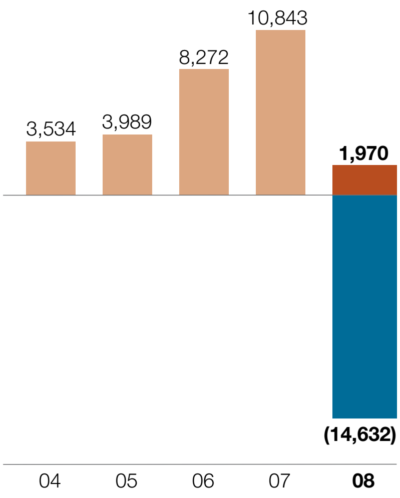
Financial Review

Group Performance

2008 proved to be a challenging year for the Group. Despite the strong performance in our underlying businesses during the first half of the year, our core activities were not immune from the ongoing economic slowdown in mainland China and as a direct result of the global economic crisis our businesses consequently slowed as the year progressed.

A net loss of HK$12,662 million was attributable to shareholders for the year ended 2008, compared with a net profit of HK$10,843 million in 2007. HK$14,632 million in losses (net of tax) were associated with a number of leveraged foreign exchange contracts described elsewhere. Before taking into account the effect of these leveraged foreign exchange losses, the operating profit attributable to shareholders was HK$1,970 million (net of tax), a 82% decline from 2007, due to deteriorating market conditions in the second half of 2008 and exceptional profits in 2007 arising from the listing of Dah Chong Hong and CITIC 1616.

Profit attributable to shareholders



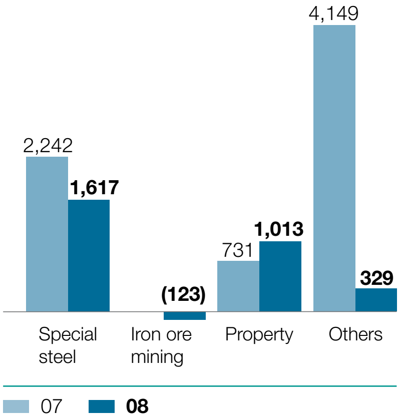
Consolidated Profit and Loss Account

Contribution by segments[1]

In HK$ million	**2008**	2007
Special steel	**1,617**	2,242
Iron ore mining	**(123)**	–
Property		
Mainland China	**523**	197
Hong Kong	**490**	534
Power generation	**(1,198)**	494
Aviation	**(994)**	1,263
Civil infrastructure	**523**	490
Dah Chong Hong	**320**	417
CITIC 1616	**181**	157
Other investments	**1,530**	111
Fair value change of investment properties	**(33)**	1,217
Total	**2,836**	7,122

[1] *A business's after tax profit that contributes to unallocated central interest, overhead and goodwill.*

Contribution



- **Special Steel** In the Special Steel division, net income declined from HK$2,242 million in 2007 to HK$1,617 million in 2008, a 28% decline year-on-year. Although turnover overall increased 23% in 2008, steel prices traded lower and demand was reduced in the second half of 2008, reflecting a general slowdown affecting the mainland China economy. In 2008, Special Steel made an inventory provision of HK$705 million in total, including HK$380 million for the jointly controlled entities. The amount attributable to CITIC Pacific's interest was HK$513 million.
- **Iron Ore Mining** The Iron Ore Mining division realised a HK$123 million loss in 2008 as construction on essential infrastructure continued. The loss was due primarily to operating expenses that could not be capitalised for accounting purposes.

Contribution from Property

In HK$ million	**2008**	2007
Mainland China		
Sales	**298**	(147)
Leasing	**277**	219
Tax rate change in 2007	**–**	177
Property under development	**(52)**	(52)
Hong Kong		
Sales	**125**	256
Leasing	**365**	278
Total	**1,013**	731

- **China Property** In our China Property division, net profit increased to HK$523 million in 2008 from HK$197 million in 2007. Leasing income was relatively stable, with CITIC Square and other retail properties showing an increase in rents on the back of long term leases. The average occupancy rates were 95%. Sales from the New Westgate Gardens and Qingpu reflected the slowdown in the luxury property market in 2008 and the results were bolstered by a write-back of HK$253 million impairment loss made in 2007 on phase II of New Westgate Gardens.

- **Hong Kong Property** While the strong leasing environment in early 2008 helped our rental properties in Hong Kong, the turmoil in the financial sector, placed pressure on the commercial property market. However due to long term leases entered into 2007 and in early 2008, profits from leasing increased from HK$278 million in 2007 to HK$365 million in 2008. The average occupancy rate for our Hong Kong portfolio was 93%. The HK$170 million profit on property sales in 2008 was mainly due to the sale of the Motor Services Centre in Yuen Long.
- **Power Generation** Despite an increase of 5% from 2007 of the total electricity generated to 100 billion kwh, the power generation division showed a HK$1,198 million loss, compared with a HK$494 million profit in the previous year. This was due to a sharp increase in coal prices, averaging 46% across our coal plants, which outpaced the maximum allowable tariff adjustments in 2008 which ranged from approximately 4-15%, depending on the power plant. Due to these factors, a net impairment loss of HK$449 million was booked on the power generation business in 2008.
- **Aviation** Aviation division showed a HK$994 million loss, compared with a HK$1,263 million profit in the previous year. Cathay Pacific saw increased turnover of 14.9% from 2007 based on passenger traffic growth of 7.3% over the year but suffered from mark-to-market losses on derivatives used to hedge fuel prices that were not effective hedges for accounting purposes. Our Aviation division income was bolstered by a one time disposal gain of HK$403 million on the sale of Air China Cargo.
- **Civil Infrastructure** Civil Infrastructure showed a profit increase to HK$523 million in 2008 from HK$490 million in 2007. The Eastern Harbour and Western Harbour tunnels suffered a slight decrease in traffic (-2% a day) compared with 2007 due to the poorer economy and the toll increase in the Western Harbour tunnel, but overall this was offset by the increased revenue per vehicle.

- **Dah Chong Hong** The Group's profit from Dah Chong Hong was HK$320 million for 2008, compared with HK$417 million from operations for 2007. Ownership in 2008 was approximately 57% compared with 100% before listing in October 2007. As with our other businesses, Dah Chong Hong was affected by the economy in the final quarter but strong results from earlier in the year increased after tax profit growth to HK$582 million in 2008 compared with HK$522 million in 2007. The motor segment performed well in Hong Kong and mainland China, compared with its other businesses, despite slowing sales and aggressive price discounts in the last quarter.
- **CITIC 1616** The Group's profit share from CITIC 1616 was HK$181 million for 2008 as compared with HK$157 million for 2007. Ownership in 2008 was 53% compared with 100% before listing in April 2007. CITIC 1616 improved operating performance, with after tax profit growing from HK$263 million to HK$332 million in 2008. This was mainly due to organic growth in its core voice, SMS and mobile value-added service businesses and the full consolidation of CPCNet on a whole-year basis.
- **Other Investments** Profit from Other Investments increased to HK$1,530 million in 2008, compared with a HK$111 million profit in the previous year, mainly from a profit on the sale of listed investments of HK$1,215 million.

Losses Due to Leveraged Forward Exchange Contracts

The iron ore mining operations utilise USD as its functional currency as the future revenues from its Iron Ore business are denominated in USD. However, a substantial portion of its developmental and operating expenditures are denominated in AUD, with smaller capital expenditure exposures in RMB, the Euro, Swedish Krona and JPY. A one-time loss of HK$15,891 million was incurred in 2008, due mainly to losses on leveraged foreign exchange contracts intended to hedge exposures at our Australian mining operations. Leveraged foreign exchange contracts as at 30 June 2008 had a fair value gain of HK$53 million as at that date. Contracts entered into before 30 June 2008 gave rise to losses of HK$389 million for the year ended 31 December 2008. The remaining losses of HK$15,502 million arose on leveraged foreign exchange contracts entered into in the second half of 2008. A deferred taxation credit of HK$1,259 million has been recognised in the iron ore mining operations. Hence, the leveraged foreign exchange loss, net of tax, for the year 2008 was HK$14,632 million.

Leveraged forward exchange contracts with a maximum deliverable amount of A$5.3 billion were novated to CITIC Group in December 2008, being the amount in excess of the AUD required for the project. Eight remaining contracts with a maximum deliverable amount of A$2.9 billion as at 31 December 2008 were retained to manage the future AUD requirements of the iron ore mining operations. Certain of the contracts retained by the Group have been restructured to plain vanilla forward contracts. As at 31 December 2008, the remaining three unstructured contracts had a maximum deliverable amount of A$2.0 billion. One of these contracts was restructured in March 2009, and the remaining contracts will be restructured later in 2009.

In addition, certain leveraged forward exchange contracts for RMB and the Euro were terminated in 2008. As at 31 December 2008, three RMB target redemption forward contracts with maximum notional amount of RMB 5.3 billion are held by the Group to manage the remaining RMB exposures of the iron ore mining operations. Euro exposures are not currently hedged by the Group.

Interest Expense

The Group's interest expense net of amounts capitalised increased from HK$305 million to HK$747 million. Capitalised interest increased from HK$680 million in 2007 to HK$1,086 million in 2008 and is mainly attributed to property projects under development in mainland China and our mining operations in Australia.

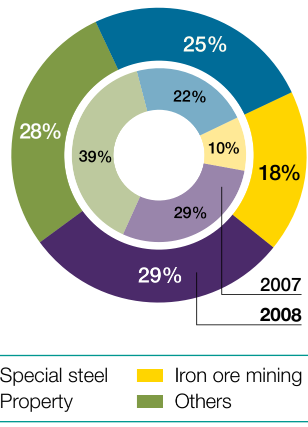
The weighted average cost of debt declined from 5.5% in 2007 to 4.7% in 2008. This was due to interest rate cuts in Hong Kong and the United States, and a decline in RMB borrowing rates.

Group Segment Assets[2]

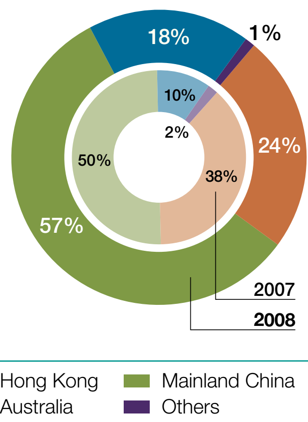
Group segment assets have increased from HK$97,564 million to HK$117,493 million in 2008. Asset growth was mainly driven by our three main lines of business – Special Steel, Iron Ore Mining in Australia and Property. These businesses have increased their share of total assets from 61% in 2007 to 72% in 2008. The share of our Australian business has also increased substantially from 10% in 2007 to 18% in 2008 as the infrastructure build-out intensified in 2008.

In HK$ million	**2008**	2007
Special steel	**28,848**	21,489
Iron ore mining	**20,976**	9,780
Property		
Mainland China	**22,529**	16,086
Hong Kong	**11,103**	11,992
Power generation	**5,857**	6,409
Aviation	**7,982**	10,689
Civil infrastructure	**2,464**	2,470
Dah Chong Hong	**9,462**	6,831
CITIC 1616	**1,576**	1,047
Others	**6,696**	10,771
Total	**117,493**	97,564

Group segment assets



Group segment assets by geographical area



[2] *Group segment assets represent segment assets + investments in jointly controlled entities + investments in associated companies*

Shareholders' Funds

Shareholders' Funds declined from HK$59,793 million in 2007 to HK$49,971 million as at 31 December 2008. The Shareholders' Funds were reduced by the loss of HK$12,662 million and the 2008 interim and 2007 final dividend payment of HK$2,415 million, but increased by HK$2,470 million with the issue of 1,453,125,000 new shares to the CITIC Group. The new capital structure of the Company is set out in the table below. The other major movements in Shareholders' Funds were due to a reduction of HK$4,095 million on the disposal of financial assets and mark-to-market losses on foreign exchange and interest rate hedges effective for accounting purposes of HK$3,459 million.

	After	Before
Shares outstanding	3,646,274,160	2,193,149,160
Shareholder		
CITIC Group	57.6%	29.4%
Larry Yung	11.5%	19.1%
Management	1.8%	3.2%
Public	29.1%	48.3%
Total	**100%**	**100%**

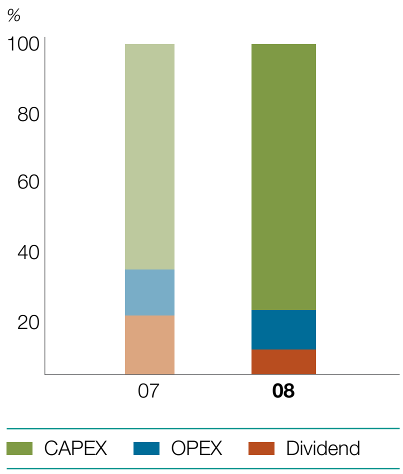
Capital Expenditure

Capital expenditure has continued to grow over the past five years with the Australian mining operations accounting for the largest share of the growth in the past two years. This share will fall as construction nears completion in 2011.

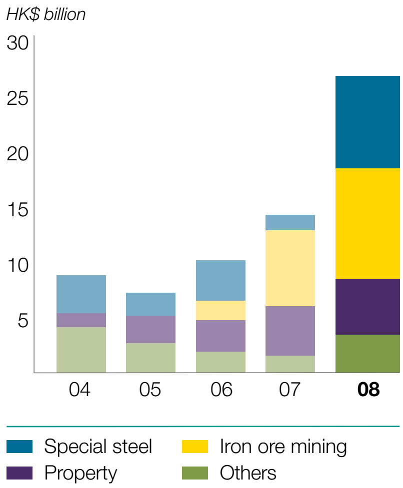
In HK$ million	**2008**	2007
Special steel	**8,381**	1,442
Iron ore mining	**10,010**	6,844
Property		
Mainland China	**5,049**	4,159
Hong Kong	**9**	366
Power generation	**581**	–
Aviation	**–**	–
Civil infrastructure	**16**	5
Dah Chong Hong	**515**	323
CITIC 1616	**116**	62
Other investments	**2,172**	1,108
Total	**26,849**	14,309

The Group has maintained its focus on its core businesses and has continued to invest approximately HK$8.4 billion in the Special Steel division, HK$10.0 billion in the Australian mining project and HK$5.1 billion in its Property division, accounting for 31%, 37% and 19% of the total respectively.

Group cash outflow by nature



Capex by business segments



- The capital expenditure for the steel business in 2008 mainly represented the construction of a new special steel plate production line at the Jiangyin steel plant with a capacity of 1.2 million tonnes. At Xin Yegang two new lines capable of producing 630,000 tonnes of medium to thick wall seamless steel tubes are under construction.
- The capital expenditure for the iron ore mining project has continued with the infrastructure build-out and construction intensified during the year. Major milestones in 2008 include the construction of earthworks for the power plant pad and construction of the first of two excavators. Construction of earthworks for the concentrator pad site have also begun with drilling and blasting in 2008. Included in these costs was a total deposit of HK$1.5 billion for the purchase of specially designed ships to transport the iron ore.
- The property projects currently under construction in mainland China include projects in Shanghai, Qingpu, Ningbo, Yangzhou and Hainan Island. In Hong Kong, the construction of a hotel in Discovery Bay is ongoing.
- Included in the capital expenditure for Other Investments is an outlay for the acquisition of a 30% interest in the Xinjulong Coal Mine in Shandong, as the Group moves to secure the raw materials needed for our steel and power plants.

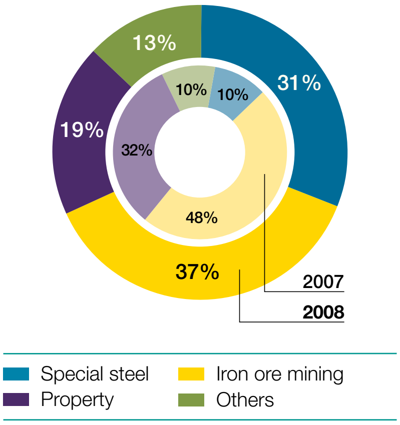
Cash Contributed from All Businesses[3]

Inflows to the Company totalled HK$8,194 million in 2008 compared with HK$13,201 million in 2007.

In HK$ million	**2008**	2007
Special steel	**194**	2,196
Iron ore mining	**–**	–
Property		
Mainland China	**925**	1,368
Hong Kong	**1,092**	833
Power generation	**242**	621
Aviation	**1,428**	508
Civil infrastructure	**510**	990
Dah Chong Hong	**88**	4,448
CITIC 1616	**53**	1,919
Others	**3,662**	318
Total	**8,194**	13,201

[3] *See 'Definition of Terms' on page 92.*

Capex by segment



Cash inflow by segment