

Report of Chief Executive Officer

Management Discussion and Analysis

1.0 Review of Operations

2003 was a challenging year. The Severe Acute Respiratory Syndrome ('SARS') outbreak during the second quarter devastated an already weak local economy and negatively impacted all sectors. Nonetheless, the economy stabilized and rebounded in the second half of the year, following the signing and gradual implementation of the Closer Economic Partnership Arrangement ('CEPA'). While the financial industry continued to face challenges including weak credit demand and narrowing interest margins, the overall operating environment had improved. CITIC International Financial Holdings Limited (the 'Group') remained conservative in its business practices during the year with particular focus on asset quality and cost control. To fully capitalize on the tremendous business opportunities opened up by CEPA, the Group issued US\$180 million five-year convertible bonds to provide for the needs of its future business development.

2.0 Business Performance

2.1 Profit

The Group's operating profit before provisions for the year ended 31 December 2003 was HK\$1,005 million, representing a fall of 11.4% from 2002. Due to improvement in the property market, the Group recorded HK\$24 million in revaluation surplus on its investment properties while profit from the sale of held-to-maturity securities more than doubled to HK\$125 million. During the year, CITIC Ka Wah Bank Limited ('CKWB') increased its interest in CITIC Capital Active Partner Fund Limited (formerly 'The Ka Wah Five Arrows China Hong Kong Fund Limited'). Due to the satisfactory performance of the fund as well as of CITIC Capital Markets Holdings Limited, net profit from associates rose sharply to HK\$175 million. Net profit attributable to shareholders rose 21.9% to HK\$657 million.

2.2 Net interest income

The Group's net interest income for 2003 amounted to HK\$1,562 million, 7.0% below that of 2002, as a result of subdued loan demand amid a weak local economy and conservative lending policies by CKWB. Outstanding loans fell 5.5% to HK\$40.6 billion while net interest margin contracted 20 basis points to 2.12%.

2.3 Non-interest income

The Group's non-interest income fell 8.8% from the 2002 level to HK\$459 million. This was due to the reduction of interests in Ka Wah Capital Limited (currently known as 'CITIC Capital Markets Limited') and Cargary Securities Limited (currently known as 'CITIC Capital Securities Limited') from 51% to 25% in May 2002, resulting in their contribution no longer being consolidated at the subsidiary level. Reduction in new loans during the year also resulted in

lower loan fees, which impacted on the overall non-interest income.

2.4 Operating expenses

Operating expenses in 2003 fell 3.2% to HK\$1,015 million. This was attributable to a reduction in staff costs, rental expenses, advertising and legal expenses.

2.5 Charge for bad and doubtful debts

The Group lent conservatively and strived to maintain its asset quality amid a weak economic environment. As a result, specific provisions fell 14.9% during the year while the charge for bad and doubtful debts dropped 4.8% to HK\$514 million. General provision coverage was 1.34%.

2.6 Final dividend

The Board of Directors proposed a final dividend of HK\$0.063 per share. Together with an interim dividend of HK\$0.03 per share, total dividend for 2003 reached HK\$0.093. The year's total dividend pay-out ratio was 45.1%.

3.0 Asset Quality

3.1 Assets, loans and deposits size

As at 31 December 2003, the Group's total assets reached HK\$79.9 billion, representing an increase of 4.9% from the HK\$76.2 billion recorded at the end of 2002. Total loans fell 5.5% from the 2002 level to HK\$40.6 billion mainly due to a fall in residential mortgages, property investment, as well as transport and transport equipment loans. The proportion of Mainland loans to total customer advances increased from 10.5% in 2002 to 11.1%. Total deposits amounted to HK\$61.6 billion, of which HK\$56.8 billion were customer deposits, representing a 2.4% increase from 2002.

3.2 Asset quality indicators

The Group resolved HK\$1,100 million in problem loans during 2003. Non-performing loans amounted to HK\$2,616 million. The NPL ratio was 6.5% while the coverage ratio rose from 90.5% in 2002 to 94.1% in 2003.

3.3 Financial position

The Group completed its issuance of US\$180 million five-year convertible bonds in December 2003, providing resources for future business development. The bond's 0.25% annual coupon rate would effectively lower the Group's funding cost. As at 31 December 2003, the Group's unadjusted capital adequacy ratio was 18.4%, the loans to deposits ratio was 66.0%, and the loans to total assets ratio was 50.9%.

CITIC International Financial Holdings Asset Quality Indicators

	31 December 2003	31 December 2002
Unadjusted Capital Adequacy	18.4%	19.1%
Loans to Deposits	66.0%	70.1%
Loans to Total Assets	50.9%	56.4%
Coverage	94.1%	90.5%
Loan Loss Coverage	47.1%	46.8%

General Provision Coverage	1.34%	1.16%
NPL	6.5%	5.6%
Mainland Loans to Total Customer Advances	11.1%	10.5%

4.0 Core Business Development

4.1 Commercial Banking - CITIC Ka Wah Bank Limited

4.11 Awards

Following receipt of the 'Hong Kong Retail Management Association Customer Service Award' and selection of the Bank's Perpetual Upper Tier II Capital Security as the 'Best Hybrid Bank Bond Deal' by The Asset, a finance magazine in 2002, CKWB continued to receive various awards during 2003, including the '2003 Hong Kong Awards for Services - Innovation Award' bestowed by the Hong Kong General Chamber of Commerce. It became one of the top 5 finalists for the 'Asia Insurance Industry Awards 2003 - Innovation of the Year'. As CKWB continues to bring value-enhancing proposals to its customers with remarkable creativity, the awards reflected the market's recognition of CKWB's innovativeness and progressive spirit. At the same time, the 2002 annual report of CKWB received the Bronze award in the financial services category of the U.S. Galaxy Awards 2003. In community services, CKWB was awarded the 'Caring Company Logo' by the Hong Kong Council of Social Service for its enduring efforts in caring for the community.

4.12 Business Performance

4.121 Earnings

For the year ended 31 December 2003, CKWB's operating profit before provisions was HK\$1,029 million, representing an 11.4% fall from 2002. Due to improvement in the property market, CKWB recorded approximately HK\$8 million in revaluation surplus on its investment properties while profit from the sale of held-to-maturity securities soared 1.4 times to HK\$124 million. During the period, CKWB increased its interest in CITIC Capital Active Partner Fund Limited (formerly 'The Ka Wah Five Arrows China Hong Kong Fund Limited'). Due to satisfactory performance of the fund, CKWB's share of the associate's profit was HK\$95 million. Profit attributable to shareholders rose 14.1% to HK\$654 million.

During 2003, CKWB recorded synergies of HK\$207 million from the integration with The Hongkong Chinese Bank, Limited, 70% of which came from cost savings and 30% from revenue increase.

4.122 Net interest income

As a result of a 36-basis point contraction in net interest margin to 2.14%, net interest income fell 9.4% from the level of 2002 to HK\$1,547 million in 2003. Net interest income mainly

comprised interest income from loans and high quality fixed income securities invested by the Treasury Department.

4.123 *Non-interest income*

Amid continued economic uncertainties during the year, CKWB adopted a cautious approach in lending, resulting in a reduction in new loans and a corresponding fall in loan fees. Coupled with less than satisfactory contribution from foreign exchange dealing and other securities investments, non-interest income fell 15.2% to HK\$400 million in 2003. It is noteworthy that wealth management services continued to register satisfactory growth, with related fee income increasing 36.3% from the 2002 level. The most outstanding performance came from the sale of unit trust, which brought in HK\$77 million in fee income, a 64.0% jump from the 2002 level. During 2003, wealth management and other retail banking activities generated HK\$202 million in fees and commissions income or 50.6% of total non-interest income; wholesale banking including trade bills contributed HK\$182 million in fee income or 45.5% of total non-interest income.

4.124 *Operating expenses*

CKWB continued to control its cost effectively in 2003. Operating expenses fell 9.8% during the period to HK\$918 million with most of the savings arising from staff costs, rental expenses, advertising, and legal expenses. Cost-to-income ratio was 47.1%.

4.125 *Charge for bad and doubtful debts*

CKWB was able to reduce its charge for bad and doubtful debts by 7.0% to HK\$474 million in 2003. The fall arose mainly from a reduction in specific provisions, of which retail banking provisions fell 40%. During the year, CKWB made provisions totalling HK\$64.5 million against the decline in and further discount of collateral values. The general provision coverage was 1.36%.

4.13 Asset Quality

4.131 *Assets, loans and deposits size*

At the end of December 2003, total assets of CKWB reached HK\$77.4 billion, an increase of 6.2% from 2002. Total loans and advances fell 5.3% to HK\$40.1 billion. Total deposits increased 3.9% to HK\$63.1 billion, of which customer deposits rose 6.4% to HK\$58.4 billion. Current account deposits surged 8.6 times to HK\$12.3 billion, driven by inflow of funds into NOW Accounts.

During 2003, CKWB issued HK\$1,448 million worth of certificates of deposit, which effectively lowered the overall cost of funds, and spreaded out the maturity profile in the longer term to attain a better liability structure. During the year,

matured certificates of deposit totalled HK\$2,567 million.

4.132 Asset quality indicators

CKWB continued to enhance its overall asset quality in 2003. During the year, CKWB resolved HK\$966 million of problem loans. Non-performing loans increased HK\$391 million mainly due to a rescheduled loan that is fully secured. CKWB is currently in negotiations with the borrower to refinance the loan or realize the collateral. It is expected that the non-performing loan ratio will decline from the 5.3% level at the end of 2003. Coverage ratio stood at 92.9% at the end of 2003.

4.133 Financial position

At the end of December 2003, CKWB's unadjusted capital adequacy ratio was 16.3%. The loans to deposits ratio was 63.5%. The loans to total assets ratio was 51.8%. The average liquidity ratio was 49.2%.

CKWB Asset Quality Indicators

	31 December 2003	31 December 2002
Unadjusted Capital Adequacy	16.3%	17.4%
Loans to Deposits	63.5%	69.7%
Loans to Total Assets	51.8%	58.0%
Average Liquidity	49.2%	Jan-Oct : 46.9% Nov-Dec : 47.1%
Coverage	92.9%	90.3%
Loan Loss Coverage	50.5%	55.2%
General Provision Coverage	1.36%	1.18%
NPL	5.3%	4.1%
Mainland Loans to Total Customer Advances	11.1%	10.3%

4.14 Continued Business Development

In 2003, CKWB launched more than two new products and services every month on average. New products from the Retail Banking Group included 'NOW Account', 'CITIC Ka Wah SEED Credit Card' and the enhanced '140% Mortgage Refinancing Service', while the Wholesale Banking Group offered 'DocPrep' export document preparation system service, 'Dividend Payment Service' and factoring service.

New Products and Services Launched in 2003

Month	New Products and Services
January	<ul style="list-style-type: none"> • 'DocPrep' export document preparation system service • 'Dividend Payment Service'
February	<ul style="list-style-type: none"> • 'NOW Account'
March	<ul style="list-style-type: none"> • Credit Card 'Interest Free Flexi Installment Plan' -

	<ul style="list-style-type: none"> 2% Cash Rebate Promotion • ‘FUTURITY Guaranteed Interest Fund’
April	<ul style="list-style-type: none"> • SME Loan Guarantee Scheme - ‘Business Installations and Equipment Loans’ and ‘Associated Working Capital Loans’ • Participated in ‘Film Guarantee Fund’
May	<ul style="list-style-type: none"> • CITIC Ka Wah SEED Credit Card • Participated in Government’s HK\$3.5 Billion Loan Guarantee Scheme for Severe Acute Respiratory Syndrome Impacted Industries
June	<ul style="list-style-type: none"> • Enhanced ‘140% Mortgage Refinancing Service’ • ‘ANNUITY 100 Retirement Plan’ • SME Loan Guarantee Scheme - ‘Accounts Receivable Loans’
July	<ul style="list-style-type: none"> • Factoring Service
August	<ul style="list-style-type: none"> • Credit Card ‘Reward Cash Rebate’
September	<ul style="list-style-type: none"> • ‘Growth Builder’ Life Insurance Plan • ‘Life Savings Plus’ Life Insurance Plan • ‘Warmth’ Retirement Plan • Credit Card Usage Spending Promotion
October	<ul style="list-style-type: none"> • Non-Delivery Foreign Exchange Forward Contract • New Wealth Management System
November	<ul style="list-style-type: none"> • One Stop Business Support Services • Pre-approved Profit Tax Loan • Credit Card ‘Flexi-Installment for Tax Payment’
December	<ul style="list-style-type: none"> • ‘CITIC STAR’ Credit Card in Collaboration with CITIC Industrial Bank • Credit Card ‘Interest Free Installment Cash-in Scheme’ and ‘Easy Cash-in Scheme’ • Credit Card Christmas Spending Gift Redemption Plan

Launched in February 2003, the NOW Account received overwhelming customer response as the product satisfied customers’ need for a higher return and offered free premium protection for redundancy that was unique in the market. 20,000 new accounts had been opened by the end of 2003, attracting HK\$9.5 billion of deposits with an average deposit size of HK\$480,000. The NOW Account created enormous cross-selling opportunities of wealth management products for CKWB.

4.15 China Banking

4.151 China International Finance Company Limited (Shenzhen)

Marking the first milestone in CKWB’s development of the Mainland market, the Bank gained approval from the China Banking Regulatory Commission to acquire the entire equity in China International Finance Company Limited (Shenzhen) (‘CIFIC’) in December 2003. CIFIC had already turned a profit

in 2003 and will be able to apply for a renminbi license by early 2005 provided that it continues to be profitable in 2004. This will give CKWB a valuable lead-time in securing a renminbi license for entry into the renminbi market.

Following regulatory approval of the acquisition, CKWB has enlarged the paid-up capital of CIFC from RMB100 million to RMB400 million. Besides focusing on foreign currency lending and deposit services at the current stage, CIFC has been actively promoting Hong Kong Dollar and US Dollar China mortgages to non-Mainland residents including Hong Kong and Macau residents, Taiwanese and other foreign residents.

With legal entity status on the Mainland, CIFC may engage in direct investments, thereby providing additional flexibility for the future development of CKWB. CIFC is currently in discussion with various Shenzhen banks to form strategic alliances that can foster cooperative development at multiple levels and create win-win situations.

4.152 Credit card business

During the fourth quarter of 2003, 'CITIC STAR' card, a Mainland credit card CKWB developed in collaboration with CITIC Industrial Bank, was launched. CKWB plays a consultancy role on the project, providing services that range from technical support, data analysis, to market positioning. Business performance has already exceeded expectations as 'CITIC STAR' issued more than 20,000 cards with total transaction volume approaching RMB34 million by the end of 2003.

4.16 Business Management

During 2003, CKWB extended its Business Excellence Model throughout the organization. The model emphasizes 7 arenas including leadership; strategic planning; customer and market focus; measurement, analysis and knowledge management; human resources focus; process management; and business results. With the gradual implementation of this plan, CKWB is establishing for itself a superb leadership model and a world-class business management system.

4.17 Future Development

Going forward, CKWB will strive to capitalize on the various opportunities brought about by CEPA and develop a successful business model for the Greater China region. This includes opening a branch in Shanghai, expanding its presence on the Mainland market and developing its Taiwanese client base. At the same time, CKWB also plans to reposition and strengthen its wealth management business in order to raise the contribution from non-interest income as a proportion of total operating income. CKWB will also strengthen its credit and risk management with a view to improving its asset quality.

4.2 *Asset Management - CITIC International Assets Management Limited*

4.21 Business Performance

2003 represented a milestone year for CITIC International Assets Management Limited ('CIAM'). Faced with various challenges and opportunities, CIAM strived to resolve non-performing assets while effectively allocating funds for direct investments, enabling the company to record its first year of profit since operation as a separate entity in late 2002. For the year ended December 2003, CIAM reported operating profit before provisions of HK\$48 million. During the year, CIAM adopted prudent provisioning policies, making new provisions of HK\$71 million while writing back HK\$33 million in provisions, resulting in a net provisioning charge of HK\$38 million. Profit before tax was HK\$10 million for the year.

4.22 Direct Investment

Basic operations of the direct investment business has already commenced with total investment amounting to HK\$120 million for the year, of which selected projects may begin to contribute profit by the second half of 2004. With the aim of enhancing return for shareholders, CIAM has formulated a series of investment strategies to promote the company's growth in profitability, including short term cash management strategies and the active pursuit of opportunities to form joint venture companies and invest in funds on the Mainland in industries or regions where growth is expected to be robust. CIAM plans to invest a further HK\$100 million to HK\$150 million during 2004.

At the same time, CIAM is offering a series of comprehensive financial services, including investment, credit and advisory services to satisfy various financial needs of its customers and to broaden its income base.

4.23 Non-performing Loans

CIAM has recorded satisfactory performance in the recoveries of problem loans during 2003. By the end of December 2003, the total amount of NPL for CIAM has fallen to HK\$530 million, 21% below the HK\$670 million level at the end of 2002. Leveraging on its experience in recoveries and distressed assets management as well as the vast network and resources of the CITIC Group, CIAM will continue to actively manage recovered assets through various means, with the ultimate goal of continuously lowering its NPL ratio.

4.3 *Investment Banking - CITIC Capital Markets Holdings Limited*

4.31 Business Performance

CITIC Capital Markets Holdings Limited ('CCMH') performed spectacularly in 2003. For the year ended December 2003, consolidated profit after tax was HK\$269 million, representing a five-fold increase from the year before.

4.32 Investment Banking

During 2003, CITIC Capital Markets Limited ('CITIC Capital Markets') acted as joint-lead manager for two large scale convertible bond issuance, including the US\$180 million convertible bond issued by the Group and the US\$100 million zero coupon subordinated convertible note issued by Sina Corporation, one of the leading internet portals in China. CITIC Capital Markets also participated in a number of corporate finance activities, with corporate clients comprising Tianjin Development Holdings Limited, Pacific Concord Holdings Limited, Jiangxi Copper Company Limited and Dawnrays Pharmaceutical (Holdings) Limited, effectively raising the company's market share and profile.

4.33 Asset Management

CITIC Capital Markets completed the infrastructure building for its asset management operations, effectively enhancing its portfolio management capabilities. At the same time, it launched a series of investment products that attracted US\$66 million in new funds and expanded its customer base. During 2003, funds managed by CITIC Capital Markets had all recorded double-digit returns.

4.34 Securities Brokerage

Benefiting from the improvement in investment sentiments for the Asian financial markets, CCMH's securities brokerage business also achieved exceptional performance. Securities brokerage income of CITIC Capital Securities Limited ('CITIC Capital Securities') more than doubled during 2003, as the company's share of the Hong Kong market expanded 70% to the 1% level by the end of December 2003. During the year, CITIC Capital Securities restructured its branch network and opened new branches in North Point and Yuen Long to cater to its expanding customer base and enhance its distribution capability. At the same time, CITIC Capital Securities further diversified its income base following the addition of a number of institutional clients and the launch of various products.

4.4 Securities Research - CITIC Frontier China Research Limited

The Group established CITIC Frontier China Research Limited ('CITIC Frontier') as a 75%-owned subsidiary in September 2003. In light of increased demand for research independence in the global market, CITIC Frontier aims to combine comprehensive research on A-shares, B-shares, H-shares and Red Chips into a single cross-border research services platform, providing a one stop shop for China investment advisory services to international and local institutional investors. CITIC Frontier will complete its recruitment in Hong Kong and Shanghai by early 2004 and begin to roll out research products on market strategy, sector analysis and stock investment ideas. The purpose is to build a new profit center for the Group through the provision of custom-made research and advisory services to a selected group of clientele.

5.0 Human Resources Development

As at the end of 2003, the Group employed 1,488 staff. Management believes it is 'people' that make the difference and create success of an organization. Therefore, to attract and retain people of talent and good performance, it is our policy to make continuous efforts in benchmarking the remuneration structure with companies in the same sector to ensure competitiveness. All companies in the Group offer discretionary bonus schemes with an objective of cultivating common goals amongst employees, driving individual performance and generating results for the Group. All bonus schemes are in direct correlation to the Group's profitability, unit performance and individual contributions.

A new share option scheme was approved by the shareholders of CITIC International Financial Holdings on 16 May 2003 while at the same time, the Senior Executive Share Option Scheme adopted in 1995 was terminated. Details of the share option schemes are given in the Directors' Report.

The Group places a high priority on ongoing staff training and people development. During 2003, the average training per employee was 4.5 days. A total of 385 classes were conducted during the year, with curriculums covering a wide range of subjects from product and computer knowledge to management, regulatory, marketing and servicing skills.

6.0 Future Development

With an expanded product range and a reduced cost base, the Group is in a unique position to capitalize on the expected economic recovery. It will actively explore new business opportunities brought about by cross-strait economic activities as well as CEPA. As the financial flagship of CITIC outside the Mainland, the Group will actively pursue other initiatives including increasing its interests in CCMH and further strengthening its synergistic cooperation with other financial institutions within the CITIC Group with the aim to develop itself into a one stop financial supermarket and a cross-strait financial bridge.

Chang Zhenming

Chief Executive Officer