

# Chairman's Letter to Shareholders



Dear Shareholders,

I am pleased to report that CITIC Pacific recorded a profit attributable to shareholders of HK\$5,950 million for the year 2009. This was achieved in a complex and difficult environment.

The conditions under which our businesses operate improved steadily throughout 2009 as major markets in the world began to recover from the economic crisis that began in 2008. Our special steel business was profitable in 2009 despite market challenges. The construction of our iron ore mine in Australia is progressing apace, and our property projects in mainland China were well received by the market when put up for sale.

Our balance sheet remains strong with HK\$36 billion of bank deposits and available committed facilities at the end of 2009, which are sufficient to fund our planned investments. Long-term financing is in place in many of our projects, such as the iron ore mine and properties, and at the corporate level. As we invest in expanded special steel manufacturing capacity, build our iron ore mine and develop our properties, I take note that our net debt to total capital ratio of 42% is higher than ideal. However, as more property projects are completed and sold, and once the iron ore mine begins production, a significant amount of cash will be generated which will reduce our leverage naturally.

The return generated on shareholder's equity for 2009 was 11%. My goal is to see the return increase over time.

We fully appreciate that our investors would like to receive steady dividend payments. After taking into consideration factors including our investment needs and our obligation to repay debts as they mature, your board has recommended paying a final dividend of HK\$0.25 per share, giving you a full year dividend of HK\$0.40 per share.

## Our Businesses and Development Strategies

There is no doubt that 2009 was a very challenging year, and so I am very proud of what we have achieved, thanks to the hard work and tireless efforts of our staff in each of our businesses. New products and new markets were developed and businesses were run more efficiently at lower cost. To put it simply, we have people who know their business and who pursue excellence in what they do every day.

### Special Steel

In a year in which demand for steel was relatively weak, particularly at the beginning of 2009, our managers focused on rationalising product mix to meet the challenges of a changing marketplace. The result was that sales of our special steel products recorded a slight increase from 2008, and our special steel mills all achieved operating profit. We now have over 2,000 product types, all manufactured to customers' specifications – a characteristic of our special steel production. Product types will be further expanded when our new plate production lines come on stream.

Shareholders will have seen that we are in discussion to sell our 65% interest in Shijiazhuang Special Steel. This steel mill is located in the city centre and for city planning and environmental reasons is required to be relocated outside the city. We believe such a task is best handled by the government rather than a private company. Our intention is to continue to serve our customers by expanding our other facilities. At the same time, we will continue to focus on developing new products and raising their overall quality and technology content. This is essential for our continued success in a competitive environment and maintaining our position as the leading special steel manufacturer in China.

### **Iron Ore Mining**

Our mine will be the largest magnetite iron ore mine in Australia. When I first visited the site, I was struck by its sheer size and scope. As I write to you, the gas pipeline that will fuel the 450MW power station has been laid, and planning is underway for the power station's pre-commissioning, the port is substantially constructed, and the first two grinding mills have been offloaded at the port with preparations underway for their installation. Almost 3,000 workers are now involved in building the project, and at the peak of construction this number will reach 4,500.

We have added experienced personnel to our team. Five senior executives from CITIC Construction have relocated to Perth. They bring with them extensive experience managing large-scale international engineering projects. One of them, Dr Hua Dongyi, has been appointed Chairman of CITIC Pacific Mining and will work closely with CEO Barry Fitzgerald. We now have a strong team focusing not only on the construction of the mine, but also on its future operation.

As with all large projects, we have to face and solve many issues and problems, big and small, every day. The project involves construction of some of the largest mining equipment and infrastructure in the world, built by numerous contractors. It requires the application of sophisticated knowledge, extensive experience and strong technical support, as well as the need to manage our contractors. Whilst we are making good progress towards our goal of beginning production on the first mill line by the end of 2010,

there is still much more to be done, and we face many challenges and tough decisions.

### **Property in mainland China**

Our property developments in mainland China are also making progress. One of the two office towers currently being finished in Shanghai Pudong's Lu Jia Zui financial district was sold to a single corporation, which will make its headquarters there. We are optimistic that the other tower will soon be sold, subject to contract, to another major corporation. Our residential developments in Shanghai, Wuxi, Yangzhou and Jiangyin continue to receive strong interest from buyers. The projects we are developing are large scale, and all are in excellent locations. We will be very busy developing them over the next few years, and we expect to see an increased profit contribution from this business.

I am aware of the current concern that the mainland property market could be overheating. We continue to believe that, although there may be short-term volatility, the long-term outlook for high quality offices and housing in China is bright, driven by rising living standards and urbanisation.

### **Strategies**

During the conversations and meetings my colleagues and I have had with many investors and analysts, two questions have been frequently raised: 'What is the business model of CITIC Pacific?' and 'What is the company's strategic direction going forward?' More specifically, will we retain only the main businesses of special steel, iron ore mining and property in mainland China and sell everything else?

I believe CITIC Pacific is, and will continue to be, a company with multiple businesses in a few industries. This is a model that works well for us; however, we are not simply an investment holding company with a portfolio of assets, but rather an operating company. A few years ago, we began to focus on three main businesses, and this exercise has been more pronounced in the past year. When we analyse a business, we look at its market position, competitiveness, future prospects and the extent of our ability to influence its management. Based on these principles, in 2009 we disposed of two power stations, sold a 14.5% interest in Cathay Pacific and restructured CITIC Capital, bringing in CIC as a 40% shareholder.

Most recently, in February 2010, CITIC Pacific agreed to sell our 20% interest in Macau Telecom (CTM) to our telecom subsidiary, CITIC 1616.

As a result of all these actions, we are now the majority owner of almost all our assets. The three main businesses are of course controlled by CITIC Pacific, and they accounted for 67% of the company's total assets at the end of 2009. The balance of our assets – with the exception of the Western Harbour Tunnel in Hong Kong – are also majority owned. They are the Eastern Harbour Tunnel, Ligang power station and our two listed subsidiaries, DCH and CITIC 1616, which will continue to provide stable profits and cash flows to CITIC Pacific.

Our strategy is clear. We will continue to invest capital in special steel, iron ore mining, their related upstream and downstream industries and property in mainland China. Any future businesses we undertake, whether they are the upstream businesses of sourcing raw materials and participating in supporting transportation infrastructure and logistics or developing downstream products, should have synergies with, or supplement and enhance, the value of the main businesses, particularly steel and mining.

Take steel as an example. We are the largest and leading special steel manufacturer in China. The raw materials used, such as iron ore, coal and alloy, are mostly sourced from third parties on the spot market, which can be unreliable and less cost effective than having our own sources. Once our own iron ore mine is in production, it will help meet the demands of our own steel mills and others too. The coal mine in Shandong province we invested in began small-scale production in late 2008. Its high quality coal is ideal for steel making and power generation. Once in full production, its output will reach six million tonnes a year, supplying not just our steel mills but also our power plants. Accessing raw materials, at production cost, will be very important to the future development of the steel business.

To efficiently transport the ore from our mine to our steel mills, we ordered 12 ships for delivery from 2011 onwards. Our port handling facilities at Jiangyin along the Yangtze River have been expanded to receive these ships, which can sail directly there from Australia. Therefore, having access to efficient transportation is also important.

The ore from our mine will not only supply our own steel mills, but also other mills in China. We have already signed letters of intent with steel mills. We believe selling and trading ore and other commodities will help enhance the value of our mining operations.

## Our Management and Governance

2009 was difficult for most major economies and for corporations both large and small. CITIC Pacific was not immune. Not only were we operating in a challenging environment, we were also recovering from the effect that the losses of 2008 had on our organisation.

In April, I became Chairman of CITIC Pacific. Many people have asked me what being a subsidiary of the CITIC Group meant to CITIC Pacific. 'How will the company be run in the future?' 'Will the culture and values of the company change?' 'What are our aspirations?' These are clearly fundamental issues that define who we are and how we intend to move forward. I have given them much thought, and I would like to share some of my thinking with you here.

CITIC Pacific has a proud history. We are managed by a team of highly qualified and experienced professionals who strive to achieve the highest standards. As CITIC Group is now the majority shareholder, we have to be even more vigilant about our obligations to minority shareholders, even as we continue to leverage our relationship with the CITIC Group to access resources and opportunities.

Our employees are very hard working and dedicated. As we evolve to a more formalised decision-making structure with a clear set of guidelines and processes, the businesses will be more resilient in dealing with increasingly volatile conditions. Our employees must become more innovative while operating within the risk management framework we have established, and they will learn to become better managers and better communicators. My aspiration is for CITIC Pacific to be recognised as one of the best-run companies in the world, although I realise that much more needs to be done for us to deserve that accolade.

In my letter of August 2009, I communicated to you a number of initiatives and measures put in place since the end of 2008, with the aim of strengthening corporate governance and improving internal controls.

I am glad to report to you that our investment, executive and asset and liability management committees continue to function well and the overall decision-making process at the company is now more formalised and systematic. Of course, these committees form just one element in our overall effort to put ourselves at the forefront of corporate governance. Equally important is our continued commitment and on-going assessment of areas for improvement. Let me tell you some other initiatives and steps we have taken.

In September 2009, we engaged a consulting firm to conduct a thorough study and assessment of CITIC Pacific's finance function. This exercise not only helped us meet the corporate governance requirements of the Hong Kong Stock Exchange, but more importantly provided us with greater clarity on the adequacy of the finance function in our company. A total of 113 senior employees in our finance areas were interviewed in depth, and a very comprehensive report was produced. I am glad to say that the finance functions at CITIC Pacific are adequately and appropriately staffed with people who have the knowledge and skills to perform well in their respective jobs. However, the report did identify certain areas requiring improvement, including the need for enhanced training and better communication between headquarters and subsidiary companies. We are taking these findings very seriously and have begun to formulate programmes to address them.

One of my goals has been and will continue to be disseminating our financial results to you as early as possible. We have made significant improvements to our reporting process and are upgrading our systems to accelerate the delivery of our accounts to you in the future. Regular readers of our annual report will notice that we have published our 2009 full year results two weeks earlier than in the previous year. We are committed to a more timely release of our financial results, bringing us in line with leading corporations in the world.

For us to do well, we must have the best people – they are our most important asset. Attracting high calibre individuals is crucial to our future as they come with new perspectives, fresh thinking and energy. Our new financial controller and treasurer are quickly making their presence felt and have already made a difference

in a short period of time. Our mining management team has also been strengthened with the appointment of a number of experienced executives.

We need not only loyal and capable employees but also strong leaders. I told our shareholders at the Annual General Meeting that I would be looking for a managing director. I am happy to report that Mr Zhang Jijing was appointed to this position in November 2009. Mr Zhang has been with the CITIC Group for over 24 years and has broad experience in both China and Australia, where he worked for 16 years. I believe he is the ideal person to implement our business strategy. Mr Zhang will work with me, the board and the management team to take CITIC Pacific forward.

At the board level, I am mindful of the fact that structural changes may be needed to meet today's governance standards, in particular the need for more independent directors. This is an area we will address.

We have accomplished much in one of the most difficult operating environments in recent history. The foundations we have laid so far will enable us to grow in a rational manner. But there is still much to be done, and together with our management team I will continue to drive the process of change. Markets are becoming increasingly competitive, and the macro environment is not always going to be in our favour. Our challenge is to continue to perform to the best of our ability and to generate strong returns for our shareholders. I believe that if we can continue to identify and grasp opportunities, the fundamentals are in place for continued success. We have got off to a good start in 2010, and I would like to invite you to share my cautious optimism for the new year – the year of the Tiger!

In closing, I would like to thank our board and our hard working employees for the results we achieved. To our investors and banks, I thank you for your continued support.



**Chang Zhenming**

*Chairman*

Hong Kong, 10 March 2010