# Treasury Risk Management

## General Policies

- Maintain central management of financial exposures while delegating finance raising to individual business units where appropriate, employing limited or non-recourse project finance when available
- Diversify funding sources through utilisation of both banking and the capital markets
- Arrange financing to match each business's characteristics and cash flow to the extent that it is possible

## Responsibilities

The Group's overall risk management program seeks to minimise the impact of fluctuations in exchange rates, interest rates and various commodity price fluctuations on the Group's financial performance.

In response to losses arising from the Group's leveraged foreign exchange contracts reported elsewhere, management has taken several concrete steps to strengthen our risk management policies and procedures. An Asset and Liability Management Committee ('ALCO') was set up by the Board in October 2008 to oversee these procedures and monitor the exposures of the Group. PricewaterhouseCoopers ('PwC') was engaged to provide advice on the Group's financial risk management policies and procedures.

The Group Finance Department is responsible for maintaining and implementing the Group's financial risk management policies and procedures endorsed by ALCO within an agreed framework authorised by the Board.

The Group Finance Department monitors funding requirements of the Group along with interest rate, currency, credit and liquidity risks. This portfolio approach to financial risk management enables activities in these areas to be carried out more economically and efficiently, and allows a greater degree of transparency for the Group.

Overseas subsidiaries and jointly controlled entities are responsible for managing their liquidity, certain interest rate risks, certain foreign exchange risks and specific commodity price risks under policies approved by the boards of their respective companies, but also within the confines of the overall ALCO strategy.

The Group's listed subsidiary companies – Dah Chong Hong, CITIC 1616 and Daye Special Steel, manage their financial and treasury affairs themselves, within Group policies.

## Derivatives Policy

Derivatives have been used to assist in the management of interest rate and exchange rate risks. To the extent possible, gains and losses of the derivatives offset the losses and gains on the assets, liabilities or transactions being hedged as accounting hedges.

The fair value of outstanding derivative transactions is calculated monthly, based on price quotations obtained from major financial institutions. These derivative instruments are monitored periodically to test for the effectiveness of the hedging strategies involved.

Following ALCO's review of the Group's policies and procedures, the use of financial instruments has currently been restricted to borrowings, deposits, interest rates swaps and plain vanilla foreign exchange contracts. The use of structured derivatives and instruments that contain embedded options will require presentation to and the approval of ALCO.

It is the Group's policy not to enter into transactions, derivative or otherwise, for speculative purposes.

## Foreign Exchange Risk

The Group has major operations in Hong Kong, mainland China and Australia. Therefore it is subject to market risk in foreign exchange rates involving HK dollars ('HKD'), US dollars ('USD'), Renminbi ('RMB') and Australian dollars ('AUD'). There are also exposures to the Japanese Yen ('JPY') (operations and assets related to DCH), Euro ('EUR') and Swedish Krona ('SEK') (equipment purchases).

The Group strives to reduce balance sheet currency exposure by matching assets with borrowings in the same currency to the extent possible. It is the Group's policy to hedge transactions where value or time to execution will give rise to material currency exposure, provided that the cost of the hedging instrument is not prohibitively expensive in comparison to the underlying exposure.

The Group's major foreign currency exposures arise from:

i) its capital expenditures relating to its iron ore mining operations in Australia;

ii) its steel and property operations in mainland China denominated in RMB and;

iii) USD denominated debt.

The Group does not hedge translational currency exposures from the consolidation of subsidiaries, whose functional currency is not HKD, as this is a non-cash exposure.

**US Dollar (USD)** The Group seeks to diversify its funding sources and also match funding requirements to subsidiaries whose functional currency and revenues are in USD through USD denominated borrowings. As at 31 December 2008, the Group has HK$8.5 billion equivalent of USD debt exposure which is fully hedged into HKD through the use of forward contracts and cash on hand.

**Renminbi (RMB)** The Group's businesses in China represented an asset exposure in RMB of approximately HK$67 billion as at 31 December 2008 (2007: HK$50 billion). RMB is currently not a freely convertible currency and 'Registered Capital', which usually accounts for no less than 25% of the total investment amount for projects in mainland China, is required to be paid in foreign currency. As the Group's investment in mainland China is expanding, CITIC Pacific has an increasing exposure to the RMB.

For the Australian mining operations, certain RMB denominated capital expenditures to pay the main contractor have been managed through non deliverable RMB target redemption forward contracts. The maximum notional amount of these contracts is RMB 5.3 billion.

**Australian Dollar (AUD)** The Australian 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. USD / AUD forward contracts and leveraged foreign exchange contracts were employed to manage these currency exposures.

The Group entered into multiple leveraged AUD foreign exchange contracts mainly in the second half of 2008. These contracts were intended to minimise the currency exposure of the Group's iron ore mining project. Due to substantial movements in the AUD to USD exchange rate, these contracts gave rise to substantial realised and mark to market losses and due to their leveraged features the amount of AUD to be delivered to the Group increased significantly and exceeded the Group's needs for AUD. Leveraged foreign exchange contracts with a maximum deliverable amount of A$5.3 billion, being contracts delivering AUD in excess of the Group's needs were novated to CITIC Group in December 2008.

The remaining contracts with a maximum deliverable amount of A$2.9 billion as at 31 December 2008 were retained to provide for the Group's further AUD needs. During the year, some of these remaining contracts were restructured into plain vanilla forward contracts that qualify as accounting hedges, as their maturity matches the need of the business. As at 31 December 2008, three unrestructured contracts with a maximum deliverable amount of A$2.0 billion were outstanding. One of the contracts was restructured in March 2009 into plain vanilla contract and the remaining two are intended to be restructured later in 2009.

**Japanese Yen (JPY)** CITIC Pacific issued a JPY Bond in 2005 to diversify its funding sources. From an economic perspective, this bond's currency exposure is managed through a cross currency swap into HKD floating rate payments which does not qualify as an accounting hedge. In addition to the JPY bond, as at 31 December 2008, JPY 6,434 million of exposure remains at the CITIC Pacific level.

For the Australian mining operations, as at 31 December 2008, there was a net JPY 1,814 million exposure for capital expenditures to purchase machinery. This position is partially hedged using plain vanilla forward contracts.

**Swedish Krona (SEK)** The Group's SEK exposure amounted to SEK 373 million at 31 December 2008 due to a contract with Siemens to supply a steam turbine generator for the Sino Iron project. This position is currently partially hedged using plain vanilla forward contracts.

**Euro (EUR)** The Group's EUR exposure amounted to EUR 101 million at 31 December 2008. This exposure is generated by contracts for procurement and design services for the Australian mining project. This position is currently not hedged as the amount is not viewed as material in terms of the operations of the Group.

Subsequent to the losses incurred with respect to the Group's leveraged foreign exchange forward contracts in 2008, the list of approved derivative instruments has been restricted to plain vanilla foreign exchange forwards and interest rate swaps.

## Interest Rate Risk

The Group's interest rate risk arises primarily from borrowings. Borrowings at variable rates expose the Group to cash flow interest rate risk. Borrowings at fixed rate expose the Group to fair value interest rate risk.

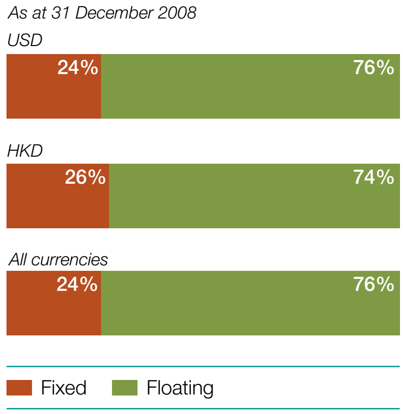
The Group Finance Department manages this risk by considering the portfolio of all of the Group's interest bearing assets and liabilities. The net desired position is then managed by borrowing fixed rate and through the use of interest rate swaps which have the economic effect of converting floating rate borrowings into fixed rates.

The appropriate ratio of fixed / floating risk for the Group is reviewed periodically. The level of fixed rate debt is decided after taking into consideration the potential impact of higher interest rates on profit, interest cover and cash flow cycles of the Group's business and investments.

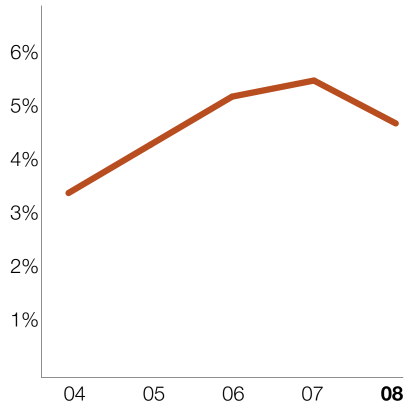
As at 31 December 2008, the Group's portfolio of interest rate derivative contracts had a notional amount of HK$13.2 billion. After hedging, 76% of the borrowing for the Group was floating rate.

The Group's overall weighted all-in cost of borrowing (including fees and hedging costs) in 2008 was approximately 4.7% compared with 5.5% in 2007.

### Interest rate base




### Average borrowing costs



## Credit Risk

To manage counterparty risk, the Group deals with international financial institutions with a credit rating of investment grade or above. The recommended credit rating was subsequently raised to A- (S&P) or A2 (Moody's) and above by ALCO in 2009. For mainland Chinese institutions that do not have an international credit rating, a maximum deposit limit is set that does not exceed the amount borrowed from those institutions. Deposits are liquid, interest-bearing and consistent with treasury and business purpose needs.

The Group Finance Department is responsible for monitoring the limits and the list of approved financial institutions. Management does not expect any losses from non-performance from these counterparties.

## Liquidity Risk

The Group takes liquidity risk into consideration when deciding its source of funds and their respective tenors. It manages its liquidity risk by maintaining substantial undrawn committed credit facilities, money market lines and cash deposits so as to avoid over reliance on any one source and to prevent substantial refinancing in any one period. In addition, the Company has established co-operative agreements with major PRC banks. These arrangements can shorten the credit approval processes substantially when applying for RMB loans.

Management monitors rolling forecasts of the Group's liquidity reserve (comprised of undrawn committed credit facilities and cash and cash equivalents on the basis of expected cash flows). In addition, the Group's liquidity management procedures involves projecting cashflows in major currencies, and considering the level of liquid assets necessary to meet these cash flow requirements. Group Finance also monitors balance sheet liquidity ratios against internal requirements and maintains debt financing plans.

## Group Debt and Liquidity

At the end of December 2008, CITIC Pacific has multiple borrowing relationships with financial institutions in Hong Kong, mainland China and internationally. The Group's policy is to diversify funding sources through bank lending and tapping the capital markets. It seeks to maintain a mix of short and long term borrowing to stagger maturities and minimise refinancing risk.

The financial position of the Group as at 31 December 2008 as compared with 31 December 2007 is as follows:

| *HK$ million* | **2008** | 2007 |
|---|---|---|
| Total debt | **57,234** | 28,654 |
| Cash and bank deposits | **18,296** | 8,045 |
| Net debt | **38,938** | 20,609 |

Total debt increased significantly due to investments in the Group's steel and property businesses in mainland China, purchases of vessels as well as significant capital expenditure outlays for the Australian mining business, for which construction intensified in the past year.

The Company's cash position was bolstered by the issuance of a convertible bond to CITIC Group which was converted into 1,453,125,000 shares, with the Company receiving a net amount of HK$2.5 billion, HK$3.4 billion from the sale of listed investments and HK$917 million from the sale of Air China Cargo.

## Changes in Financing

During the year, bilateral facilities totalling HK$14 billion were established or renewed at the Company and subsidiary level.

For the development of the Australian iron ore mining project, a 20-year US$1.3 billion project finance loan was signed. In addition, a 20-year US$1.1 billion corporate loan was arranged, which is intended to be converted into a project finance loan in due course. As at 31 December 2008, US$792 million of the project finance loan was drawn down.

The Company has also completed a ship financing transaction for US$380 million 12-year term (from delivery of the ships) loan facilities for the purchase of twelve 115,000 DWT capesize dry bulk carriers for iron ore transportation.

## Available Sources of Financing

In addition to the cash and deposits balance of HK$18.3 billion as at 31 December 2008, the Group had available loan and trade facilities totalling HK$20.3 billion and HK$3.4 billion respectively. Borrowings by source of financing as at 31 December 2008 are summarised as follows:

| *HK$ million* | Total facilities | Outstanding | Available facilities | Percentage available |
|---|---|---|---|---|
| Committed facilities | | | | |
| Short term loan * | 4,290 | 3,198 | 1,092 | 25% |
| Term loans | 63,469 | 46,056 | 17,413 | 27% |
| Global bonds *(USD Bond)* | 3,510 | 3,510 | – | 0% |
| Private placement *(JPY Bond)* | 529 | 529 | – | 0% |
| **Total committed** | 71,798 | 53,293 | 18,505 | 26% |
| Uncommitted facilities | | | | |
| Money market lines and short term facilities | 5,645 | 3,833 | 1,812 | 32% |
| Trade facilities | 4,536 | 1,163 | 3,373 | 74% |

* *This is a USD short term bridging loan to support the funding requirement of the iron ore mining project Phase II.*

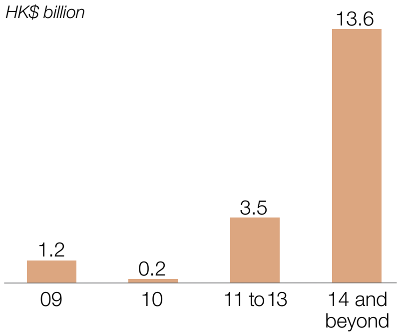
As at 31 December 2008, total committed facilities amounted to HK$71.8 billion, of which HK$18.5 billion (26%) remain undrawn. In addition to the above facilities, the Company has established Cooperative Agreements with major banks in mainland China. Under these Cooperative Agreements, CITIC Pacific's projects in mainland China can apply for credit facilities subject to the banks' approval on a project-by-project basis in accordance with banking regulations in the Mainland.

## Leverage

Net debt divided by total capital was 44% as at 31 December 2008 compared with 26% at the end of 2007.

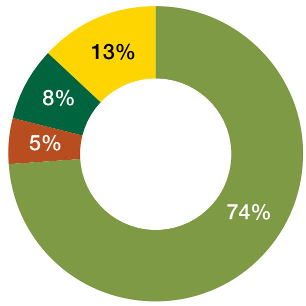
### Available committed facilities by maturity (total HK$18.5 billion)

*As at 31 December 2008*
*HK$ billion*




### Available facilities by type (total HK$23.7 billion)

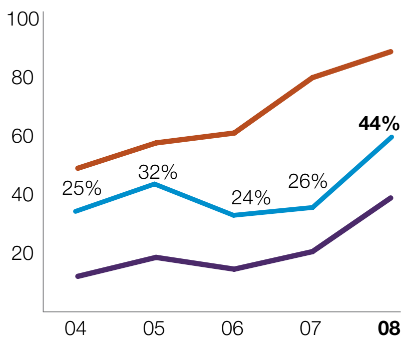
*As at 31 December 2008*




Long term loan
Short term loan
Money market
Trade

### Leverage

*HK$ billion*




Total capital
Net debt/total capital %
Net debt

## Maturity Profile of Outstanding Debt

The Group prefers raising long term debt over short term debt and actively manages its debt portfolio to ensure that the debt maturing in each year will not exceed the anticipated cash flow and the Group's ability to refinance the debt in that year. As at 31 December 2008, outstanding loans that will mature at the end of 2009 amounted to HK$9.4 billion, against a cash and deposits balance totaling HK$18.3 billion.

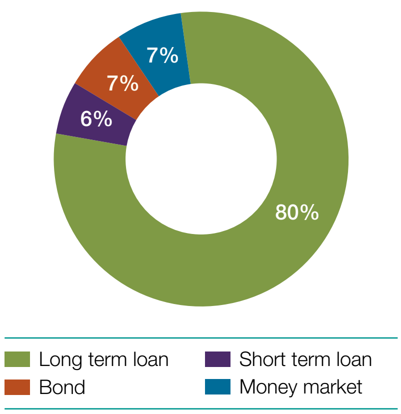
The weighted average life of the Group's debt was 5.6 years (2007: 6.0 years).

| *HK$ million* | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 and beyond | Total | Percentage |
|---|---|---|---|---|---|---|---|---|
| Parent company | 4,601 | 2,992 | 7,690[1] | 7,550 | 4,245 | 8,799[2] | 35,877 | 63% |
| Subsidiaries | 4,781 | 2,633 | 3,896 | 1,005 | 991 | 8,051 | 21,357 | 37% |
| Total maturing debt | 9,382 | 5,625 | 11,586 | 8,555 | 5,236 | 16,850 | 57,234 | 100% |

1. *Includes a US$450 million global bond due in 2011 which was issued by a wholly owned special purpose vehicle.*
2. *Includes a JPY 8.1 billion floating rate note due in 2035 which was issued by a wholly owned special purpose vehicle.*

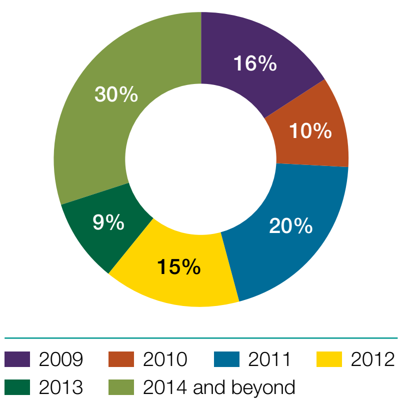
### Outstanding debt by type

*As at 31 December 2008*




### Outstanding debt by maturity

*As at 31 December 2008*




## Loan Covenants

Over the years, CITIC Pacific has developed a set of standard loan covenants to facilitate the management of its loan portfolio and debt compliance. The financial covenants are generally limited to three major categories, namely, a minimum net worth undertaking, a maximum ratio of total borrowings to net worth and a limit on the amount of pledged assets as a percentage of the Group's total assets. CITIC Pacific monitors these ratios on a regular basis and has been in compliance with these ratios.

| | Covenant limits | Actual 2008 |
|---|---|---|
| Minimum consolidated net worth<br>Consolidated net worth | ≥ HK$25 billion | HK$51.7 billion |
| Gearing<br>Consolidated borrowing / consolidated net worth | ≤ 1.5 | 1.11 |
| Negative pledge<br>Pledged assets / consolidated total assets | ≤ 30% | 0.5% |

*For the purpose of the above covenant limits, as defined in the relevant borrowing agreements:*

*'Consolidated net worth' means the aggregate of shareholders' funds, goodwill from acquisitions and developments having been written off against reserves or the profit and loss account, convertible debt and subordinated debt (including perpetual debt).*

*'Consolidated Borrowing' means the aggregate of all consolidated indebtedness for borrowed money (includes indebtedness arising under acceptances and bills of exchange other than in respect of goods or services acquired in the ordinary course of business) and all contingent obligations in respect of indebtedness for borrowed money other than aforesaid consolidated indebtedness for borrowed money.*

*'Negative Pledge' allows certain exceptions including but not limited to any security over any asset acquired or developed, which security is created to finance or refinance the acquisition or development of such asset.*

## Credit Ratings

In November 2008 Moody's and Standard & Poor's downgraded their long-term credit ratings for the Company to Ba2 and BB respectively, following losses on the Company's derivative portfolio. Following the issuance and conversion of the convertible bond into shares to CITIC Group, in February 2009, Moody's and Standard & Poor's upgraded the Company's credit rating to Ba1 and BB+ respectively.

One of the Group's risk management objectives is to maintain a stable credit profile. Despite the uncertain economic environment, the stability of our core businesses will ensure that we meet all our commitments to our lenders and allow us to secure replacement or additional financing to support our funding needs in the future.

## Forward Looking Statements

This Annual Report contains certain forward looking statements with respect to the financial condition, results of operations and business of the Group. These forward looking statements represent the Company's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements.

Forward looking statements involve inherent risks and uncertainties. Readers should be cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward looking statement.