HK$'000

Management's Discussion and Analysis

FINANCIAL REVIEW

Group's financial results:

Operating results and ratios

	Year ended 31 December 2005	Restated 2004	Increase/ (decrease)
Revenue	**5,786,386**	3,610,791	60.3%
Gross profit	**455,222**	250,685	81.6%
Profit attributable to shareholders of the Company	**221,703**	4,772	45.5 times
Earnings per share	**HK 5.14 cents**	HK 0.12 cent	41.8 times
Gross profit margin [1]	**7.9%**	6.9%	
Inventory turnover [2]	**7.7 times**	9.2 times	

Financial position and ratios

	31 December 2005	Restated 2004	Increase/ (decrease)
Cash and bank balances	**1,519,595**	1,606,833	(5.4%)
Total assets	**6,020,027**	5,698,250	5.6%
Bank and other loans	**1,905,616**	2,074,324	(8.1%)
Equity attributable to shareholders of the Company	**2,941,773**	2,636,840	11.6%
Current ratio [3]	**2.0 times**	2.2 times	
Gearing ratio [4]	**39.3%**	44.0%	

1 gross profit / revenue x 100%
2 cost of sales / [(opening inventories + closing inventories) / 2]
3 current assets / current liabilities
4 bank and other loans / (equity attributable to shareholders of the Company + bank and other loans) x 100%

The Group has achieved a good financial performance for 2005, building on the encouraging results of 2004, which is indicative of the progress that the Group is making. The sound financial performance principally follows the Group's decision to adopt a business strategy to diversify its activities and position itself as an integrated provider of key natural resources and commodities.

The strong increase in both revenue and profit for the year was primarily attributable to the Group's acquisitions of the Australian interests in 2004 which have made a significant contribution to the Group's earnings. The Group has been able to incorporate a full year's contribution from its Australian interests in 2005 rather than 9 months' as in 2004 (the acquisitions were completed at the end of 1Q of 2004).

Management's Discussion and Analysis

The businesses in Australia comprising aluminium smelting, coal mining and the import and export of commodities continue to perform well. The following is a comparison of the results between 2005 and 2004, but on a full year basis.

Aluminium smelting

- The Group has a 22.5% interest in the Portland Aluminium Smelter joint venture in the State of Victoria, Australia, the principal activity of which is the production and sale of aluminium ingots overseas.

- Revenue ▲ 8%
  Net profit after tax (from ordinary activities) ▼ 1%

- Revenues were driven by higher average selling prices while sales volume increased marginally. Net profit remained almost unchanged as the benefit of higher selling prices was offset by increases in production costs. Certain costs, such as alumina and electricity, are linked to the selling price of aluminium and have increased correspondingly. Other costs have also risen.

Coal mining

- The Group has:

  – a 7% interest in the Coppabella and Moorvale coal mines joint venture in the State of Queensland, Australia, the principal activity of which is the mining and sale of coal overseas;

  – a 11.81% shareholding in Macarthur Coal Limited ("Macarthur"), a company listed on the Australian Stock Exchange ("ASX") (ASX Code: MCC), which owns a 73.3% interest in, and is the operator of, the Coppabella and Moorvale coal mines; and

  – a 10-15% interest in seven separate coal exploration joint ventures with Macarthur and a 50% interest in the CB Exploration joint venture, the principal activities of which are the exploration and development of coal.

- Consolidated revenue ▲ 70%
  Consolidated net profit after tax, including ▲ 552% (net of below, ▲285%)
  – dividend income from Macarthur of HK$19.8 million
  – profits on sale of coal exploration interests of HK$55.0 million (after tax)

- Coal operations achieved a record result in 2005. Sales rose due to strong demand from the steel industry and higher contract selling prices.

  Mining costs rose more than 20% due to general cost pressures facing the industry, such as fuel and labour shortages, and demurrage costs due to congestion at loading ports. These cost increases were, however, outweighed by the increase in coal prices.

- Consistent with the strong performance of coal mining operations, the Group received higher dividends payment from Macarthur.

- In December 2005, the Group partially sold down its 25% interest in various coal exploration tenements held by the Bowen Basin Coal Exploration joint venture to Macarthur. The consideration received was 2,590,392 Macarthur shares. Based upon the Macarthur share price on the day the shares were issued, a profit of HK$78.5 million was recognised. After the sale, the Group retains interests of 10% to 15% in each of the tenements and the Bowen Basin Coal Exploration joint venture was restructured into seven separate joint ventures.

Import and export of commodities

- The Group has a 77.9% equity interest in CITIC Australia Trading Limited ("CATL"), a company incorporated in the State of Victoria, Australia and listed on the ASX (ASX code: CAL), whose principal activity is trading in various metals, minerals, manufactured products and other commodities.

- Revenue ▲ 23%
  Net profit after tax ▲ 47%

  The following table shows a breakdown of the revenue and the net profit before tax for 2005 and a comparison with the full year of 2004:

		Total	Alumina exports	Iron ore exports	Other exports	Imports	Others
Revenue	HK$ million	4,300.7	1,676.8	1,614.4	166.5	712.5	130.5
	Compare to 2004	▲ 23%	0	▲ 142%	▼ 69%	▲ 44%	▲ 45%
Net profit before tax	HK$ million	72.1	31.5	6.3	4.6	21.7	8.0
	Compare to 2004	▲ 47%	▲ 95%	▼ 25%	▲ 33%	▲ 42%	▲ 45%

- CATL is a trader which buys goods from producers and then on-sells them to its customers. Export products are alumina, aluminium ingots and iron ore, mainly destined for the People's Republic of China (the "PRC"). Imports include steel and aluminium products, batteries, tyres and wheels. CATL focuses predominantly on trade between the PRC and Australia.

  Although many commodities have continued to experience "super boom" market conditions, the operating environment in which the 2005 results were achieved has been tough. Prices of most commodities were strong during the early part of 2005, but then diverged.

- The increase in revenues reflects higher prices of alumina and steel products, as well as increased sales volume of iron ore exports. Led by alumina exports, all product lines generated record results.

  Alumina exports remained the largest revenue generator. Substantially higher than normal profit margins were achieved on a few cargoes in the rising alumina market in the first half of 2005, which boosted the results. Iron ore exports (particularly to the Chinese steel mills) grew rapidly in 2005, the second year of regular iron ore trading by CATL, but profit margins returned to normal levels. Iron ore was sourced from various origins including Australia, India, South Africa and Brazil.

Imports continued to increase their contribution to overall profit. The steel and battery divisions performed strongly while the tyre and wheel imports faced increasing competition. The continued profit growth of the import division is very encouraging.

- CATL will continue its strategy of diversification by developing multiple trading lines to reduce its relative reliance upon earnings from alumina. However, alumina remains an important trading line. Iron ore has developed into an important new export line since its introduction two years ago.

  The most challenging task for CATL remains the trend of western producers to bypass traders and sell products directly to end-users.

As a consequence of the adoption of new Hong Kong Financial Reporting Standards, certain adjustments to fair value of assets and liabilities of our Australian interests acquired in 2004 were required which resulted in a reduction of a net amount of HK$45.1 million. The Group's results for the financial year ended 31 December 2004 were restated to HK$4.8 million. These are explained in notes 2.4(b) and 15 to the financial statements.

Other than the businesses in Australia, the Group had an interest in an oilfield in the PRC.

Crude oil

- The Group had a 40% participating interest in the development and production of petroleum in the Kongnan Block within the Dagang Oilfield in the PRC.

- Revenue ▲ 217%

- The project is in its development stage. An additional 19 wells were drilled and completed in 2005 (2004: 19 wells), which was less than scheduled. As at the end of 2005, 39 wells were in production. Net production volume was 282,582 barrels of oil equivalent ("Boe") (2004: 190,309 Boe), increasing 48% for 2005 but was much lower than anticipated.

  In the 4Q of 2005, drilling was temporarily suspended to allow for detailed evaluation of well productivity and production decline performance. As at the end of 2005, the independent engineering evaluators have revised downward their estimate of the proved reserves. Since depletion was provided on the substantial capitalised development costs incurred during the year, the project made a loss as a result.

- In February 2006, the Group exercised its option to convert its 40% participating interest into common shares in the share capital of Ivanhoe Energy Inc. ("Ivanhoe") and a loan repayable by Ivanhoe.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

Cash

As at 31 December 2005, the Group had a cash balance of HK$1,519.6 million.

Borrowings

As at 31 December 2005, the Group had outstanding borrowings of HK$1,905.6 million, which comprised secured bank loans of HK$686.4 million, unsecured bank loans of HK$772.6 million and unsecured other loans of HK$446.6 million. The secured bank loans were secured by the Group's 22.5% interest in the Portland Aluminium Smelter joint venture. The bank trade finance facilities available to CATL are guaranteed by CITIC Resources Australia Pty Limited.

Most transactions of CATL are debt funded, which means CATL is highly geared. However, in contrast to term loan, CATL's borrowings are transactions specific and of short duration, matching the term of the underlying trade. When sales proceeds are received at the completion of a transaction, the related borrowings are repaid accordingly.

Of the total outstanding borrowings, HK$858.4 million was repayable within one year. The gearing ratio of the Group was 39.3%.

Financial risk management

The Group's diversified business is exposed to a variety of financial risks, such as market risks (including foreign exchange, commodity price and interest rate risks), credit risks and liquidity risks. The management of such risks is dictated by a set of internal policies and procedures designed to minimise potential adverse effects to the Group. The policies and procedures have proven to be effective. Further details are set out in note 39 to the financial statements.

New investments

In January 2005, the Group agreed to form a joint venture with a Chevron Corporation subsidiary to develop a regional network of Caltex branded service stations in Southern China and to explore development possibilities in the Yangtze river delta. The completion of the transaction is subject to PRC approval which needs to be obtained before 7 June 2006.

In August 2005, the Group, through CITIC Dameng Investments Limited ("CITIC Dameng"), entered into a joint venture contract with Guangxi Dameng Manganese Industrial Co., Ltd. ("Guangxi Dameng") to jointly establish a sino-foreign equity joint venture, CITIC Dameng Mining Industries Limited (the "Manganese Company"), to undertake the business of manganese mining and processing. The Manganese Company is owned as to 40% by Guangxi Dameng and as to 60% by CITIC Dameng. CITIC Dameng is ultimately owned as to 80% by the Group and as to 20% by CITIC United Asia Investments Limited, a wholly-owned subsidiary of CITIC Group.

In respect of capital contribution to the Manganese Company, before the end of 2005, Guangxi Dameng has contributed assets of RMB200 million (HK$192.3 million) and CITIC Dameng has paid cash of RMB300 million (HK$288.5 million). The share of the Group's capital contribution of RMB240 million (HK$230.8 million) was effected from internal resources. This acquisition was completed in March 2006 and the financial results of the Manganese Company will be included in the accounts of the Group from the 2Q of 2006.

Management's Discussion and Analysis

Changes to investments

In February 2006, Richfirst Holdings Limited ("Richfirst"), a wholly-owned subsidiary of the Group, exercised its option to convert its 40% participating interest in the Kongnan Block within the Dagang Oilfield in the PRC, with a carrying value of US$27,386,135 (HK$213,612,000), into 8,591,434 common shares in the share capital of Ivanhoe and a non-interest bearing, unsecured loan of US$7,386,135 (HK$57,612,000) repayable by Ivanhoe. The first instalment of the loan was due in March 2006. Further details are set out in notes 16(b), 24 and 40 to the financial statements.

Opinion

The Board is of the opinion that after taking into account the existing available borrowing facilities and internal resources, the Group has sufficient resources to meet its foreseeable working capital requirements and there will be no adverse change to its financial position.

EMPLOYEES AND REMUNERATION POLICIES

As at 31 December 2005, the Group had around 120 full time employees, including management and administrative staff. Most of the employees are employed in Australia while the remainder are employed in Hong Kong.

The employees' remuneration, promotion and salary increment are assessed based on an individual's performance, professional and working experience and by reference to prevailing market practice and standards.

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance for those employees who are eligible to participate in the MPF Scheme. The Group also operates a defined contribution retirement benefits scheme (the "RB Scheme") under the superannuation legislation of the Australian government for those employees in Australia who are eligible to participate.

Contributions are made based on a percentage of the employees' basic salaries. The assets of the MPF Scheme and the RB Scheme are held separately from those of the Group in an independently administered fund. The Group's contributions as an employer vest fully with the employees when contributed into the MPF Scheme and the RB Scheme.

The Company and CATL operate share option schemes for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations.