

# Chairman's Letter to Shareholders



Dear Shareholders,

CITIC Pacific achieved a profit attributable to shareholders of HK\$8,915 million for the year 2010, the second highest in the history of the company. This was due both to the strong performance of our business, particularly special steel, and the sale of non-core assets, which added HK\$3,008 million to our bottom line.

Return on equity improved to 14% for the year compared with 11% in 2009, and our financial position remains strong. As at the end of 2010, bank deposits and available committed facilities totalled HK\$43,152 million, sufficient to meet our investment needs. As we are investing to complete our iron ore mine in Australia, finish the expansion of our special steel business and develop our property projects in mainland China, our net debt has inevitably increased, and as a result leverage was 46% at the end of 2010. This is higher than ideal but not something I am overly concerned about as CITIC Pacific is coming to the end of a major investment period. When our iron ore mine begins operation and more property projects are sold, substantial cash will be generated which will naturally reduce our leverage.

Your board recommends paying a final dividend of HK\$0.30 per share, giving you a full year dividend of HK\$0.45 per share. This is an increase of HK\$0.05 per share compared with that of 2009. We considered a number of factors when deciding how much to pay our shareholders, including our future investment needs and our obligation to repay borrowings.

## Our Businesses

For CITIC Pacific, 2010 can be characterised as a year during which we made significant progress in all our businesses, particularly our three major businesses. In this letter, I will update you on their activities so you can understand clearly why we chose to invest in these businesses, what our expectations are for them in 2011, and why we think they will transform our company. I believe CITIC Pacific has emerged from the difficulties faced two years ago and has become stronger and better positioned for the future.

### Iron Ore Mining

The number one priority for our management continues to be bringing our magnetite iron ore mine in Australia into production as early as possible. During the year, we made tremendous progress towards achieving this objective, as our management team and employees in Australia have all been dedicated to ensuring the completion of the mine, which is unprecedented in scale.

In mid January, we provided a project progress update. As I write, the structures for major facilities such as the power station, four grinding mills, dewatering plant, desalination plant and port are being completed. Commissioning of the power station has begun, and the desalination plant will begin soon so the necessary power and water can be supplied to other components of the production line. Our target is to begin commissioning the first production line as an integrated system by the end of July. Export of iron ore

is expected to be in the latter part of this year. By then, the second production line should also be ready for system commissioning. When the senior management of our major contractors, equipment manufacturers and suppliers met in Beijing in January, everyone expressed their strong commitment to the success of this project and the start of production according to plan.

In the business review section, you will find a detailed project report. I would like to explain here the key reasons for the schedule change. For each component, there is one – and in some cases, more than one – power supply and control system, which our engineers call ‘e-houses’. These are effectively the heart of their respective components or plants. Without them, nothing can operate. There are altogether 17 of these e-houses needed for commissioning the first production line. Of these, 8 have been delivered to site and are in various stages of being installed and tested. The remaining e-houses are scheduled to arrive in mid May. Delivery of these e-houses was delayed primarily due to design changes on some units, which affected their manufacturing schedule. We also experienced some contractual disputes, which are not uncommon in such massive projects. One example was our termination in October of the company responsible for building our power station due to their breaching of the contract. This was certainly not a happy situation. However, we were able to quickly engage most of the subcontractors directly to continue their work, which minimised interruption to the construction.

Since we began this journey of building the biggest magnetite iron ore mine in Australia, we have learned a great deal despite the steep learning curve. We are now more familiar with operating conditions in Australia, better equipped to deal with issues arising, and more confident that once the mine is completed we will be able to operate it as well as any other organisation. It is no secret that the cost of building and operating a magnetite mine is higher than that of a haematite mine. Although the money we are investing is by no means a small amount, let’s not forget that the price of iron ore has increased considerably since we initially committed to the investment. Personally, I

believe that there will be a continuing strong demand for the type of high quality ore we will be producing, and this mine will add substantial value to your investment in CITIC Pacific.

Looking back, I have to admit that we have come through some challenging times, and the process has not been without stress. But, I am happy to see that we are making solid progress. Our goal is to complete construction of the mine as soon as possible so that it can contribute to our bottom line over its 25-year life.

### **Special Steel**

Our special steel business recorded an impressive HK\$2,102 million in profit contribution, a growth of 49% from that of 2009. It is worth noting that this was achieved by our two plants – Xingcheng Special Steel and Xin Yegang – unlike in 2009 when we also had contribution from Shijiazhuang Steel, which was subsequently sold. Over the last three years, we have expanded our production capacity. More importantly, we further broadened our portfolio of products, optimised their mix, and increased their technology content. In certain categories of special steel, we are the only producer in China. We are on track to reach our target annual steel production capacity of nine million tonnes this year. Our goal is to supply our customers not only with high quality bar steel but also new special steel plates and increased volumes of seamless steel tubes.

The market for special steel has significant potential as China continues to develop and the demand for special steel inevitably grows to become more in line with that of the industrialised countries. As the largest manufacturer dedicated to the production of special steel in China, we have the advantage and leading market position to excel. However, we cannot ignore the fact that this market has grown increasingly competitive and customers expect better quality products and more services. For this reason, the management at our steel mills have been focusing their efforts on raising product quality and expanding their customer base. The result is that we are producing an increasing percentage of very high quality products every year. These efforts are particularly important for

our special steel plates, which are new to us. With one of the two plate lines entering production, our efforts are already paying off as we see improving margins in this area. Of course, there is much more to be done for our new plate products to occupy the same leading position as our well established bar products.

The first two months of this year saw good production volume at our steel mills. Product prices were firm, supported in part by the increased price of raw materials. For 2011, we should bear in mind that we are facing increased capacity in the steel industry in China, which will put pressure on all producers. However, we are comforted by the fact that supply and demand in the special steel sector is mostly balanced and the industries we sell our products to all have strong future growth potential. My colleagues in our steel business have set themselves a challenging target for this year and, as always, they will work very hard to achieve their objectives.

### Property in Mainland China

Construction and sales of our property projects in mainland China are progressing apace. The twin office towers in Shanghai Pudong's Lu Jia Zui financial district are being fitted out before they are handed over to Agricultural Bank of China and China Construction Bank, which have purchased them for their Shanghai headquarters. Our residential developments in Shanghai, Wuxi, Yangzhou, Jiangyin and Hainan Island are being completed in phases.

In the past year, a number of measures were put in place by the Chinese government with the aim of moderating the rapid increases in property prices. These have clearly had an impact on our property sales. I have often been asked by investors if I was worried about this and whether we should change our property development strategy. I am a firm believer in the long-term potential of the Chinese property market. Of course, short-term fluctuations are inevitable, but CITIC Pacific is a long-term developer in this market. We have sufficient financial resources and staying power. What's more, our land banks were acquired some time ago and

at relatively low prices. So we are better equipped to withstand market volatility, and temporary adjustments in the market do not worry us unduly.

The projects we are developing are large in scale and very well situated. According to our development schedule, we will be busy for the next seven to eight years. In the meantime, we will be on the lookout for attractive new sites. I would like to point out here that CITIC Pacific is not a pure property company, and therefore we are not pressured to buy land or sell completed units. We are also fortunate to have a team of highly experienced property professionals who are very good at designing and building to suit the needs of individual markets in China. This is evident in our products being well received by the market when they go on sale.

### Our People and Our Organisation

As in any organisation, no matter what our strategy is and how good our assets are, the key to success is always people. In my letter of March last year, I mentioned we were looking at ways to enhance our training programmes so that our employees would be equipped with up-to-date knowledge and skills they can apply in their jobs. In 2010, we further strengthened our training efforts by adding an experienced professional to focus on senior management training. We also renewed our focus on hiring young talent through our graduate training programme and took on 12 new trainees who will be the future of our business.

With improved communication among our operations, we are a much stronger organisation. I often remind people that effective communication is essential to our success and that this is a continuous process which needs to be improved at every level. To that end, we held our second group-wide finance conference last year which was attended by senior finance personnel from all parts of our business. This conference was invaluable for ensuring that our finance policies and priorities are aligned with our overall business strategy. Similar activities are now taking place regularly in other businesses and functions.

I am proud to say that as a direct result of our improved communication and management we are able to provide our 2010 financial results to shareholders even earlier than last year, which was already a big improvement from the previous years. We are now in the forefront of leading Hong Kong listed companies disseminating timely information to shareholders and the public.

I would like to mention that five long serving directors will retire in May. I want to thank them for their many and varied contributions to CITIC Pacific's development over so many years. I am also pleased to report that two highly experienced businessmen have agreed to join our board in the middle of the year as independent directors. They will be able to provide a variety of perspectives to the board, which will benefit our company.

## Our Future

In the nearly two years since I have been Chairman of CITIC Pacific, we have expanded and built our three main businesses of special steel, iron ore mining and property in mainland China. We also sold a number of assets over which we had little management control or were not a strategic part of our future. We are now much more focused, and this is clearly demonstrated by the fact that our main businesses accounted for 72% of our assets at the end of 2010. Our future emphasis will be on further developing the businesses we have so that we can become a leader in each of them. This is what I believe our shareholders and investors should focus upon. I spelled out quite clearly in my last annual letter that CITIC Pacific is, and will continue to be, a company with multiple businesses in a few industries.

In December, I was appointed Chairman of CITIC Group, the 58% shareholder of CITIC Pacific. I have spent almost my entire career with CITIC Group. Since its establishment in the late 1970s by Mr Rong Yiren, CITIC Group has grown into the largest conglomerate in China with assets of over RMB2.5 trillion and businesses ranging from banking and insurance to resources and property. I am very honoured to be given the opportunity to lead the Group, and I welcome the challenge my new position brings.

In June last year, during an interview with Caixin Media my predecessor Mr Kong Dan and I talked about the development history of CITIC Group and why we believe this is the right time for the Group to be transformed into a shareholding company. We are now at the stage of consolidating information at the CITIC Group level. Clearly, one of the benefits of the process is that it is an opportunity to take stock and develop plans to achieve greater synergies among the businesses of the whole Group. One example is the real estate business. CITIC Real Estate has a substantial property business with a focus on residential development. Moreover, it has a vast sales network. CITIC Pacific is also an experienced property developer, particularly in the development of commercial properties. The two companies are working together with the objective of leveraging off their individual strengths and utilising their resources effectively. Although they already have an agreement to work more closely together, including sharing market intelligence and sales networks, we are considering the possibility of further integration. There are likely to be other areas we identify that could serve CITIC Pacific well and benefit CITIC Group as a whole. Any significant opportunities would be reviewed carefully by the CITIC Pacific board and presented to shareholders for approval as appropriate. It is clear that CITIC Pacific is, and will continue to be, a very important part of CITIC Group.

Our employees are fundamental to our success as a company, and I thank them from the bottom of my heart for their dedication and hard work. I would also like to say thank you to our board, our investors and banks for their trust and support.



**Chang Zhenming**

*Chairman*

Hong Kong, 3 March 2011