295	4,898	830	191	19,214
Operating expenses					
– depreciation	(470)	(350)	(34)	–	(854)
– others	(4,474)	(3,287)	(496)	(4)	(8,261)
	(4,944)	(3,637)	(530)	(4)	(9,115)
Provision for impairment losses	(3,176)	(399)	(62)	–	(3,637)
Total expenses	(8,120)	(4,036)	(592)	(4)	(12,752)
Profit before tax	5,175	862	238	187	6,462
Capital expenditure	691	515	50	–	1,256
	31 December 2005				
Segment assets	390,429	75,331	263,748	5,105	734,613
Segment liabilities	378,475	255,929	63,210	11,001	708,615

(b) Geographical segments

The Group operates principally in the PRC with branches located in major provinces, autonomous regions and municipalities directly under the central government.

In presenting information on the basis of geographical segments, operating income is allocated based on the location of the branches that generated the revenue. Segment assets and capital expenditure are allocated based on the geographical location of the underlying assets.

	2006											
	Eastern China		**Southern and Central China**		**Western China**		**Northern China**		**Others**		**Total**	
	Amount	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*
Total operating income *(note (i))*	13,280	35	12,830	34	3,692	10	7,462	20	557	1	37,821	100
Capital expenditure *(note (ii))*	509	29	898	51	123	7	233	13	5	–	1,768	100
Total assets	234,884	25	481,722	52	68,741	7	122,700	13	26,055	3	934,102	100
Gross loans and advances to customers	212,829	38	177,092	31	63,327	11	108,986	19	3,468	1	565,702	100
Total customer deposits	249,848	32	246,712	32	84,898	11	167,831	22	24,468	3	773,757	100

	2005											
	Eastern China		Southern and Central China		Western China		Northern China		Others		Total	
	Amount	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*
Total operating income *(note (i))*	9,573	33	9,940	35	3,124	11	5,857	20	244	1	28,738	100
Capital expenditure *(note (ii))*	459	37	431	34	217	17	149	12	–	–	1,256	100
Total assets	164,978	22	407,999	56	56,696	8	98,438	13	6,502	1	734,613	100
Gross loans and advances to customers	145,287	31	192,617	41	49,085	10	82,656	17	2,540	1	472,185	100
Total customer deposits	207,412	33	189,717	30	77,353	12	154,110	24	5,812	1	634,404	100

Notes: i Total operating income represents the operating income gross of interest expense and fee and commission expense.

ii Capital expenditure represents total amount incurred for acquiring assets that are expected to be used for some periods.

7 Contingent liabilities and commitments

(a) Credit commitments

At any given time the Group has outstanding commitments to extend credit. These commitments take the form of approved loans and credit card limits.

The Group provides financial guarantees and letters of credit to guarantee the performance of customers to third parties.

Acceptances comprise undertakings by the Group to pay bills of exchange drawn on customers. The Group expects most acceptances to be settled simultaneously with the reimbursement from the customers.

The contractual amounts of commitments and contingent liabilities are set out in the following table by category. The amounts reflected in the table for commitments assume that amounts are fully advanced. The amount reflected in the table for guarantees and letters of credit represents the maximum potential loss that would be recognised at the balance sheet date if counterparties failed completely to perform as contracted.

	2006	2005
Contractual amount		
Irrevocable guarantees	**37,063**	34,691
Irrevocable letters of credit	**28,323**	22,436
Bills of acceptances	**166,513**	123,525
Loan commitments		
– with an original maturity of under one year	**1,371**	878
– with an original maturity of one year or over	**5,172**	2,455
Credit card commitments	**31,694**	19,731
Shipping guarantees	**–**	22
	270,136	203,738

Loan commitments only include, credit limits granted to offshore customers and onshore and offshore syndicated loans. The Directors are of the opinion that the Group will not assume any risks on the unused credit limits for other loan customers as such limits are revocable. As a result, such balances are not included in the above contingent liabilities/commitments.

These commitments and contingent liabilities have off-balance sheet credit risk. Before the commitments are fulfilled or expire, management assesses and makes allowances for any probable losses accordingly. As the facilities may expire without being drawn upon, the total of the contractual amounts is not representative of expected future cash outflows.

	2006	2005
Credit risk weighted amounts of contingent liabilities and commitments:		
Contingent liabilities and commitments	**86,444**	68,095

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% of contingent liabilities and commitments.

There are no relevant standards prescribed by IFRSs in calculating the above credit risk weighted amounts.

The credit risk weighted amounts stated above have taken into account the effects of bilateral netting arrangements.

(b) Capital commitments

Authorised capital commitments not provided for were as follows:

	2006	2005
For purchase of fixed assets:		
– Contracted for	**126**	335
– Not contracted for	**–**	132

(c) Operating lease commitments

Total future minimum lease payments under non-cancellable operating leases of properties are payable as follows:

	2006	2005
Within 1 year	**739**	539
After 1 year but within 5 years	**1,852**	1,387
After 5 years	**696**	425
	3,287	2,351

The Group and the Bank lease a number of properties under operating leases. The leases typically run for an initial period of 1 to 20 years. Lease payments are usually increased every 1 to 10 years to reflect market rental. None of the lease include contingent rental.

(d) Outstanding litigations

As at 31 December 2006, the Group was a defendant in certain pending litigations with gross claims of RMB118 million (2005: RMB250 million) arising from its banking activities. Many of these proceedings are in relation to steps taken by the Bank to collect delinquent loans and enforce rights in collateral securing such loans. The Directors consider that no material losses would be incurred by the Group as a result of these pending litigations and therefore no provision has been made in the financial statements.

(e) ***Redemption obligations***

As an underwriting agent of PRC government bonds, the Group has the responsibility to buy back those bonds sold by it should the holders decide to early redeem the bonds held early. The redemption price for the bonds at any time before their maturity date is based on the coupon value plus any interest unpaid and accrued up to the redemption date. Accrued interest payable to the bond holders are calculated in accordance with the relevant rules of the MOF and the PBOC. The redemption price may be different from the fair value of similar instruments traded at the redemption date.

The redemption obligations below represent the nominal value of government bonds underwritten and sold by the Group, but not yet matured at the balance sheet date:

	2006	2005
Redemption obligations	**11,621**	11,604

The Group expects that the amount of redemption before the maturity date of these government bonds through the Group will not be material.

8 Use of derivatives

Derivatives are off-balance sheet financial instruments which include forward, swap and option transactions undertaken by the Group in the foreign exchange and interest rate markets.

The Group enters into financial derivative transactions for treasury business and its assets and liabilities management purpose.

Treasury business includes the formation and sale of financial derivatives to enable customers to transfer, change or mitigate existing or anticipated risks.

When there are mismatches in the interest rates of assets and liabilities, the Group will use interest rate swaps to swap fixed interest rates into floating interest rates.

For assets and liabilities denominated in foreign currencies, the Group will be exposed to risks due to the fluctuations of exchange rates. The Group will use currency swaps and forward contracts to mitigate these risks.

The following tables provide an analysis of the notional amounts of derivatives of the Group by maturity groupings based on the remaining periods to settlement and the corresponding fair values at the balance sheet date. The notional amounts of the derivatives indicate the transaction volume outstanding at the balance sheet date; they do not represent amounts at risk.

	2006						
	Notional amounts with remaining life of					**Fair values**	
	Less than 3 months	**Between 3 months and 1 year**	**Between 1 year and 5 years**	**More than 5 years**	**Total**	**Assets**	**Liabilities**
Interest rate derivatives							
Interest rate swaps	**5,023**	**6,740**	**6,243**	**1,006**	**19,012**	**108**	**(53)**
Currency derivatives							
Spot	**15,717**	**–**	**–**	**–**	**15,717**	**10**	**(9)**
Forwards	**1,803**	**2,526**	**470**	**–**	**4,799**	**17**	**(13)**
Foreign exchange swaps	**11,976**	**17,063**	**156**	**–**	**29,195**	**41**	**(1)**
Currency options	**22,950**	**176**	**–**	**–**	**23,126**	**27**	**(30)**
	52,446	**19,765**	**626**	**–**	**72,837**	**95**	**(53)**
Total						**203**	**(106)**

2005							
	Notional amounts with remaining life of					Fair values	
	Less than 3 months	Between 3 months and 1 year	Between 1 year and 5 years	More than 5 years	Total	Assets	Liabilities
Interest rate derivatives							
Interest rate swaps	1,272	4,949	3,907	294	10,422	39	(51)
Currency derivatives							
Spot	2,826	–	–	–	2,826	1	(1)
Forwards	364	3,481	–	–	3,845	39	(34)
Foreign exchange swaps	182	726	162	–	1,070	7	–
	3,372	4,207	162	–	7,741	47	(35)
Total						86	(86)

The replacement costs and credit risk weighted amounts in respect of these derivatives are as follows. These amounts take into account the effects of bilateral netting arrangements.

Replacement costs

	2006	2005
Interest rate derivatives	**108**	39
Currency derivatives	**95**	47
	203	86

Replacement cost represents the cost of replacing all contracts which have a positive value when marked to market. Replacement cost is a close approximation of the credit risk for these derivative contracts as at the balance sheet date.

Credit risk weighted amounts

	2006	2005
Interest rate derivatives	**100**	26
Currency derivatives	**107**	25
	207	51

The credit risk weighted amount refers to the amount as computed in accordance with the rules set out by the CBRC and depends on the status of the counterparty and the maturity characteristics.

9 Events occurred after the Balance Sheet Date

On 16 March 2007, the Tenth National People's Congress (NPC) plenary session passed a resolution of the draft corporate income tax law submitted by the standing committee of the Tenth NPC. According to the income tax law that was passed at the Tenth NPC plenary session, the Group's applicable income tax rate will be changed from 33% to 25% with effective from 1 January 2008. Given the resolution of the new tax law is a non-adjusting event after the balance sheet date, the Group did not apply the new income tax rate in preparing the financial statements for the year ended 31 December 2006. The Group is in the process of making an assessment of the impact of applying the new tax law on the Group's financial position. Except for the above, the Group had no material post balance sheet date events for disclosure.

3.6 Unaudited Supplementary Financial Information

Significant differences between the financial statements prepared under IFRSs and those prepared in accordance with the relevant accounting rules and regulations in the PRC

As a bank incorporated in the People's Republic of China ("PRC") and listed in Shanghai Stock Exchange, the Bank prepared its statutory financial statements for the year ended 31 December 2006 in accordance with the PRC GAAP. The above financial statements are named as "PRC statutory financial statements" for the purposes of this reconciliation.

A reconciliation of differences between the financial statements prepared under IFRSs and those PRC statutory financial statements are set out below.

	2006	2005
Net profit attributable to the Bank's equity holders under IFRSs	**6,794**	3,749
Foreign exchange translation	**313**	38
Net profit shown in PRC statutory financial statements *(Note)*	**7,107**	3,787

Note: There is no difference in the shareholders' equity as shown in the financial statements prepared under IFRSs and the PRC statutory financial statements as at 31 December 2005 and 31 December 2006.

Effective from 1 January 2006, the Bank has adopted the new Provisional Regulations On the Recognition and Measurement Of Financial Instruments No. 14 which are substantially consistent with IAS 39 on "Financial Instruments: Recognition and Measurement". 2005 comparative figures have been retrospectively adjusted.

4 MANAGEMENT DISCUSSION AND ANALYSIS

4.1 Financial Highlights

In 2006, in response to the market changes and macro-control policies, the Company adjusted its business structure to ensure proper business development and balanced development of profits, quality and scale, and achieved significant operating results.

4.1.1 Analysis of Income Statement

(1) Financial results highlights

	For the year ended 31 December	
	2006	2005
	(in millions of RMB)	
Net interest income	**21,509**	16,642
Net fee and commission income	**2,514**	1,567
Other net income	**843**	1,005
Operating expenses	**11,091**	9,115
Provision for impairment losses	**3,691**	3,637
Profit before tax	**10,084**	6,462
Income tax	**3,290**	2,713
Net profit attributable to equity holders of the Bank	**6,794**	3,749

In 2006, the Company's financial results achieved a strong growth while its profit growth was nearly 3 times that of the asset growth. The profit before tax was RMB10.084 billion, an increase of 56.05% compared to the previous year; net profit attributable to the Bank's equity holders was RMB6.794 billion, an increase of 81.22% compared to the previous year.

In 2006, the effective tax rate of the Company was 32.63%, a decrease of 9.35 percentage points compared to the year 2005. This is primarily due to the MOF of the PRC and the State Administration of Taxation approved the special deductible salary expenses on 9 April 2007. As such, the income tax payable by the Company was reduced by approximately RMB0.905 billion.

The net profit attributable to the Bank's equity holders for the year of 2006 was RMB6.794 billion which exceeded the amount as reported in the profit forecast announced (i.e. less then RMB5.5 billion) before the listing of H-shares of the Company by 23.53%, primarily attributable to the above deduction of income tax. The following table sets out the influences of major gains and losses on the profit before tax of the Company in 2006.

Changes in profit before tax	*(in millions of RMB)*
Profit before tax in 2005	**6,462**
Changes in 2006	
Net interest income	4,867
Net fee and commission income	947
Other net income	(162)
Operating expenses	(1,976)
Provision for impairment losses	(54)
Profit before tax in 2006	**10,084**

(2) ***Operating income***

In 2006, the operating income of the Company was RMB24.866 billion, an increase of 29.42% compared to the previous year. It was primarily due to rapid growth in interests income from loans and advances to customers, money market placements, and fee and commission income. Net interest income accounted for 86.50%, a decrease of 0.11 percentage point compared to the previous year; fee and commission income accounted for 10.11%, an increase of 1.95 percentage points compared to the previous year.

The following table set out the income structure of the Company in the past 5 years.

	For the year ended 31 December				
	2006	2005	2004	2003	2002
Net interest income	**86.50%**	86.61%	91.17%	90.60%	92.34%
Net fee and commission income	**10.11%**	8.16%	5.67%	5.00%	4.56%
Other net income	**3.39%**	5.23%	3.16%	4.40%	3.10%
Operating income	**100.00%**	100.00%	100.00%	100.00%	100.00%

(3) Net interest income

In 2006, the net interest income of the Company was RMB21.509 billion, an increase of 29.25% compared to the previous year. It was primarily attributable to the increase of average balance of and average return on interest-earning assets.

The following table sets out, for the period indicated, the average balance of assets and liabilities, interest income/interest expenses and average yield/cost of the Company. The average balance of interest earning assets and interest bearing liabilities is the daily average balance. The average balance of non-interest-earning assets and interest-bearing liabilities and average balance of allowances for impairment losses were the average balances for the year 2006 and 2005.

	For the year ended 31 December *(in millions of RMB, excluding percentages)*					
	2006			2005		
Assets	**Average balance**	**Interest income**	**Average yield (%)**	Average balance	Interest income	Average yield (%)
Loans and advances to customers	**526,122**	**26,891**	**5.11**	429,325	21,058	4.90
Debt investments	**124,520**	**3,919**	**3.15**	95,227	2,981	3.13
Balances with central bank	**66,431**	**1,044**	**1.57**	53,115	836	1.57
Placements with banks and other financial institutions	**74,103**	**2,136**	**2.88**	40,444	1,002	2.48
Total interest-earning assets	**791,176**	**33,990**	**4.30**	618,111	25,877	4.19
Provision for impairment losses	**(15,150)**	**–**	**–**	(12,682)	–	–
Non-interest-earning assets and assets held for trading purpose	**29,610**	**–**	**–**	29,970	–	–
Total assets and total interest income	**805,636**	**33,990**	**4.22**	635,399	25,877	4.07
Liabilities	**Average balance**	**Interest Expense**	**Average cost (%)**	Average balance	Interest Expense	Average cost (%)
Deposits from customers	**694,702**	**10,449**	**1.50**	550,719	7,558	1.37
Amounts due to banks and other financial institutions	**65,205**	**1,551**	**2.38**	46,303	1,076	2.32
Issued debts	**15,528**	**481**	**3.10**	11,881	601	5.06
Total interest-bearing liabilities	**775,435**	**12,481**	**1.61**	608,903	9,235	1.52
Non-interest-bearing liabilities	**12,629**	**–**	**–**	9,985	–	–
Total liabilities and interest expense	**788,064**	**12,481**	**1.58**	618,888	9,235	1.49
Net interest income	**–**	**21,509**	**–**	–	16,642	–
Net interest spread[1]	**–**	**–**	**2.69%**	–	–	2.67%
Net interest margin[2]	**–**	**–**	**2.72%**	–	–	2.69%

(1) Net interest spread is the difference between the average yield of total interest earning assets and the average cost of total interest-bearing liabilities.

(2) Net interest margin is net interest income divided by the average balance of total interest-earning assets.

The following table set out, for the period indicated, the distribution of changes in interest income and interest expenses resulting from changes in volume and rate of the Company: changes in volume are measured by change in average balances (daily average balance); changes in rate are measured by changes in average rates. Changes caused by both volume and rate have been allocated to changes in rate.

	For the year ended 31 December 2006 compared with the previous year		
	Increase/(decrease) resulting from		Increase/ (decrease)
	Scale	**Interest rate**	**Net value**
		(in millions of RMB)	
Assets			
Loans and advances to customers	4,748	1,085	5,833
Investments	917	21	938
Balances with central bank	210	(2)	208
Placements with banks and other financial institutions	834	300	1,134
Changes in interest income	6,709	1,404	8,113
Liabilities			
Deposits from customers	1,976	915	2,891
Amounts due to banks and other financial institutions	439	36	475
Issued debts	184	(304)	(120)
Changes in interest expense	2,599	647	3,246
Changes in net interest income	–	–	4,867

(4) ***Interest income***

In 2006, the interest income of the Company increased by 31.35% compared to the previous year, which was primarily attributable to an increase of average balance and average yield of loans and advances to customers and placements with banks and other financial institutions. Interest income from loans and advances to customers accounted for the majority of the interest income of the Company.

Interest income from loans and advances to customers

The following table sets out, for the period indicated, the average balances, interest income and average yield of respective components of loans and advances to customers of the Company.

	For the year ended 31 December					
	2006			2005		
	Average balance	**Interest income**	**Average yield (%)**	Average balance	Interest income	Average yield (%)
		(in millions of RMB, excluding percentages)				
Corporate loans	**336,814**	**18,853**	**5.60**	277,083	14,655	5.29
Retail loans	**84,320**	**4,967**	**5.89**	63,089	3,454	5.47
Discounted bills	**104,988**	**3,071**	**2.93**	89,153	2,949	3.31
Loans and advances to customers	**526,122**	**26,891**	**5.11**	429,325	21,058	4.90

The average balances of items in the table were on daily basis.

In 2006, the interest income from loans and advances to customers of the Company increased by 27.70% compared to the previous year. The increase of interest income is primarily driven by the following factors: (1) rapid economic growth in China, resulting in rapid development of corporate loans, mortgages and credit card business. the average balance of corporate loans increased by 21.56%, the average balance of retail loans increased by 33.65%, and the impact of the increasing average balance of loans and advances to customers accounted for 81.40% of the total increase in interest income. (2) the raise of interest rate twice for loans as announced by PBOC and the rise in US dollar interest rate, resulting in a rise in average yield of both loans and retail loans. Owing to the slump in the bills market in the first half of the year and rebounding in the second half of the year, the average yield of bills discounted was 2.93%, down by 38 BP compared with the previous year.

Interest income from investments

Interest income from investments was the second largest component of interest income of the Company, and the interest income from investments in 2006 increased by 31.47% compared to the previous year. It was primarily because the Company had anticipated increasing interest rates in RMB and foreign-currency markets and took appropriate measures to enjoy the benefits of several increases in USD interest rates and RMB interest rates, contributing to satisfactory yield of investment portfolios as a whole; in addition, recognizing the investment value of credit products, the Company stepped up investment in RMB credit-linked bonds, and the Company, as a tier-1 underwriter of commercial paper, benefited substantially from the price difference between primary and secondary markets, contributing to satisfactory performance of the portfolios.

Interest income from placements with banks and other financial institutions

In 2006, the interest income from placements with banks and other financial institutions increased by 113.17% compared to the previous year, and the contribution of interest income from placements with banks and other financial institutions to the total interest income increased from 3.87% in 2005 to 6.28% in 2006. Such an increase was primarily driven by two factors. One was that the Company had more funds from the proceeds of its H share issuance of RMB20.505 billion and raised by its Hong Kong Branch in domestic and overseas markets. The other was due to the increase of market rates.

(5) Interest expenses

In 2006, the interest expenses of the Company increased by 35.15% compared to the previous year. It was primarily attributable to the increase in average balance of deposits and average cost.

Interest expenses on deposits from customers

Deposits from customer are the major funding source of the Company. In 2006, the Company's interest expenses on deposits from customers increased by 38.25% compared to the previous year. The influence of increase in average balance and the change in average cost accounted for 68.35% and 31.65% respectively. With the raise of interest rate of RMB deposits and the USD interest rate, the overall funding cost increased to some degree. Increase of funding cost slowed down in the second half of the year, which was primarily due to the slow-down of the growth in higher yield time deposits, especially time deposits from retail customers as a result of the booming stock markets and issuance of funds.

The following table set forth, for the period indicated, the average balance, interest expense and average cost for corporate and retail deposits of the Company.

	For the year ended December 31 (in millions of RMB, excluding percentages)					
	2006			2005		
	Average balance	**Interest expense**	**Average cost (%)**	Average balance	Interest expense	Average cost (%)
Deposits from corporate customers						
Demand	**235,488**	**2,136**	**0.91**	194,522	1,924	0.99
Time	**176,897**	**4,158**	**2.35**	138,578	2,912	2.10
Subtotal	**412,385**	**6,294**	**1.53**	333,100	4,836	1.45
Deposits from retail customers						
Demand	**128,226**	**951**	**0.74**	104,593	713	0.68
Time	**154,091**	**3,204**	**2.08**	113,026	2,009	1.78
Subtotal	**282,317**	**4,155**	**1.47**	217,619	2,722	1.25
Total deposits from customers	**694,702**	**10,449**	**1.50**	550,719	7,558	1.37

The average balances of items in the table were on daily basis.

Interest expenses on amounts due to banks and other financial institutions

In 2006, interest expenses on amounts due to banks and other financial institutions increased by 44.14% compared to the previous year. It was primarily attributable to the increase in borrowings from banks and other financial institutions with greater transaction volume in the active stock markets in 2006.

Interest expenses on issued debts

In 2006, the interest expenses on issued debts decreased by 19.97% compared to the previous year, primarily due to significant amount of the convertible bonds issued by the Company on 10 November 2004 was converted into shares in 2006.

(6) Net interest spread and net interest margin

In 2006, the net interest spread of the Company was 2.69%, up by 2BP compared to the previous year. It was primarily because the average interest margin of the interest-earning assets of the Company increased from 4.19% in 2005 to 4.30% in 2006, up by 11BP, and the average cost of the interest-bearing liabilities increased from 1.52% in 2005 to 1.61% in 2006, up by 9BP.

In 2006, the net interest margin of the Company was 2.72%, up by 3BP compared to the previous year. Such an increase was primarily due to the raise of interest rate twice for loans and advances by PBOC in 2006 and the raise of interest rate once for time deposits, while the activity in the capital market slowed down the increase of time deposit interest rate, resulting in higher net interest margin. The net interest income increased by 29.25%, which was slightly higher than the 28% increase of total interest-earning assets.

(7) Net fee and commission income

In 2006, the contribution of fees and commissions to the total operating income of the Company increased to 10.11% from 8.16% in 2005. The following table set forth, for the period indicated, the principal components of net fee and commission income of the Company.

	For the year ended December 31	
	2006	2005
	(in millions of RMB)	
Fee and commission income	**2,988**	1,856
Bank card fees	**1,003**	570
Remittance and settlement fees	**607**	429
Agency services fees	**571**	315
Commissions from credit commitment and loan business	**267**	186
Trust service fees	**259**	101
Others	**281**	255
Fee and commission expenses	**(474)**	(289)
Net fee and commission income	**2,514**	1,567

In 2006, net fee and commission income of the Company increased by 60.43%. Such an increase was primarily attributable to increases in all categories of fees and commissions, particularly the bank card fees, agency services fee and remittance and settlement fees.

In 2006, the bank card fee income increased by 75.96% compared to the previous year. It was primarily due to increased issuance and transactions volume of bank cards, especially credit cards; of which, POS fee income was RMB548 million, representing an increase of 56% compared to the previous year; income from credit card cash advance and installment business was RMB0.32 billion, representing an increase of 188% compared to the previous year.

In 2006, the income from agency services increased by 81.27% compared to the previous year. The increase was primarily attributable to booming stock market in China during 2006, so that the Company stepped up marketing of its bancassurance and securities agency business.

In 2006, income from remittance and settlement service increased by 41.49% compared to the previous year. Such an increase was primarily driven by collection of personal account management fee and gradual expansion of the business scale and customer base, resulting in increased remittance and settlement transactions. In 2006, the personal account management fee of the Company was RMB0.12 billion, representing an increase of 300.7% compared to the previous year.

In 2006, commissions from credit commitment and loan business of the Company increased by 43.55% over the previous year, which was primarily attributable to the expanding customer base and enlarged business volume.

In 2006, income from trust service increased by 156.44% compared to the previous year, which was primarily attributable to significant increase in income from fund distribution business.

In 2006, fee and commission expenses increased by 64.01% compared to the previous year. The increase was primarily attributable to rapid growth of credit cards issuance. On the other hand, there was an increase in expenses on credit card service. Commissions on loan transfer business and ATM cross-bank withdrawals also recorded an increase.

(8) Other net income

In 2006, other net income of the Company decreased by 16.12% compared to the previous year. It was primarily due to increased net loss arising from currency translation as well as decreased net income on financial instruments at fair value through profit or loss. Other net income accounted for 3.39% of the operating income.

The following table set forth, for the period indicated, the principal components of other net income of the Company.

	For the year ended December 31	
	2006	2005
	(in millions of RMB)	
Net gain arising from foreign currency dealing	**607**	509
Net loss on foreign exchange	**(313)**	(38)
Net gain on financial instruments at fair value through profit or loss	**357**	428
Net (loss)/gain on disposal of available-for-sale financial assets	**(22)**	5
Distributions from investment in funds	**117**	25
Net gain on disposal of fixed assets	**1**	4
Rental income	**64**	59
Others	**32**	13
Total other net income	**843**	1,005

In 2006, net gain arising from foreign currency dealing increased by 19.25% compared to the previous year, which was primarily because the Company acted as RMB market maker in 2006 and launched new products such as personal options, resulting in increased volume of dealing activities.

In 2006, net loss on foreign exchange increased by 723.68% compared to the previous year, which was primarily due to the RMB appreciation against the proceeds from H shares issuance.

In 2006, net gain on financial instruments at fair value through profit or loss, decreased by 16.59% compared to the previous year, which was primarily attributable to lower transactions volume.

In 2006, the distributions for investment in funds increased by 368% compared to the previous year. The distributions were derived from investment in the foreign currency markets for the purpose of liquidity management. The significant return was primarily attributable to the increase in USD interest rate.

(9) Operating expenses

In 2006, the operating expenses were RMB11.091 billion, representing an increase of 21.68% compared to the previous year. The increase in operating expenses was 7.74 percentage points lower than the increase in operating income, reflecting that there was an increase in the efficiency. In 2006, the cost-to-income ratio was 38.28%, decreased by 2.82 percentage points compared to the previous year, which was primarily attributable to robust growth of the operating income of the Company.

The following table set forth, for the period indicated, the principal components of the operating expenses of the Company.

	For the year ended 31 December	
	2006	2005
	(in millions of RMB)	
Staff costs	**5,053**	4,241
Business tax and surcharges	**1,573**	1,219
Depreciation and rental expenses	**1,741**	1,547
Other general and administrative expenses	**2,724**	2,108
Total operating expenses	**11,091**	9,115

Staff costs constituted the majority of the operating expenses of the Company. In 2006, staff costs increased by 19.15% compared to the previous year, which was primarily due to increased headcounts and performance-based bonuses with the business expansion. In 2006, the Company recruited 2,549 employees, mainly for retail banking including credit card business. Depreciation and rental expenses increased by 12.54%, which was primarily due to increased capital expenditure on fixed assets including electronic equipments, in new branches and offices. Other general and administrative expenses increased by 29.22% and the business tax and surcharges increased by 29.04%, which was in line with the overall growth of business development and the operation of the Company.

(10) Provision for impairment losses

In 2006, provision for impairment losses was RMB3.691 billion, an increase of 1.48% compared to the previous year. The following table set forth, for the period indicated, the principal components of provision for impairment losses of the Company.

	For the year ended 31 December	
	2006	2005
	(in millions of RMB)	
Impairment losses charged/(released) on:		
– Loans and advances	**3,537**	3,575
– Deposits and placements with banks and other financial institutions	**(91)**	62
– Other assets	**245**	–
Total provision for impairment losses	**3,691**	3,637

Provision for impairment losses on loans and advances constituted the largest component of the provision for impairment losses. In 2006, provision for impairment losses on loan was RMB3.537 billion, representing a decrease of 1.06% compared to the previous year. For the details of the provision for impairment losses on loan and advances, please refer to the section headed "Loan Quality Analysis" of this section.

In 2006, the provision for impairment losses on deposits and placements with banks and other financial institutions was a release of RMB91 million, primarily due to a decrease in the history loss used in assessing the impairment of these assets.

Provision for impairment losses on other assets consisted primarily of provision for impairment losses on repossessed assets, which represented the difference between the estimated realizable value and the carrying value of our repossessed assets. In 2006, the provision for impairment losses on other assets of the Company was RMB0.245 billion.

4.1.2 Analysis of balance sheet

(1) Assets

As at 31 December 2006, the total assets of the Company were RMB934.102 billion, representing an increase of 27.16% compared to the previous year-end. The increase in total assets was primarily due to the increase in loans and advances to customers, securities investment and other financial assets, and placements with banks and financial institutions, which were the three major components of the Company's asset portfolio. The increase in these types of assets accounted for approximately 89.69% of the increase in total assets. The rapid increase in deposits from customers, placements from banks and other financial institutions, and proceeds from H Share IPO provided adequate funds for the asset growth of the Company.

In 2006, due to the continued strict control in loan growth, the increased efforts to diversify its assets, and the intensified investment in securities, the increase of investment in securities and other financial assets in the year was higher than the increase of loans. Meanwhile, to enhance the efficiency in fund use, the Company increased placements with other well-established banks and financial institutions. In particular, at the end of 2006, the Company responsively lent the funds raised through the IPO that were deposited with its Hong Kong Branch to other banks, resulting in a significant increase of placements with banks and other financial institutions.

The following table set forth, as at the dates indicated, the components of the total assets of the Company.

	As at 31 December			
	2006		2005	
	(in millions of RMB, excluding percentages)			
	Amount	**Percentage of total (%)**	Amount	Percentage of total (%)
Gross loans and advances to customers, total	**565,702**	**60.56**	472,185	64.28
Provision for impairment losses on loans and advances	**(16,282)**	**(1.74)**	(13,510)	(1.84)
Net loans to customers	**549,420**	**58.82**	458,675	62.44
Investment securities and other financial assets	**178,885**	**19.15**	131,902	17.96
Balances with the central bank	**82,372**	**8.82**	62,102	8.45
Cash and balances with banks and other financial institutions	**20,861**	**2.23**	22,491	3.06
Placement with banks and other financial institutions	**88,171**	**9.44**	46,982	6.40
Other assets	**14,393**	**1.54**	12,461	1.69
Total assets	**934,102**	**100.00**	734,613	100.00

Loans and advances to Customers

As at 31 December 2006, total loans and advances to customers amounted to RMB565.702 billion, representing an increase of 19.81% compared to the previous year; the percentage of total loans and advances to customers to the total assets was 60.56%, representing a decrease of 3.72 percentage points compared to the previous year.

Distribution of loans by product type

The following table set forth, as at the dates indicated, the loans and advances to customers by product type.

	As at 31 December			
	2006		2005	
	Amount	**As a Percentage to total loans to customer (%)**	Amount	As a percentage to total loan to customer (%)
	(in RMB million, excluding percentages)			
Corporate loans	**359,883**	**63.62**	298,622	63.24
Discounted bills	**103,836**	**18.35**	99,527	21.08
Retail loans	**101,983**	**18.03**	74,036	15.68
Total loans and advances to customers	**565,702**	**100.00**	472,185	100.00

In recent years, the Company continued to increase our efforts to expand our business in retail loans, and the proportion of our retail loans in the loan portfolio. As at 31 December 2006, retail loans accounted for 18.03% of the total loan to customers, representing an increase of 2.35 percentage points compared to the end of the previous year. Meanwhile, the Company increased the yield on discounted bills by speeding up the turnover of bills. As at 31 December 2006, discounted bills accounted for 18.35% of the total loans and advances to customers, which was lower when compared to the end of the previous year.

Corporate loans

As at 31 December 2006, corporate loans represented 63.62% of the total loans to customers. The following table set forth, as at the dates indicated, our corporate loans by product type.

	As at 31 December			
	2006		2005	
	Amount	**Percentage of total (%)**	Amount	Percentage of total (%)
	(in millions of RMB, excluding percentages)			
Working capital loans	**282,089**	**78.38**	242,524	81.21
Fixed asset loans	**60,427**	**16.79**	38,762	12.98
Trade finance	**12,204**	**3.39**	13,804	4.62
Others[1]	**5,163**	**1.44**	3,532	1.19
Total corporate loans	**359,883**	**100.00**	298,622	100.00

[1] Others consists primarily of factoring and corporate mortgage loans.

As at 31 December 2006, our corporate loans was amounted to RMB359.883 billion, an increase of 20.51% compared to the end of the previous year. Amongst all, the working capital loans increased by 16.31%, whose growth rate was steady; fixed asset loans increased by a slightly rapid rate of 55.89%, which was primarily attributable to the robust demand for fixed asset loans in quality industries such as communications, energy and transportation along with rapid economic growth in China, and the Company increased loans to the said industries as a result; trade finance loans decreased by RMB1.6 billion, primarily due to reduced demand for the said products as a result of the interest rate rise in USD loan market.

Discounted bills

As at 31 December 2006, our discounted bills were amounted to RMB103.836 billion, an increase of 4.33% compared to the previous year. Over the years, as the loss rate of discounted bills was relatively low, and the capital consumption was relatively small, the Company has continued to focus on the expansion of this business. However, owing to the increased fluctuations of market interest rates for the year, the Company appropriately adjusted its operational strategies, primarily by speeding up the turnover of bills to acquire earnings from the difference, so that the growth rate of the total discounted bills was lower accordingly.

Retail loans

As at 31 December 2006, our retail loans were amounted to RMB101.983 billion, increased by 37.75% compared to the end of the previous year. The increase was primarily due to continued growth of residential mortgage loans and rapid development of credit card business. The following table set forth, as at the dates indicated, our retail loans by product type.

	As at 31 December			
	2006		2005	
	(in millions of RMB, excluding percentages)			
	Amount	**Percentage of total (%)**	Amount	Percentage of total (%)
Residential mortgage loans	**81,383**	**79.80**	64,609	87.27
Automobile loans	**895**	**0.88**	1,144	1.55
Credit card balances	**10,146**	**9.95**	4,550	6.14
Others[1]	**9,559**	**9.37**	3,733	5.04
Total retail loans	**101,983**	**100.00**	74,036	100.00

(1) Consists primarily of retail loans secured by monetary assets, home improvement loans, education loans and general consumption loans.

As at 31 December 2006, our residential mortgage loans increased by 25.96% compared to the previous year, primarily due to the continued efforts made by the Company to expand the business of residential mortgage loans, and that the residential mortgage loans kept growing rapidly.

Our credit card balances increased by 122.99% compared to the end of the previous year. The relatively rapid increase was primarily due to the rapid growth of the credit card business of the Company.

As the Company continued to be prudent with automobile loans, the personal automobile loans decreased by RMB0.249 billion compared to the previous year.

(2) Investment Securities and Other Financial Assets

Investment securities and other financial assets of the Company included listed and unlisted securities dominated in RMB and foreign currencies. According to the requirements of IFRSs, the investment securities and other financial assets of the Company fell into the following catagories: financial assets at fair value through profit or loss, available-for-sale investments, held-to-maturity debt securities, and receivables.

The following table sets forth, as at the dates indicated, the components of the investment portfolio of the Company:

	As at 31 December *(in millions of RMB, excluding percentages)*			
	2006		2005	
	Amount	**Percentage of total (%)**	Amount	Percentage of total (%)
Financial assets at fair value through profit or loss	**7,960**	**4.45**	15,869	12.03
Available-for-sale investments	**109,476**	**61.20**	60,086	45.55
Held-to-maturity debt securities	**54,065**	**30.22**	48,711	36.93
Receivables	**7,384**	**4.13**	7,236	5.49
Total investment securities and other financial assets	**178,885**	**100.00**	131,902	100.00

Financial assets at fair value through profit or loss

The securities dealing activities of the Company was primarily in response to increased volumes of trading with our customers. As at 31 December 2006, the financial assets at fair value through profit or loss decreased by 50% compared to the end of the previous year. The decrease was primarily due to the change in the investment preference of our customers, reduced demand for the bond investments as a result of the supplementary investment after maturity of Chinese government bonds, listed bonds issued by policy banks and Central Bank bills.

The following table sets forth, as at the dates indicated, the components of the financial asset portfolio of the Company.

	As at 31 December	
	2006	2005
	(in millions of RMB)	
Financial assets at fair value through profit or loss		
PRC government bonds	**2,452**	5,523
PBOC bills	**1,993**	5,081
Bonds issued by policy banks	**1,952**	4,003
Others[(1)]	**1,563**	1,262
Total financial assets at fair value through profit or loss	**7,960**	15,869

(1) Consists of other bonds, equity investments and financial derivatives, etc.

Available-for-sale investments

As at 31 December 2006, the available-for-sale investments of the Company increased by 82.2%, represented 61.20% of the investment securities and other financial assets of the Company, which was the largest investment category of the Company. The increase was mainly due to the support of adequate liquidity generated from the increased deposits. Amongst all, (1) policy bank bonds have sovereign-equivalent credit ratings. With the significant increase in the issuing volumes, the Company increased the purchase of mid-to-short term policy bank bonds accordingly; (2) PBOC bills enjoyed the sovereign bond status. In recent years, PBOC adopted measures to control the currency supply, issued large amount of such bonds with maturities meeting the Company's requirements, and the sound yield and liquidity of such bonds could consistent with investment strategy of the Company, thus leading to the significant increase in its investments. (3) The increase in other bond investments was in line with the Company's investment directions and diversification, so as to meet the needs of effective risk control, enhance the gain of such portfolio. In general, the bonds consisted of the available-for-sale investments portfolio was mainly in mid-to-short term with relatively short average remaining maturity, sound liquidity, an appropriate degree of credit risk and market risk and controllable.

The following table sets forth, as at the dates indicated, the components of the available-for-sale investment portfolio of the Company.

	As at 31 December	
	2006	2005
	(in millions of RMB)	
Available-for-sale investments		
PRC government bonds	**7,387**	7,891
PBOC bills	**43,699**	27,502
Policy bank bonds	**26,411**	9,751
Other bonds	**25,017**	13,685
Other debt securities	**6,914**	1,211
Equity investments	**48**	46
Total available-for-sale investments	**109,476**	60,086

Held-to-maturity debt securities

As at 31 December 2006, the held-to-maturity debt securities of the Company increased by 10.99% compared to the end of the previous year. The increase was primarily due to the support of a steady growth of core liabilities business of the Company. Amongst all, (1) the decreased in PRC government bonds due to the relatively more of such bonds became mature while the new issuances of government bonds with tenor that met the Company's requirement decreased; (2) a larger growth of policy bank bonds, as there were more new issued policy bank bonds that met the maturity preferences of the Company.

Such held-to-maturing portfolio has higher credit quality, it consisted most of the floating-rate bonds held by the Company. These coupon rates of these bonds would be changed and adjusted according to the statutory benchmark rates. With the gradual increase in the PBOC's benchmark interest rate, the bond portfolio would have good investment return, with average remaining maturity of no more than 5 years and controllable risk in general.

The following table sets forth, as at the dates indicated, the components of held-to-maturity debt securities of the Company.

	As at 31 December	
	2006	2005
	(in millions of RMB)	
Held-to-maturity debt securities		
PRC government bonds	**13,802**	15,765
PBOC bills	**2,270**	1,137
Policy bank bonds	**28,626**	23,532
Other bonds	**9,367**	8,277
Total held-to-maturity debt securities	**54,065**	48,711

Receivables

Receivables are certificated government bonds held by the Company in the form of contracting underwriting. As at 31 December 2006, the account receivable of investments increased by RMB0.148 billion over the end of the previous year. The fluctuation mainly resulted from such acts as issuing, falling in maturity of and encashing certificated government bonds before maturity.

Carrying value and fair value

All financial assets classified as at fair value through profit or loss and the available-for-sale investments were stated at market value or at fair value. Due to the Company's intention and ability to hold these investments to maturity despite the lack of market value, the Company considers no provision for impairment losses is required as full recoverability is anticipated at maturity.

The following table sets forth, as at the dates indicated, the carrying value and the market value of the held-to-maturity debt securities in our investment portfolio:

	As at 31 December			
	2006		2005	
	(in millions of RMB)			
	Book value	**Market/ fair value**	Book value	Market/ fair value
Held-to-maturity debt securities	**54,065**	**54,335**	48,711	48,997

Investment concentration

The following table sets forth, as at December 31, 2006, our investment securities and other financial assets whose carrying value exceeded 10% of our shareholders' equity.

	As at 31 December 2006			
	Book value	**Percentage of total investment securities and other financial assets (%)**	**Percentage of total shareholder's equity (%)**	**Market/ fair value**
The PBOC	47,962	26.81	86.95	47,954
The Ministry of Finance	29,119	16.28	52.79	29,265
China Development Bank	41,992	23.47	76.13	42,118
The Export-Import Bank of China	6,113	3.42	11.08	6,114
Agriculture Development Bank of China	8,954	5.01	16.23	8,954
Total	134,140	74.99	–	134,405

(3) Liabilities

As at 31 December 2006, the total liabilities of the Company amounted to RMB878.942 billion, an increase of 24.04% compared to the end of the previous year. Total deposits from customers was RMB773.757 billion, an increase of 21.97% compared to the previous year, representing 88.03% of the total liabilities of the Company, and was the major source of funding of the Company. The increase of liabilities was primarily due to a rapid growth of deposits from customers and inter-bank borrowings.

The following table sets forth, as at the dates indicated, the components of the total liabilities of the Company.

	As at 31 December (in millions of RMB, excluding percentages)			
	2006		2005	
	Amount	**Percentage of the total (%)**	Amount	Percentage of the total (%)
Deposits from customers	**773,757**	**88.03**	634,404	89.53
Deposits from banks and other financial institutions	**68,854**	**7.83**	39,673	5.60
Placements from banks and other financial institutions	**7,749**	**0.89**	3,574	0.50
Certificates of deposit issued	**1,170**	**0.13**	1,211	0.17
Convertible bonds issued	**22**	**0.00**	5,184	0.73
Subordinated notes issued	**3,500**	**0.40**	3,500	0.49
Other debts issued	**9,987**	**1.14**	9,982	1.41
Other liabilities	**13,903**	**1.58**	11,087	1.57
Total liabilities	**878,942**	**100.00**	708,615	100.00

Deposits from customers

The Company provides demand and time deposit products to corporate and retail customers. The following table sets forth, as at the dates indicated, the deposits from customers by product type and customer type.

	As at 31 December			
	2006		2005	
	Amount	**Percentage of the total (%)**	Amount	Percentage of the total (%)
	(in millions of RMB, excluding percentages)			
Corporate deposits				
Demand	**257,235**	**33.24**	219,230	34.56
Time	**204,563**	**26.44**	159,245	25.10
Subtotal	**461,798**	**59.68**	378,475	59.66
Retail deposits				
Demand	**152,449**	**19.70**	118,566	18.69
Time	**159,510**	**20.62**	137,363	21.65
Subtotal	**311,959**	**40.32**	255,929	40.34
Total deposits from customers	**773,757**	**100.00**	634,404	100.00

The Company has put continued emphasis on developing deposit business. Deposits from customers of the Company maintained high growth as a result of rapid economic growth in the PRC, increased disposable income of the public, increased PBOC's deposit interest rate. As at 31 December 2006, deposits from customers of the Company amounted to RMB773.757 billion, an increase of 21.97% compared to the previous year.

Although booming of the stock markets in the second half of 2006 affected retail deposits of commercial banks including the Company, the percentage of retail deposits to total deposits from customers of the Company amounted to 40.32%, maintaining a relatively higher level among the banks, and basically of the same as in 2005, reflecting the Company's strategy and efforts to focus on retail business.

Owing to increased interest spread between time deposit and demand deposit after PBOC adjusted the deposit interest rate, time deposits of the Company grew faster than demand deposits, and time deposits accounted for a slightly larger percentage of the total deposits. However, as the stock markets became more active in the second half of the year, the increase of time deposits, especially retail time deposits, slowed down to some extent. The proportion of corporate fixed-term deposits accounted for 47.05% of the deposits from customers, an increase of 0.30 percentage point compared to the previous year; amongst all, the proportion of corporate fixed-term deposits accounted for 44.30% of the corporate deposits, an increase of 2.22 percentage points compared to the previous year. The proportion of retail fixed-term deposits accounted for 51.13% of the retail deposits, a decrease of 2.54 percentage points compared to the previous year.

(4) Shareholder's equity

	As at 31 December	
	2006	2005
	(in millions of RMB)	
Share capital	**14,703**	10,374
Capital reserve	**27,536**	6,095
Surplus reserve	**2,377**	1,591
Investment revaluation reserve	**195**	404
Regulatory general reserve	**6,500**	3,000
Retained profits	**1,374**	2,918
Proposed profit appropriations	**2,475**	1,616
Total shareholder's equity	**55,160**	25,998

The significant increase of share capital and capital reserve of the Company was primarily due to the amount of RMB20.505 billion of the public offering of H Shares of the Company.

4.1.3 Loan quality analysis

Asset quality analysis on loan classification

The Company evaluates and supervises the quality of loan portfolios through the loan classification system. The Company formulated and implemented five-tier loan classification system in accordance with the relevant guidelines of CBRC. Meanwhile, to strengthen internal risk management and monitoring, the Company further classified the normal and special-mention loans. For more information about classification standard, refer to "Risk Management – Credit Risk Management" in this annual report.

(1) Distribution of loan portfolios by loan classification

The following table sets forth, as at the dates indicated, the loan portfolios divided by loan quality. Under the 5-tier loan classification, the non-performing loans of the Company are classified into substandard, doubtful and loss.

	As at 31 December *(in millions of RMB, excluding percentages)*			
	2006		2005	
	Amount	**Percentage of the total (%)**	Amount	Percentage of the total (%)
Normal	**542,238**	**95.85**	445,504	94.35
Special mention	**11,458**	**2.03**	14,514	3.07
Substandard	**3,342**	**0.59**	4,924	1.04
Doubtful	**5,092**	**0.90**	4,752	1.01
Loss	**3,572**	**0.63**	2,491	0.53
Total loans and advances to customers	**565,702**	**100.00**	472,185	100.00
Total Non-performing loans	**12,006**	**2.12**	12,167	2.58

In 2006, the Company continued to benefit from "quality industries and quality customers", and with the implementation of credit management framework and risk culture, the Company was able to gradually improve credit management and loan quality. In 2006, the Company succeeded in reducing non-performing loans, and non-performing loan ratio. The year-end non-performing loan balance was RMB12.006 billion, decreased by 0.161 billion compared to the previous year; year-end non-performing loan ratio was 2.12%, decreased by 0.46 percentage point compared with the beginning of the year.

In 2006, the Company took the following measures to effectively manage and control non-performing loans: (1) implementing target-based management on non-performing loan recovery by formulating Measures of China Merchants Bank for Rewarding Recovery of Non-Performing Assets; (2) reporting, checking and announcing new non-performing loans, thereby effectively preventing the occurrence and deterioration of non-performing loans; (3) establishing and improving bank-wide non-performing loan management framework and setting up Special Assets Management Centre at the headquarters, thereby effectively centralized recovery and management of bank-wide non-performing loans; (4) upgrading the credit information system, risk warning system and credit retreat mechanism; (5) improving the credit risk management procedure, formulating and amending credit examination and approval regulations such as Regulations on Headquarters Risk Control Committee, Headquarters Credit Examination and Approval System, and Regulations on Due Diligence Investigation for Credit Loans of China Merchants Bank, conducting industry-specific credit examination, implementing professional and vertical management on credit risks and improving the credit examination, approval and decision-making system, thereby controlling non-performing loans from the very beginning.

(2) Allocation of loans and non-performing loans by product type

The following table sets forth, as at the dates indicated, our loans to customers and non-performing loans by product type.

	As at 31 December (in millions of RMB, excluding percentages)					
	2006			2005		
	Total loan balance	**Total non-performing loans**	**Non-performing loan ratio[1] (%)**	Total loan balance	Total non-performing loans	Non-performing loan ratio[1] (%)
Corporate loans	**359,883**	**11,452**	**3.18**	298,622	11,707	3.92
Working capital loans	**282,089**	**9,903**	**3.51**	242,524	10,554	4.35
Fixed asset loans	**60,427**	**796**	**1.32**	38,762	611	1.58
Trade finance	**12,204**	**240**	**1.97**	13,804	101	0.73
Others[2]	**5,163**	**513**	**9.94**	3,532	441	12.49
Discounted bills[3]	**103,836**	**0**	**0.00**	99,527	0	0.00
Retail loans	**101,983**	**554**	**0.54**	74,036	460	0.62
Residential mortgage loans	**81,383**	**322**	**0.40**	64,609	320	0.50
Credit card balances	**10,146**	**155**	**1.53**	4,550	78	1.71
Automobile loans	**895**	**54**	**6.03**	1,144	45	3.93
Others[4]	**9,559**	**23**	**0.24**	3,733	17	0.46
Total loans to customers	**565,702**	**12,006**	**2.12**	472,185	12,167	2.58

(1) Percentage of a certain category of non-performing loan to the total loan of the said category.

(2) Loans of this category were mainly factoring and corporate mortgage loans, including non-performing commercial acceptance discounted bills.

(3) Excluding non-performing commercial acceptance discounted bills described in Note (2). Once commercial acceptance bills are classified as non-performing, the Company will state them as non-performing corporate loans.

(4) Including retail loans secured by monetary assets, home improvement loans, education loans and general consumption loans.

At 31 December 2006, non-performing corporate loans decreased by RMB0.255 billion, and non-performing loan ratio decreased by 0.74 percentage point. The improved quality of corporate loans was primarily attributable to credit policies and industry research, implementation of industry-specific credit systems such as credit examination system and credit officer assignment system, thereby strictly controlling credit access standard and effectively preventing credit risk.

At 31 December 2006, non-performing loan retail ratio decreased by 0.08 percentage point. Specifically, home mortgage non-performing loan ratio decreased by 0.10 percentage point and credit card balances of non-performing loan ratio decreased by 0.18 percentage point. Automobile retail ratio increased by 2.10 percentage points over the beginning of the year, primarily because the balance of automobile loans decreased by RMB0.249 billion compared to the previous year.

(3) Allocation of loans and non-performing loans by industry sectors

The following table sets forth, as at the dates indicated, the distribution of loans and non-performing loans by industry.

	As at 31 December *(in millions of RMB, excluding percentages)*					
	2006			2005		
	Loan balance	**Non-performing loan balance**	**Non-performing loan ratio[1] (%)**	Loan balance	Non-performing loan balance	Non-performing loan ratio[1] (%)
Corporate loans	**359,883**	**11,452**	**3.18**	298,622	11,707	3.92
Transportation and communications	**81,789**	**505**	**0.62**	66,154	669	1.01
Manufacturing	**82,527**	**3,168**	**3.84**	75,735	3,351	4.42
Energy and raw materials	**62,046**	**594**	**0.96**	44,820	351	0.78
Construction	**12,562**	**108**	**0.86**	11,305	129	1.14
Trade	**30,983**	**2,500**	**8.07**	33,966	2,345	6.90
Real estate	**26,775**	**2,373**	**8.86**	20,089	2,830	14.09
Investment management	**23,840**	**790**	**3.31**	16,604	409	2.46
Hospitality	**9,514**	**659**	**6.93**	7,513	659	8.77
Others[2]	**29,847**	**755**	**2.53**	22,436	964	4.30
Discounted bills	**103,836**	**0**	**0.00**	99,527	0	0.00
Retail loans	**101,983**	**554**	**0.54**	74,036	460	0.62
Total non-performing loans	**565,702**	**12,006**	**2.12**	472,185	12,167	2.58

(1) Percentage of a certain category of non-performing loan to the total loans of the said category.

(2) Consists primarily of education, public utility, government agencies, finance, etc.

In 2006, both the non-performing loan balance and non-performing loan ratio of the Company decreased in real estate, manufacturing, transportation and communications, and construction. The improved loan quality was primarily attributable to the Company's growing credit risk management capacity and intensive integrated management on credit orientation.

The non-performing loan ratio for trade, investment management, energy and raw materials increased to some extent in 2006, which was primarily attributable to such factors as macro control in China, big fluctuations in the prices of energy and raw materials on the international markets, intensified trade barriers worldwide, deteriorating operating environment, increased industry risks, and poor operations and decreased solvency of some borrowers.

(4) *Allocation of loans by collateral*

The following table sets forth, as at the dates indicated, the allocation of our loan portfolios by collateral.

	As at 31 December *(in millions of RMB, excluding percentage)*			
	2006		2005	
	Balance	**Percentage of total (%)**	Balance	Percentage of total (%)
Loans secured by monetary assets[(1)]	**145,870**	**25.79**	135,449	28.69
Loans secured by tangible assets, other than monetary assets	**132,943**	**23.50**	99,435	21.06
Guaranteed loans	**154,830**	**27.37**	137,192	29.05
Unsecured loans	**132,059**	**23.34**	100,109	21.20
Total loans and advances to customers	**565,702**	**100.00**	472,185	100.00

(1) Primarily consists of loans guaranteed by pledged deposits, financial instruments (including discounted bills) and account receivables of future cash flow.

In 2006, loans (including loans secured by monetary assets and secured by tangibles assets, other than monetary assets) collateralized by assets accounted for 49.29% of the loan portfolios of the Company, a decrease of 0.46 percentage points compared to the previous year. Amongst all, the percentage of loans secured by tangible assets, other than monetary assets increased by 2.44 percentage points, which was primarily because the Company had been taking collateral as an important means to mitigate credit risk; the percentage of loans secured by monetary assets decreased by 2.90 percentage points, which was primarily attributable to the decreased balance of discounted bills (which was classified as loans secured by monetary assets) in the loan and advances to customers, decreasing from 21.08% in 2005 to 18.35% in 2006. The percentage of unsecured loans increased by 2.14 percentage points compared to the previous year, due to the increased percentage of unsecured loans granted by the Company to quality customers in the quality industries.

(5) Movements of allowances for impairment losses on loans and advance to customers

The following table sets forth, for the period indicated, the movements of allowances for impairment losses on loans and advance to customers of the Company.

	As at 31 December	
	2006	2005
	(in millions of RMB)	
At 1 January	**13,510**	10,920
Charge for the year	**4,152**	4,031
Releases for the year	**(615)**	(456)
Unwinding of discount[1]	**(222)**	(244)
Recoveries of loans and advances previously written off	**58**	84
Write-offs	**(328)**	(745)
Transfers out[2]	**(188)**	(2)
Exchange differences	**(85)**	(78)
At 31 December	**16,282**	13,510

(1) Represents the interest income accrued on impaired loans as a result of subsequent increases in their present values due to the passage of time.

(2) Represents transfers out of loan loss allowance resulting from the transfer of loans and advances to customers to repossessed assets.

At the end of 2006, provision for impairment losses on loans and advances to customers of the Company was RMB16.282 billion, and the provision coverage (total provisions for impairment losses on loans and advances to customers/total non-performing loans) was 135.61%. Balance of loan loss allowance increased 2.772 billion compared to the previous year primarily due to: (1) total loans and advances to customers increased by 19.81%; (2) deterioration in certain loans and downgrading; (3) the estimated recoverable amount of certain non-performing loans decreased with the passage of time.

4.1.4 Analysis of capital adequacy ratio

The Company calculated capital adequacy ratio according to the guideline "Regulation Governing Capital Adequacy of Commercial Banks" issued by CBRC on 23 February 2004.

The Company adopts a prudent capital management policy and supports business development with adequate capital base. As at 31 December 2006, the capital adequacy ratio of the Company was 11.40%, up by 2.39 percentage points compared to the previous year. The increase was primarily due to the Company's issuance of H Shares in its IPO exercise during 2006, which brought RMB20.505 billion net proceeds. In addition, as at 31 December 2006, the convertible bonds of the Company were converted into shares and reported as core capital, totaling RMB6.478 billion, which also contributed to the increase of core capital adequacy ratio of the Company.

The following table sets forth, as at the dates indicated, the capital adequacy ratio and its related components.

	As at 31 December	
	2006	2005
	(in millions of RMB, excluding percentages)	
Core capital		
Paid-up ordinary share capital	**14,703**	10,374
Reserves	**38,422**	13,466
Total core capital	**53,125**	23,840
Supplementary capital		
General provisions for doubtful debts	**8,005**	6,135
Term subordinated bonds	**2,100**	2,800
Convertible bonds	**22**	5,864
Investment revaluation reserve	**136**	–
Total supplementary capital	**10,263**	14,799
Eligible supplementary capital	**10,263**	14,799
Total capital base before deduction	**63,388**	38,639
Deductions:		
Investments in unconsolidated subsidiary and other long-term investments	**125**	108
Investments in commercial real estate	**406**	409
Total capital base after deductions	**62,857**	38,122
Risk-weighted assets	**551,503**	423,312
Core capital adequacy ratio	**9.58%**	5.57%
Capital adequacy ratio	**11.40%**	9.01%

4.2 Business Operations

4.2.1 Retail banking segment

The Company provides retail customers with diversified retail banking products and services, including retail loan, deposit, debit card, credit card, wealth management service, investment service, agency sale of insurance products and fund products, forex trading, and foreign exchange service, of which "All-in-one Card", credit card, "Borrow & Repay Anytime", "Sunflower" and personal internet banking have won wide spread recognition. The Company provides the above services and products via diversified channels, including branches and sub-branches, self-service centers, ATM, CDM, internet banking and telephone banking service system. As at 31 December 2006, the retail loan balance of the Company was RMB101.983 billion, accounting for 18.03% of total loans and advances to customers; retail deposit balance was RMB311.959 billion, accounting for 40.32% of deposits from customers; operating income from retail banking accounted for 26.49% of the total operating income.

Retail loans

The Company provides retail customers with various loan products. In 2006, in view of the fierced competition in retail loans (mainly the residential mortgage loans) and intensified macro control on real estate, the Company made greater efforts to innovate and promote retail loan products, launching new products such as "Borrow & Repay Anytime", thereby enhancing the development of credit card business, further sharpening the overall competitive edge of retail loans. As at 31 December 2006, the percentage of retail loan of total loans and advances to customers increased by 2.35 percentage points, total retail loans increased by 37.75% compared to the previous year, of which the total residential mortgage loan increased by 25.96% compared to the previous year while the total receivables of credit cards increased by 122.99% compared to the previous year.

Retail deposits

The retail deposit products of the Company mainly consist of demand deposits, time deposits and call deposits. Retail deposits are the most important source of low-cost funding of the Company. In 2006, in response to the attraction of extensive retail deposits to the active capital markets, the Company stepped up the marketing activities such as Payroll services. In 2006, the percentage of retail deposits of total deposits from customers remained at a similar level as that of the previous year; of the retail deposits, the percentage of demand deposits increased by 2.54 percentage points to 48.87%.

Retail non-interest income business

The Company keeps developing non-interest income business in recent years, which is now on the right track of development. In 2006, the non-interest income from retail banking was RMB2.097 billion, up by 91.07% compared to the previous year. Amongst all, income from POS business was RMB548 million, an increase of 56.1% compared to the previous year; income from securities agency services was RMB0.227 billion, an increase of 383.7% compared to the previous year; and income from fund agency services was RMB0.21 billion, an increase of 442% compared to the previous year. Income from agency sale of insurance was RMB0.06 billion, an increase of 115% compared to the previous year; income from credit card non-interest business was RMB0.74 billion, an increase of 80.7% compared to the previous year. Amongst all, POS service charge was RMB0.376 billion, an increase of 65% compared to the previous year; the annual fee was RMB60.15 million, up by 16.8%; and the installment service charge was RMB71.79 million, an increase of 560% compared to the previous year.

Bank card business

As at 31 December 2006, the Company had cumulatively issued 38.849 million All-in-one cards, including 2.09 million cards newly issued during the year. All-in-one Card deposit balance was RMB240.68 billion, accounting for 77.15% of the total retail deposits, representing RMB6,195 average balance per card. As at 31 December 2006, the Company had issued 10.34 million credit cards, including 5.17 million cards issued during the year. The total number of cards in circulation was 7.12 million, the total number of card holders was 4.47 million, the cumulative transaction volume via credit cards was RMB66.4 billion, and the revolving credit balance was RMB3.6 billion.

Customers

As at 31 December 2006, the total number of retail deposit accounts of the Company was 23.79 million, and deposit balance was RMB311.959 billion. Among them, the total number of high-end customers (Sunflower customers, with more than RMB0.5 million deposit in the Company) was 0.142 million, and their deposit balance was RMB115.09 billion, accounting for 36.89% of the retail deposit balance of the Company.

Marketing

With the sustained efforts of the Company in brand building for its products and services, the brands such as All-in-one Card and credit cards have gained satisfactory recognition. In 2006, while continuing to build up the above brands, the Company actively promoted the brands of "Sunflower" and "Lifetime Partner" financial planning. The Company believes that brand building will help develop customers base and enhance customer loyalty.

At present, the Company sells retail banking products primarily via its branches and sub-branches. In the meantime, to meet the market changes, the Company established a multi-level marketing system in branches. As at 31 December 2006, the Company had built up 129 financial management centers, 351 Sunflower VIP rooms and 360 VIP counters.

4.2.2 Corporate banking

The Company provides corporate customers, government agencies and financial institutions with diversified banking products and services. As at 31 December 2006, the corporate loan balance of the Company was RMB359.883 billion, accounting for 63.62% of the total customer loans; the total discounted bills was RMB103.836 billion, accounting for 18.35% of the total customer loans; total corporate deposit was RMB461.798 billion, accounting for 59.68% of total customer deposits; income from corporate banking business accounted for 59.88% of the total operating income of the Company.

Corporate loans

Corporate loan products of the Company include working capital loans, fixed asset loans and other loans. Other loans mainly include trade finance and factoring. In 2006, the Company actively implemented the strategy of industry focus and professionalized operations, and provided more support for quality industries such as transportation, energy and electricity, urban infrastructure and high-tech industries, while controlled loans to industries under macro control such as steel, cement and real estate, therefore further improving the industry structure of corporate loans.

In 2006, the Company focused on developing small and medium sized enterprises customers which in line with the adjusted business strategies. To promote the development of small and medium sized enterprises loan business, the Company conducted pilot operations at branches in Hangzhou, Nanjing, Shenzhen, Suzhou, Ningbo, Foshan, Dongguan, Fuzhou and Xiamen; designed and launched "Go Fortune Growth Program" financial product portfolios for small and medium sized enterprises, provided such new products as floating charge, real estate collateral, trade finance and Online banking overdraft to meet the needs of small and medium sized enterprises at different stages of development, and simplified the business procedure to provide efficient and convenient credit services for small and medium sized enterprises.

The above-mentioned measures of the Company help bringing substantial growth to small and medium sized enterprises. The number of small and medium sized enterprise borrowers reached 5,720, 879 more than that of the previous year; small and medium sized enterprise customers accounted for 75.22%, up by 1.53 percentage points over the previous year; the general loan balance of small and medium sized enterprises reached RMB141 billion, up by 24.06% over the previous year.

Discounted bills

In view of the fairly low risk, good liquidity and high return of discounted bills, the Company took it as one of the important means of assets and liabilities management and fund usage. The Company launched Bill-Express business in April 2005, earlier than any of its counterparts in China. It combined traditional bills with e-banking technologies to provide customers with online application, custody, pledge, discounting and payment services, thereby building up the competitive edge of the Company on the bill markets. Since the launching of Bill Express, the annual cumulative transaction volume increased from RMB2.4 billion in 2005 to RMB21.3 billion in 2006. As at 31 December 2006, the discounted bills balance was RMB103.836 billion.

Corporate deposits

The Company made efforts to develop profitable corporate deposit products and maintain a high percentage of demand deposits in corporate deposits. In recent years, the Company made greater efforts to develop online corporate banking and cash management businesses, which became an effective channel for bank-enterprise cooperation and brought extensive demand deposits to the Company while providing customers with efficient e-banking services.

As at 31 December 2006, corporate deposit balance of the Company was RMB461.798 billion, an increase of 22.02% compared to the previous year. Specifically, demand deposits accounted for 55.70%, which was 11.40 percentage points higher than time deposits. The high percentage of demand deposits helped reduce interest expenses on deposits.

Non-interest-based Corporate banking business

An important policy of the Company in restructuring the corporate banking of the Company in recent years was to increase fee-based income. In 2006, while ensuring stable growth of income from traditional domestic and international settlements, acceptance and guarantee commitment, the Company stepped up its efforts to develop fee-based businesses such as cash management, treasury operation, asset custody, corporate annuity, financial consultation and investment banking, thereby increasing the percentage of fees and commissions income to the total income from corporate banking business. In 2006, net fee-based income of the Company was RMB1.355 billion, up by 27.83% compared to the previous year.

In respect of internet corporate banking and cash management, the Company leveraged advanced IT support to upgrade its products and technologies and diversify its products and services. The online corporate banking of the Company provides online payment and settlement services, as well as Bank-Custom Express, Bill Express and Online Letter of Credit, to meet the needs of different enterprises for networking financial services. In 2006, the number of online corporate banking customers reached 41,260, the annual cumulative number of transactions was 8.26 million, and the annual transaction amount was RMB4,800 billion. Besides the traditional account settlement services, the Company also provides an well-assorted range of cash management services including nominal fund management, corporate payment, corporate negotiated transfer, RMB cash pool, foreign currency cash pool, fund balance management and financial management platform. As at 31 December 2006, the number of cash management service customers of the Company was 4,224, including 1,132 national corporate customers. The Company was awarded the honor of "China's Best Local Cash Management Bank" by Asia Money for two years consecutively in 2005 and 2006.

In 2006, the Company completed USD91 billion international settlement, an increase of 23% compared to the previous year; the foreign exchange settlement was USD50.1 billion, an increase of 27% compared to the previous year. The cumulative non-interest income from international businesses was RMB0.9 billion.

As to the corporate wealth management, the Company introduced 11 corporate wealth management products with various maturities, different investment targets and diversified operation ways. The accumulative realized product sale was RMB5.842 billion.

As to the underwriting of short-term financing debts, the Company has completed lead underwriting for 16 enterprises in 2006, with the lead underwriting volume of RMB16.0 billion, and the total project finance amount up to RMB21.4 billion.

As to asset custody, the balance of net assets under custodian of the Company in 2006 was RMB40.9 billion, up by 19%. Particularly, securities companies integrated wealth management program under custodian was RMB11.8 billion; the corporate annuity under custodian was RMB2.38 billion, securities investment fund custodian scale was RMB21.0 billion; trust fund custodian scale was RMB3.73 billion. The Company became the third bank in China to provide QDII custodian service and the first primary custodian bank to undertake QDII products for foreign banks.

As to corporate annuity management, the number of corporate annuity contract customers was 108, 58 increase over the previous year; the total number of personal accounts of contract customers was 0.3 million, up by 200% over the previous year; and the corporate annuity management fund exceeded RMB2.5 billion. Both the business growth and size were in a leading position in the banking industry in China.

Customer base

Over the course of 20 years of development, the Company has developed 0.22 million corporate depositors and 8,000 corporate borrowers, including Chinese leading enterprises and enterprise groups, government agencies, financial institutions, and Fortune Top 500 mutinational enterprises operating in China. In recent years, the Company stepped up market planning and priority development of target industries, forming a more rational and balanced industry pattern. Meanwhile, the Company made greater efforts to develop small and medium sized enterprises, forming a balanced customer structure. The corporate business products and services of the Company won widespread recognition among customers. According to customer satisfaction survey conducted by AC Nielson in 2006, customer satisfaction with the corporate business of the Company increased significantly as compared with last year, and customer satisfaction with the Company in service provision, business and credit facility approval, financial products and charging is in a leading position in China.

4.2.3 Treasury

Business strategy

In 2006, the Company made greater efforts to develop RMB and foreign currency treasury business and achieved satisfactory results while keeping various risks under proper control. The operating income of treasury business accounted for 13.87% of the total operating income of the Company.

In respect of the use of RMB funds, the Company stepped up fund operations in line with the high fund liquidity of the Company and the increased RMB interest rate. The Company enhanced fund utilization efficiency by expanding fund lending business such as taking and placing in the money markets, repurchase agreements and open market operations, and increasing investment in bonds such as corporate debts securities and policy-related financial bonds. The Company effectuated effective control of market risks and guaranteed return on investment by increasing investment in Central Bank bills and shortening their overall duration.

In respect of the use of foreign currency funds, in view of the uncertain market prospect of interest rate and the soaring swap rate, the Company responsively swapped floating interest rate for fixed interest rate to lock up future earnings, brought ECP in line with inverted yield curve, and made moderate investment in structured bonds while exercising proper risk control, thereby further enhancing return on foreign currency funds.

Operating results

In 2006, the RMB fund trading volume of the Company expanded rapidly, totaling RMB1,390 billion. Accordingly, the money market placement volume was RMB63.1 billion, repurchase volume was RMB838.7 billion, and secondary market spot trading volume was RMB482.6 billion.

In respect of bond underwriting, the Company has established extensive market partnerships and stepped up underwriting and distribution on the primary bond markets, thereby building up its good image on the markets. In 2006, the Company underwrote RMB133.6 billion bonds and distributed RMB13.0 billion bonds, and the underwriting commission reached RMB87.87 million, up by 16.9% over the previous year.

At the end of 2006, the Company duly launched products linking equity and commodity performance, QDII products, corporate liquid forex management program and personal daily forex management program, thereby maintaining a leading position on the market. In 2006, the Company launched 129 foreign currency corporate and personal integrated financial management products, raising RMB43.7 billion proceeds; opened 44 settlement agency accounts, the transaction volume reached RMB67.7 billion, the agency assets reached RMB36.1 billion, and transactions under various interest rate swap and forward interest rate contracts reached USD0.623 billion.

Business development

In respect of forex trading, the Company developed China's first self-service forex option product of 24-hour continuous quotation, and through professional design, made forex options available for trading for common investors in China. In respect of RMB wealth management, the Fund Transaction Department launched "GoFortune" corporate integrated financial management product series, "Daily Wealth" personal liquidity financial management product, liquidity financial management product linked to CMB money market fund index, single customer financial management business, as well as energy-related non-break-even integrated financial management product and high-grade trust financial management product.

4.2.4 Distribution channels

The Company provides products and services via different distribution channels. As at 31 December 2006, the Company had 36 branches, 464 sub-branches (including offices), 1 representative office, 1,050 self-service banks and 812 independent machines (ATM & CDM) across 36 cities in China). The efficient outlets of the Company are primarily located in developed areas in China such as Yangtze River Delta, Pearl River Delta and Bohai Rim, and some large cities in other areas. Besides expanding physical distribution channels, the Company also made efforts to develop and improve e-banking channels such as online banking and telephone banking. The highly acclaimed online retail banking of the Company has effectively relieved the pressure on the business outlets of the Company. The number of transactions on the professional version of online banking was 20.07 million, up by 84% year on year, and the number of online payments was 24.60 million, up by 139% year on year.

4.3 Risk management

As a commercial bank, the Company mainly faces credit risk, liquidity risk, market risk and operational risk. The Company is well aware of such risks and is making continued efforts to enhance its risk management ability by building a bank-wide risk management system and prudent risk management culture, optimizing risk management framework, improving risk management policy and procedure, and using advanced risk measurement and management tools, thereby effectively controlling risks, effectuating growth and increasing return after risk adjustment while maintaining good quality of assets. Throughout the year, there was no risk which imposed heavy effects on the operation of the Company.

4.3.1 Credit Risk management

Credit risk refers to risk arising from failure of the borrower or the other party of the Bank to fulfill his obligations as per the negotiated terms and conditions. The credit risk faced by the Company mainly comes from loan portfolio, investment portfolio, guarantee, etc.

The Company has formulated and is implementing bank-wide credit risk identification, measurement, monitoring and management policy and procedure to control the credit risk of the Company at a rational level. The credit business procedure of the Company consists of credit application, before-loan investigation, credit review and approval, loan disbursement, and post-disbursement inspection.

To effectively control the possible credit risk from credit business and product development, the Company plans to formulate credit management manual, adjust credit direction policy, optimize credit structure and asset portfolio, optimize credit business operation standard and procedure, speed up improving credit information system, customer credit rating and performance evaluation system, etc.

Corporate loans

Loan application and investigation report. The Company usually starts the loan application procedure by interviewing with the credit applicants. The account manager prepares the investigation report by analyzing the application documents submitted by the credit applicant, combined with onsite investigation and the score obtained from the customer credit rating system.

Credit review and approval. The credit application is reviewed and approved by the branch or the Head Office based on the approval limit. The Company establishes credit review teams by different industries at the Head Office at the beginning of the year. Through industry-specific credit review, the Company can better evaluate the credit risks of different industries and enhance the credit review and approval efficiency.

Loan disbursement. Loan disbursement center is in charge of the loan disbursement of each branch. The loan disbursement center shall check relevant documents before releasing any loan to ensure that the loan is duly reviewed and approved and the loan documents are ready and complete.

Post-disbursement inspection

(1) **Loan classification**. The loan classification of the Company is mainly based on the solvency of borrowers as well as other factors such as borrowers' loan repayment records, repayment intention, guarantees and the length of overdue period. The sub-branches and branches of the Company collect, check and confirm the loan classification information and report to the Credit Management Department of the Head Office. The Credit Management Department of the Head Office may require the branches to adjust loan classification based on the information obtained from the loan monitoring system or other channels. The Company classifies outstanding loans into five tiers as per the requirements of CBRC and reports the classification data to CBRC on a monthly basis. To strengthen credit risk management, the Company begins from September 2005 to further classify normal loans into excellent and good loans and classify special mention loans into general mention and special mention loans.

(2) **Management and collection of non-performing loans**. The Credit Management Department of the Company is responsible for managing, coordinating, monitoring and analyzing non-performing loans. Special Assets Management Center of the Head Office is responsible for collecting, restructure, arbitration and lawsuit, auction, disposal, etc. of corporate non-performing loans.

    The Company mainly takes the following measures for collection of non-performing loans: (1) sending a demand notice; (2) restructuring the non-performing loans; (3) exercising the right to dispose of collateral or to recover the loan from the guarantor; (4) recovering the loan by lodging legal proceedings or arbitration procedure. If recovery is confirmed as impossible, the Company will write off the loan in accordance with relevant regulations of the Ministry of Finance.

Retail loans

The Company provides retail loans strictly in accordance with relevant state regulations on retail loans. At the same time, the Company has formulated specific credit review and approval procedure and standard loan operation procedure based on the risk characteristics of different retail loan products. In respect of loan approval process, the Company has set 3-level retail loan review and approval authority at the Head Office, branch and sub-branch according to different regions and different business products. In respect of pre-granting investigation, the Company focuses on analyzing and evaluating the financial position, past credit information and the market value of the collateral of the applicant. In respect of loan review and approval and disbursement procedures, for regions with extensive retail loans, the Company gradually effectuates intensive, procedural and standard management of retail loan business by establishing retail loan review and approval centers and retail loan release centers. In respect of after-loan management, the Company monitors overdue loans in real time via the regular reports of the credit systems, and based on the length of overdue period, takes such measures as verbal dunning, written dunning, doorstep demand notices and legal proceedings to recover overdue loans, thereby constantly improving the quality of retail loans of the Company.

4.3.2 Liquidity risk management

Liquidity risk refers to the risk that funds will not be available to meet liabilities as they fall due by realising the assets at appropriate prices to provide fund for maturity liabilities. The liquidity risk of the Company mainly comes from fund providing activities such as loans, transactions and investments, as well as management of liquid assets.

The Asset and Liability Management Committee ("ALCO") of the Company is responsible for formulating liquidity risk management policies, and the Planning and Finance Department under the Committee is responsible for daily liquidity risk management, monitoring and analyzing the daily, monthly and quarterly liquidity of the Company, and making decisions on liquidity risk management within the authorized range.

The Company implements centralized management on bank-wide liquidity via FTP. In respect of assets, the Company maintained adequate liquidity of its assets by maintaining an appropriate percentage of discounted bills in the total assets and allocating high-liquidity short-term assets such as money market placement, repurchase arrangement and investment in Central Bank bills; in respect of liabilities, the Company secured fund sources via diversified channels including PBOC open market, inter-bank money market and inter-bank bill market, and at the general meeting held in May 2006, the Company obtained authorization of shareholders to issue financial bonds in the coming three years by a certain percentage of the total liabilities of the Company, thereby meeting the daily liquidity requirements.

The Company sets various percentage requirements (including but not limited to loan-deposit ratio, provision ratio and guided target ratio for every branch) and transaction amount limits based on the overall position of assets and liabilities of the Company, in order to monitor and manage liquidity risk; and formulated liquidity warning mechanism and liquidity management system to daily monitor the position shortage of every branch to ensure liquidity safety.

The Company measured and monitored liquidity net position and liquidity ratio mainly through the assets and liabilities management information system, and conducted liquidity scenario analysis and liquidity stress test relating to the assets and liabilities of the Company as a whole. The Company has established a liquidity risk reporting system to keep the senior management updated about the liquidity risk.

	As at 31 December 2006								
	Repayable on demand	**Within 1 month**	**After 1 month but within 3 months**	**After 3 months but within 1 year**	**After 1 years but within 5 years**	**After 5 years**	**Undated**	**Overdue**	**Total**
				(in millions of RMB)					
Assets									
Cash and balances with Central Bank	29,324	–	–	–	–	–	57,670	–	86,994
Amounts due from bank and other financial institutions	13,282	58,826	15,104	15,568	1,591	39	–	–	104,410
Loans and advances to customers	–	49,314	93,463	228,092	66,783	108,718	–	3,050	549,420
Investment securities and other financial assets	6,914	10,843	12,698	59,374	69,726	19,079	251	–	178,885
Other assets	3,679	302	326	174	243	9	9,636	24	14,393
Total assets	53,199	119,285	121,591	303,208	138,343	127,845	67,557	3,074	934,102
Liabilities									
Amounts due to banks and other financial institutions	53,405	4,704	4,530	7,359	6,605	–	–	–	76,603
Deposits from customers	489,451	46,856	66,385	141,802	27,610	1,653	–	–	773,757
Financial liabilities at fair value through profit or loss	–	–	–	–	–	–	106	–	106
Certificates of deposit issued	–	–	–	1,170	–	–	–	–	1,170
Convertible bonds issued	–	–	–	–	22	–	–	–	22
Other debts issued	–	–	–	–	9,987	–	–	–	9,987
Subordinated notes issued	–	–	–	–	3,500	–	–	–	3,500
Other liabilities	10,242	532	1,841	881	228	73	–	–	13,797
Total liabilities	553,098	52,092	72,756	151,212	47,952	1,726	106	–	878,942
Long/(short) position	(499,899)	67,193	48,835	151,996	90,391	126,119	67,451	3,074	55,160
Cumulative long/(short) position	(499,899)	(432,706)	(383,871)	(231,875)	(141,484)	(15,365)	52,086	55,160	–

Long/(short) position of the Company in 2006 was RMB55.160 billion and short position for timely repayment was RMB499.899 billion, which was primarily because there were huge RMB demand deposits, accounting for approximately 50% or above of customer deposits. The deposition rate of RMB demand deposits remained above 70% in the recent two years, therefore the liquidity risk of timely repayment was quite small.

4.3.3 Market risk management

Market risk refers to the risk of unfavorable impact of market changes on the value of assets and liabilities or net income of the Company. The ALCO of the Company is responsible for bank-wide market risk management, including formulating market risk management strategies and policies, supervising implementation of market risk management policies, hearing market risk analysis and report, and making decisions on relevant risk management policies. The Planning and Finance Department under the ALCO is responsible for formulating market risk management guidelines and granting authorization for fund transactions, setting market risk limits for investment and transactions, and monitoring implementation of the same.

The Company implemented centralized market risk management by formulating uniform market risk management policy and procedure, improving FTP mechanism, strengthening basic data management and using the assets and liabilities management information system.

Concerning the market risks existing in bank accounts and transaction accounts, the Company used different measuring methods, including but not limited to value at risk (VAR), gap analysis, sensitivity analysis and stress test, and has basically established a temporary system for regular reporting of market risks and important risk events, in order to keep the senior management updated and informed of the market risks.

(1) Interest rate risk management

Interest rate risk refers to the risk of unfavorable impact of fluctuating interest rates on the financial positions of banks. The primary interest rate risks of the Company are mainly mismatching risk in repricing maturity and basis risk. Mismatch may put the net interest income or market price of the assets of the Company under the impact of interest rate fluctuations at the time. The short-term target of interest rate risk management of the Company is to maintain stable growth of net interest income of the Company, and the long-term target is to gradually increase the market price of the assets of the Company. The Company monitors and analyzes the domestic and overseas interest rate environments and accordingly manages the interest rate risks of the Company. The Company monitors and manages the overall interest rate risk of the assets and liabilities portfolio of the Company by quantitative methods, including but not limited to VAR, shortage analysis, duration analysis and scenario analysis, and uses the assets and liabilities management system to prepare regular and irregular analysis and report.

	As at 31 December 2006						
	Effective interest rate	**3 months or less (including overdue)**	**Over 3 months to 1 year**	**Over 1 year to 5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
				(in millions of RMB)			
Assets							
Cash and balances with Central Bank	0.00%-1.89%	82,372	–	–	–	4,622	86,994
Amounts due from banks and other financial institutions	0.41%-6.22%	97,752	5,583	1,075	–	–	104,410
Loans and advances to customers	0.00%-18.00%	332,397	202,096	12,559	2,368	–	549,420
Investment securities and other financial assets	1.75%-9.05%	45,668	86,730	35,008	11,228	251	178,885
Other assets	–	–	–	–	–	14,393	14,393
Total assets		558,189	294,409	48,642	13,596	19,266	934,102
Liabilities							
Amounts due to banks and other financial institutions	0.00%-6.20%	73,563	3,040	–	–	–	76,603
Deposits from customers	0.00%-7.00%	616,189	131,932	25,199	437	–	773,757
Financial liabilities at fair value through profit or loss	–	–	–	–	–	106	106
Certificates of deposit issued	5.72%	1,170	–	–	–	–	1,170
Convertible bonds issued	6.39%	–	–	22	–	–	22
Other debts issued	2.34%	–	–	9,987	–	–	9,987
Subordinated notes issued	4.74%	–	–	3,500	–	–	3,500
Other liabilities	–	–	–	–	–	13,797	13,797
Total liabilities		690,922	134,972	38,708	437	13,903	878,942
Asset-liability Gap		(132,733)	159,437	9,934	13,159	5,363	55,160
Cumulative asset-liability gap		(132,733)	26,704	36,638	49,797	55,160	–

As shown in the table of asset-liability gap, in 2006, the asset-liability gap of the Company was RMB132.733 billion in 3 months, which was due to the demand deposits (interest rate sensitive liabilities) of the Company accounted for over 50% of customer deposits. In view of the raise of interest rates in the past, the Central Bank has seldom changed the interest rate of demand deposits, and as the interest rates become more market-oriented and demand deposits will have almost no interest, similar to banks in western countries, the interest rate risk faced by asset-liability gap within 3 months is very small.

(2) Currency risk management

Exchange rate risk mainly come from currency mismatch of assets and liabilities in self-operating businesses and agency businesses and currency position mismatch resulting from foreign currency transactions. Exchange rate risks faced by the Company come from holding loans, deposits, securities and other financial derivatives not denominated in RMB.

To manage the exchange rate risks resulting from self-operating and agency businesses, the Company made efforts to match loans in various currencies, conducted timely back-to-back cut-off to restrict the exchange rate risk exposure, and conducted hedging on the forex markets. Also, the Company reduced currency risks by setting upper exposure limit and stop-loss limit.

The Company paid special attention to the continued and wide spread anticipation of appreciation of RMB against US dollar, and in June 2005, changed next-day trade to day trade for the settlement of exposure between RMB and major foreign currencies, and strictly controlled forex exposure to guarantee the full value of forex mortgage.

4.3.4 Operational risk management

Operational risk refers to the risk of loss arising from inappropriate or unsounded internal procedure, personnel and system or external incidents. The Company reduces and controls the operational risk by strengthening internal control, enhancing the risk prevention awareness and ability of staff and implementing a strict accountability system. Major measures taken in 2006:

(1) restructured the organization and management framework and risk management system, established compliance department at Head Office to specialize the compliance management;

(2) stepped up inter-department independence and coordination to promote professional management;

(3) handled specific cases and dealt with commercial bribery cases; implemented comprehensive self-inspection and review at all level of branches, further implemented the accountability system, and stepped up penalty on misconducts of staff;

(4) leveraged H share listing to implement "bank-wide and whole-course" internal control and enhance internal control level as per international banking industry standard and the requirements of regulatory authority and investors. The internal audit departments intensified inspections and reports on high-risk businesses and improper operations; abided by regular internal control evaluation meetings. The Head Office and branches of the Company held quarterly internal control evaluation meetings to evaluate and analyze internal and external improper operations, misconducts and illegal practices, and improve the risk case prevention and internal control mechanisms;

(5) regarding the information technology, the Company enhanced the set up of production center of the information technology department and disaster recovery center, so as to increase the capacity and ability of anti-disaster of the system; enhanced the security of the application system, increasing the system's security efficiently, strengthened the security management of the information system and procedure setup; formulated the system and regulations in respect of the use of key, maintenance of servers, computer-related emergency cases and security of audit data accordingly; the number of branches operating new integrated business systems increased from 9 to 18, systematically improving the accounting, saving and intermediate business operation procedure and control procedure; with reference to the monitoring requirements of anti-money laundering of the China Securities Regulatory Committee and PBOC, developed a monitoring and analysis system of suspicious RMB transactions, which was in line with the anti-money laundering efforts of the regulatory authorities;

(6) Through continued education on law, discipline and compliance, and further reinforcement and training of internal control, criminal case prevention to department head, branch general managers and sub-branch managers, and also the special education of law, discipline, and compliance to staff, the Company has cultivated bank-wide awareness of abiding by laws, and the culture of compliance.

4.4 Outlook

The year 2007 is a year of continuing operational adjustment and management internationalization of the Company. In its operations management, the Company is both blessed with development opportunities brought by rapid and stable economic growth and improved financial ecosystem, and confronted with challenges posed by escalating inter-bank competition and greater financial risks.

From the business environment perspective, the sustained rapid economic growth, the accelerated reform of the social security system, and the increasing income and changing consumption ideas of the public have created opportunities for the stable growth in business scale and profits of the Company and provided substantial support for our strategic transformation and restructuring. The accelerated marketization of interest rates and exchange rates provides further room for the financial innovation of the Company. The rapid development of the financial markets, especially the capital market, and the relaxed business environment provide favorable market environment for the Company to explore new business frontiers, which will contribute to the rapid growth of net non-interest income.

In respect of industry developments, the extensive opening of the banking industry to the outside world will escalate inter-bank competition. Foreign funded banks expand partnership, increase equity investment, and strive for high-end customers and retail banking markets in China; state-owned banks reform their shareholding structure and transform their operation mechanism, thereby reinforcing their strength in scale; small and medium joint-stock banks speed up operation transformation and use advanced technologies to develop new financial products; urban commercial banks invigorate themselves by speeding up ownership system restructuring and bank capital restructure, and some urban commercial banks are doing well in trans-regional operations. The escalating inter-bank competition lays pressure in our business development, profitability and staff building.

The development of the Company is also affected by uncertainties in the markets. The structural contradictions still exist in economic development, and the escalating macro control is a challenge for the adjustment of business structure and customer structure and credit risk management of the Company. The changes in financing pattern arising from rapid development of the capital market and securities market and redundant capital liquidity pose challenges to the traditional income mode and profitability based on differential interest rates. Internationalized regulation presents higher requirements for the risk quantification and capital management of the Company. The accelerated marketization of interest rates and exchange rates has some impact and pressure for us on the market risk management ability and pricing ability of the Company.

In response to the opportunities and challenges ahead brought by social and economic development, the Company undertakes to develop itself into China's best commercial bank with international competitiveness by speeding up reform, taking effective measures to break through bottlenecks in risk management, internal distribution, IT support, human resources, etc., and speeding up shaking off the traditional operations management ideas and modes and building up new core competitiveness. The Company will 1. give full play to the core function of capital management in assets and liabilities management and improve capital allocation in order to provide substantial support for strategic adjustment of business operations; 2. step up reforming the retail banking management system, maintain and expand the high-end retail customer base, improve the personal asset business system, promote marketing of retail banking portfolios, and further develop credit card business; 3. steadily reform the wholesale banking management system, actively and steadily develop business products oriented to small and medium enterprises, and create featured wholesale banking business. 4. step up product integration and innovation and maintain the rapid development of intermediate businesses; 5. enhance risk management awareness and risk management level to improve the quality of credit assets; 6. reinforce the base for system security, speed up promoting new systems, strengthen management of basic data, and enhance IP support capacity; 7. step up human resources training, and improve the staff incentive system; 8. strengthen evaluation of service quality and standardize the service management procedure to improve the service quality.

5. Significant Events

5.1 Share merger reform completed

Upon approval by the State-owned Assets Supervision and Administration Commission of the State Council and Shanghai Stock Exchange, the Company implemented Share Merger Reform (the "Reform") on 24 February 2006 pursuant to "Certain Opinions Regarding the Promotion of Further Reform and Stable Development of the Capital Market of State Council" (Guo Fa [2004] No. 3), "Guidelines on Share Merger Reform of Listed Companies" jointly issued by the CSRC, the State-owned Assets Supervision and Administration Commission of the State Council, the Ministry of Finance, the People's Bank of China and the Ministry of Commerce, as well as "Administration Procedure for the Implementation of State-owned Share Merger Reform for Listed Companies" issued by China Securities Regulatory Commission. Based on its total share capital recorded on the equity registration date, the Bank issued 0.8589 new shares for every 10 shares to all shareholders through funding from its capital reserve. The holders of non-tradable shares paid CMB shares in the form of acquired new shares to all holders of tradable shares registered with Shanghai Branch of China Securities Depository and Clearing Corporation Limited on the equity registration date specified in the plan of the Reform, and undertake that every 10 tradable shares are entitled to 1.6 shares paid by holders of non-tradable shares based on the shares held by holders of tradable shares after implementation of the Plan and before payment of consideration. Every 10 shares of holders of tradable shares are entitled to 2.59632 new shares. After the share merger reform, the original non-tradable shares change to restricted-sale shares, totaling 7,573,629,579 shares; the original tradable shares changed to shares without selling restrictions, totaling 4,705,433,834 shares; the total share capital increased by 971,229,827 shares as a result of the share merger reform.

5.2 Issue of H Shares

Upon approval by CSRC and The Stock Exchange of Hong Kong Limited, the Company issued 2.2 billion H shares on 22 September 2006 at HK$8.55 per share. Our state-owned shareholders reduced their shareholdings as a result of transferring 220 million state-owned shares to Social Security Fund. The total H shares issued by the Company amounted to 2.42 billion, which commenced trading on SEHK on 22 September 2006 (stock code: 3968).

On 27 September 2006, in response to the request of the joint bookrunners/lead arrangers to exercise the over-allotment option of the H Share Issue granted by us, the Company issued an additional 220 million H Shares at HK$8.55 per share. Due to the exercise of the over-allotment option, the state-owned shareholders of the Company reduced their shareholdings by transferring 22 million state-owned shares all to Social Security Fund for conversion into H shares. The above 242,000,000 H shares in total commenced trading on SEHK on 5 October 2006. After the over-allotment, the total number of H Shares of the Company is 2,662,000,000.

6 REPORT OF BOARD OF DIRECTORS

6.1 Statement of compliance

The Company has prepared the financial statements for the year 2006 in compliance with the guidelines on "Financial Disclosure by Locally Incorporated Authorized Institutions", under the Supervisory Policy Manual issued by Hong Kong Monetary Authority.

6.2 Compliance with the Code of Corporate Governance Practices

In accordance with the code provision A.4.2 of the Code on Corporate Governance Practices as set out in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, all directors appointed to fill a casual vacancy should be subject to election by shareholders at the first general meeting after their appointment. Every director, including those appointed for a specific term, should be subject to retirement by rotation at least once every three years. According to the Company's Articles of Association, the newly appointed directors shall, upon expiry of the current board of directors (the term of each board is 3 years), be subject to re-election by the shareholders together with other members of the board, instead of being separately re-elected at the first general meeting after their appointment.

Except for the details disclosed above, the Company has complied with the code provisions as set out in the Code on Corporate Governance Practices.

6.3 Purchase, Sale or Redemption of Listed Securities of the Company

For the year ended 31 December 2006, neither the Company, nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

6.4 Results and Profit Appropriations

The audited profit after tax of the Company for the year 2006 stated in the financial statements (overseas edition) prepared in accordance with IFRS was RMB6.794 billion, while the audited profit after tax stated in the financial statements (domestic edition) prepared in accordance with the PRC GAAP was RMB7.107 billion. 10% of the profit after tax in the financial statements prepared in accordance with the PRC GAAP, which was amounted to RMB0.711 billion, was transferred to statutory surplus reserve. Regulatory general reserve was RMB3.5 billion. The profit distributable to shareholders for the current year was RMB3.489 billion. The profit distributable to shareholders for the current year in the financial statements prepared in accordance with the IFRS was RMB3.138 billion. According to Zheng Jian Kuai Ji Zi [2001] No. 58 of the CSRC, the benchmark of dividend to be distributed should be the lower one of the distributed profits audited by domestic and overseas auditors. That means the cash dividends should be distributed under the audited distributable profit shown in the financial statements prepared in accordance with the IFRS.

Based on the total share capital of A shares and H shares, the Company proposed to declare a cash dividend (including tax) of RMB1.20 (denominated in RMB) for every 10 shares, to pay in RMB for A share-shareholders and pay in HKD for H share-shareholders. The actual profit distribution amount in HKD will be calculated based on the average benchmark rate for RMB to HKD announced by the People's Bank of China one week before the date of convening the general meeting of shareholders (inclusive of the day for the general meeting).

Whereas the convertible bonds (CMB convertible bonds 110036) issued by the Company have not yet been completely converted into A shares share capital or capital reserve of the Company and it is impossible to determine the total share capital on the equity registration date, the total cash dividend cannot be determined. Therefore, the Company will implement the profit appropriations plan on the basis of the total share capital at the closing of the equity registration date of A share dividend payout.

The above profit appropriations proposal will be submitted for approval in the general meeting of shareholders to be held on 15 June 2007. If approved, the above dividend will be paid to shareholders whose names appear on the Register of Members of the Company before 15 August 2007.

6.5 Review of annual results

The Bank's external auditors, KPMG has audited the financial statements of the Group prepared in accordance with IFRS, and has issued unqualified report. The Audit and Related Party Transactions Control Committee of the Company has reviewed the results and the financial statements of the Company for the year ended 31 December 2006.

6.6 Securities Transactions of Directors and Supervisors

The Company has adopted the standard set out in the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 to the Listing Rules as the code of conduct regarding the securities transactions by Directors and Supervisors of the Company. Upon making specific enquiry of all Directors and Supervisors, the Company confirmed that they have fully complied with the above Model Code during the year ended 31 December 2006.

6.7 Independent Non-executive Directors' Confirmation of Independence

The six independent non-executive directors of the Company did not involve in the factors that would result in the independence in question as stated in Rule 3.13 of the Listing Rules which will cause their independence to be questioned. In addition, the Company has received from each of the independent non-executive directors a written annual confirmation of his/her independence pursuant to the Listing Rules. Accordingly, the Company considers all of the independent non-executive directors to be independent.

6.8 Closure of Register of Members

In order to determine the shareholders list of H shares who will be entitled to attend the annual general meeting of the Company and/or receive the final dividend for the year ended 31 December 2006, the Company will close its share register and suspend registration of transfer of shares from 16 May 2007 (Wednesday) to 15 June 2007 (Friday) (both days inclusive). In order to qualify to attend the meeting and/or receive the final dividend, holders of H Shares of the Company whose transfer have not been registered should deposit the transfer documents accompanied by the relevant share certificates at the Company's H Share Registrar, Computershare Hong Kong Investor Services Limited at Rooms 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong by no later than 4:30 p.m. on 15 May 2007 (Tuesday). Regarding the registration date and arrangement for the shareholders of A Shares who will be entitled to attend the annual general meeting of the Company and/or receive the final dividend for the year ended 31 December 2006, the Company will make further announcement in the PRC.

6.9 Annual General Meeting of Shareholders

The Company has decided to hold its annual general meeting of shareholders for the year 2006 at 9:00 a.m. on 15 June 2007 (Friday) at the Conference Room, 5/F, China Merchants Bank Tower, 7088 Shennan Boulevard, Shenzhen. Further details of the date of the annual general meeting and other matters in relation to the annual general meeting will be set out in the notice of annual general meeting.

6.10 Publication of Results Announcement and Annual Report

Both the Chinese and English versions of this results announcement are available on the websites of the Company (www.cmbchina.com) and The Stock Exchange of Hong Kong Limited (www.hkex.com.hk). In the event of any discrepancies in the interpretation of the English and the Chinese versions, the Chinese version shall prevail.

In addition, the Company also prepared the annual report in Chinese in accordance to the PRC GAAP, which are available on the websites of the Company (www.cmbchina.com) and Shanghai Stock Exchange (www.sse.com.cn).

By Order of the Board of
China Merchants Bank Co., Ltd.
Qin Xiao
Chairman of Board of Directors

16 April 2007

As at the date of this announcement, the executive director of the Company is Ma Weihua; the non executive directors of the Company are Qin Xiao, Wei Jiafu, Fu Yuning, Li Yinquan, Huang Dazhan, Tan Yueheng, Sun Yueying, Wang Daxiong and Fu Junyuan; and the independent non-executive directors of the Company are Wu Jiesi, Lin Chuxue, Austin Hu Chang Tau, Chow Kwong Fai, Edward, Liu Yongzhang and Liu Hongxia.

"Please also refer to the published version of this announcement in the South China Morning Post"