Review of Operations

CITIC KA WAH BANK LIMITED (THE "BANK")

Retail Banking Group

The Bank's retail banking business registered another year of strong growth in 2004. Building on its strategy of competitive differentiation through the delivery of exceptional value and pragmatic solutions to customers, its Retail Banking Group ("RBG") continued its drive in product innovation for affluent customers during the year. Business momentum was further boosted by a number of important business initiatives, including the Bank's re-entry into the retail mortgage loan and personal loan markets, the introduction of its proprietary yield-enhancement programmes, and the launch of the small business customer segment as a new business development focus.

The success of RBG's business strategy and its customer-centric service orientation was evident in the significant progress made in the performance of the business unit. Total non-interest income was HK$273.7 million, representing a 28% year-on-year increase. Active management of the risk profile of the Bank's retail loan book led to a hefty reduction in provisioning charges. As a result, RBG recorded a growth of HK$175.2 million in profit before tax in 2004, a 170% improvement in its contribution compared to 2003.

Enhancement of Wealth Management Services

RBG continued to build on the success of the NOW account, maintaining a high level of client retention during 2004, with average customer balance standing firmly in the region of HK$400,000 each; a high proportion of this client base was also active in Hong Kong stock trading through CCMH. Management is pleased with this performance and believes this will provide a healthy base for further developing the Bank's Wealth Management business going forward.

Meanwhile, in pursuit of enhancing wealth creation for the Bank's affluent customers, a number of financial planning solutions were introduced during the year:

- ***RMB+ China Linked Services:*** A premium package of China-related services designed to provide value-added financial convenience for customers who demand relevant personal Renminbi banking services, as well as business-focused CEPA-related banking benefits.

- ***Yield-Enhancement Programmes:*** The Bank launched its inaugural proprietary Hong Kong dollar callable step-up certificate of deposit ("CD") programme in July 2004 and, subsequently, a similar US dollar programme in September 2004. Both programmes offered 100% principal protection and stepped-up interest rates which enabled customers to earn higher returns (up to 18.5% over five years) than time deposits with similar tenors in the respective currencies. The two programmes met with resounding successes, attracting total subscriptions of up to HK$1.3 billion.

Another yield enhancement solution was the step-up deposit launched in October 2004. Available in both Hong Kong and US dollars, it offered customers bonus interest rates for keeping their deposits with the Bank over a period of five months. The programme was greeted by an overwhelming response, drawing HK$2 billion in deposits from 4,865 customer accounts in the last quarter of the year.

- ***Bancassurance:*** Three life insurance plans were introduced during the year to meet the varying life cycle needs of customers: the "HOPE Educator" plan, designed to meet childrens' education needs; the "BRIGHT Insurance" plan, designed for affluent customers looking for a yield-enhancing protection plan; and the "WARMTH" retirement plan, with an annuity option. The Bank's success in this area was reflected in its 26% growth in insurance fee income during the year.

Backed by these successful initiatives, Wealth Management income recorded a 26% growth over 2003, and new core relationships acquired during the year totalled 44,000.

Re-entry into Retail Lending Market

As Hong Kong's economy returned to a firm path of recovery, both unemployment and personal bankruptcies were showing a definitive downward trend in early 2004. Helped further by the implementation of positive data sharing in the banking sector, the Bank made its decisive re-entry into the retail lending market in the second quarter of the year.

In the area of retail mortgage lending, RBG rolled out a series of market-competitive solutions that allowed customers to select from a range of fixed-rate mortgage plans, or Prime- and HIBOR-based floating rate mortgage plans, depending on their individual financial circumstances and interest rate outlooks. On the unsecured personal lending side, RBG launched Dollar$mart, a personal instalment loan product bundled with credit card benefits at a single competitive rate. Other Dollar$mart products introduced throughout the year included a revolving loan product with first-in-market "payment holidays" and personalised interest rates, as well as tax instalment loans.

The new initiatives successfully drew in HK$3.4 billion and HK$122 million in new bookings, respectively, for mortgages and unsecured personal lending. Moreover, despite fierce pricing competition, the Bank was able to uphold its margins through rigorous asset and liability management, which strives to balance the products' asset qualities and profitability.

Robust Growth in Credit Card Business

A healthy growth in RBG's credit card business was recorded in 2004, despite the pressure of an intensively competitive environment. Total new sales and account receivables increased by 43% and 26.2%, respectively, compared to the industry averages of 22% and 3%, respectively, according to data released by VISA Hong Kong. A new product, the Business Credit Card, was launched in the fourth quarter with SMEs as the target segment. RBG will continue to grow its credit card business aggressively, with the focus on credit quality and profit potential.

Launch of Business Banking Segment

In mid-2004, the Bank undertook a client segmentation initiative whereby small business customers with an annual sales turnover of HK$50 million or under, or an outstanding loan value with the Bank of HK$20 million or below, were segregated from the Wholesale Banking Group and placed into the Business Banking segment within RBG. The objective was to allow RBG to embrace this clientele with dedicated resources that suit their business needs. The service platform was designed to encompass product management, risk portfolio assessment, branch distribution and dedicated working capital lending specialists.

The "BUSINESS NOW" programme, launched in October 2004, offers these small business customers comprehensive, flexible banking services and leverage that will help them stay ahead in today's highly competitive business environment. It features an interest-bearing business checking account that enables these customers to more effectively utilise their available cash balances and maximise interest earnings when funds are idle.

RBG plans to introduce more upgraded services in 2005 to provide further hassle-free solutions to suit the business financial needs of this clientele.

Expansion of Cross-Border Revenue Base

Another significant development during the year was the expansion of the Bank's revenue base into the China mortgage market. Two mortgage direct sales teams were established, one located in Shenzhen to cover business opportunities in the Pearl River Delta region through the Bank's fully-owned subsidiary, CIFC, and the other in Shanghai to cover the Yangtze River Delta region through the Bank's Shanghai branch. Both teams work very closely with the Wholesale Banking and China Banking Groups, as well as with other CITIC companies, to provide end-user mortgage products and service support to leading property developers of high-quality luxury residential projects in China.

Significant Improvement in Asset Quality

As a result of rigorous credit risk management and significant improvement in effective collection management and delinquency rate reduction, RBG was able to write-back HK$0.5 million in provisions in 2004. The Bank's residential mortgage delinquency ratio was 0.35%, better than Hong Kong Monetary Authority's published industry average 0.38%. The annualised net charge-off ratio of its credit card portfolio was 3.10%, which was also lower than the sector average of 4.73%.

Outlook

With the firm foundation built over the past years, RBG is well-poised to capitalise on the growing market momentum both in Hong Kong and China. In particular, it will focus on launching a new upscale retail banking programme in Hong Kong in the coming year. Other areas will include the continuing enhancement of its wealth management services and i-banking platform for affluent customers, as well as the introduction of upgraded services for the Business Banking segment. In China, efforts will be coordinated to leverage on the Bank's growing presence in the Pearl River and Yangtze River Delta regions.

CITIC KA WAH BANK LIMITED

Wholesale Banking Group

In 2004, the Bank's Wholesale Banking Group ("WBG") embarked on a three-pronged strategy to build on its business foundation: enhancing its overall service quality; strengthening its delivery capability; and perfecting its total customer experience through proactive relationship management. WBG places emphasis on identifying customer needs and offering tailor-made financial solutions to a wide spectrum of mid-cap companies and large corporations.

To this end, thorough reviews were conducted to align WBG's resources, refine its service methodology, and enrich its product range. Smaller customers were transferred to RBG where they will benefit from the portfolio business approach of the newly created Business Banking unit. In doing so, valuable WBG resources can be applied to focus on customising financial solutions for the mid-cap companies and large corporations. The potential for enhanced service sophistication is great, with more room to partner with the Treasury and Markets Group for structuring support.

In the third quarter of 2004, WBG further strengthened its ability to take on the increasing volumes in syndicated loans as well as trade finance and remittance businesses by integrating the Financial Institutions Department into the WBG family.

With asset quality improvement as an ongoing target, WBG has always placed a high priority on risk management. Over the past two years, it has paid close attention to refining its risk management tools and disciplines to ensure that they are appropriately implemented in its business. These measures have yielded good results, with its loan loss provision hitting a five-year historic low in 2004. Management is pleased that WBG's asset quality and business underwriting foundations are more solid than ever before.

Corporate and Syndication

The Corporate and Syndication Department targets customers who are Hong Kong-based corporates and multinational corporations. It also handles origination and distribution work in the loan syndication market. To keep pace with the sophisticated needs of its customers, dedicated relationship management teams were formed during the year, and were equipped with specialised skills in a number of selected business segments. New business models were put in place to facilitate transaction processing in relation to real estate projects, hotel development and investment, as well as infrastructure projects, such as power plants and toll roads.

As a result of its sharpened business and customer focus, the Bank acted as sole arranger for a number of sizeable syndicated loans in Hong Kong and China, successfully concluding for our customers term finance in excess of HK$4 billion in 2004.

China Corporates

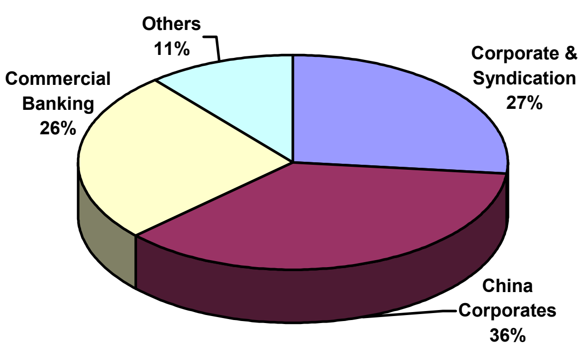
The China Corporates Department has customers that include major China state-owned enterprises, Hong Kong-listed red-chip companies, privately-owned corporations in China, and companies of other origins that do business predominantly in China. These customers are served by veteran bankers who have a deep knowledge of the Chinese market, and by the full support of the CITIC companies in China, including CIB and CITIC Securities Company Limited. In 2004, the Bank boosted its delivery network by opening a branch in Shanghai, giving it a foothold for developing our business in the Yangtze River Delta region in Eastern China. That will complement its business development drive in the Pearl River Delta region in Southern China through CIFC, the Bank's wholly-owned finance subsidiary in Shenzhen. With these two business development pillars in place, and leveraging on the network of our parent CITIC, the Bank is confident that it will be able to significantly broaden its service and capability offering, as well as its customer base, in China.

Riding on China's impressive economic performance and the rebound of Hong Kong's economy, the China Corporates Department reported continued satisfactory business growth in 2004.

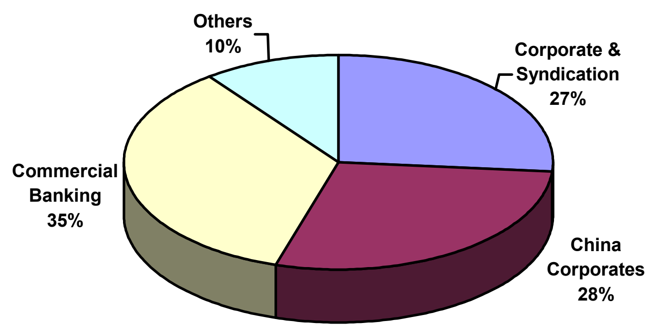
Commercial Banking

The Commercial Banking Department offers banking services to public and privately-owned middle-market companies that are primarily of Hong Kong origin and are engaged in the manufacturing and trade businesses. In 2004, as part of the Bank's commitment to improving service quality, it upgraded its bills computer system and further expanded its range of trade finance products. Cross-selling of its customer base continued to be a main business driver, and increased collaboration with RBG, Treasury and Markets Group and CCMH has helped to generate useful fee income during the year.

WBG 2004 Loan Asset Breakdown



WBG 2004 Operating Income Breakdown



Financial Institutions

The Financial Institutions Department is a new member of the WBG family. Leveraging on its close relationships with correspondent banks and export insurance agencies, WBG was able to strengthen its loan syndication distribution channels and business referral networks, as well as its trade finance capability. Going forward, in addition to continuing its support of both WBG and the Treasury and Markets Group, the Financial Institutions Department will be exploring new revenue opportunities by serving local non-bank financial institutions on niche products.

US Branches

The Bank currently operates two branches in the US, in Los Angeles and New York, where their sizeable Asian communities had traditionally formed the bedrock of its customer base. With the realisation of the Bank's expansion strategy in China, these branches will play an important and strategic complementary role to help meet the needs of the Bank's Chinese customers who are looking for investment opportunities in the US. The US branches will also be actively expanding their customer bases to include US-based corporations that are engaged in Sino-US trade, or have banking and financing needs for their activities in China. The US branches will create meaningful new revenue streams for the Bank in due course.

Outlook

Growing the Bank's customer base and revenue streams are the primary goals of WBG. Its strategy is to ensure that it has an intimate knowledge of its customers: their services and product ranges, their business goals and, hence, their financing needs. In 2005, WBG will continue to expand its skilled talent pool to enable the Bank to increase its market share, particularly in the business sectors where it has successfully developed a niche position. Project teams, drawing on cross-departmental resources, will help to streamline operational procedures, and shorten the delivery time of products and services to customers. A Strategic Development Unit has been formed to design and promote trade finance, wealth management, insurance, and treasury products that will benefit its customers.

CITIC KA WAH BANK LIMITED

Treasury and Markets Group

The year 2004 was awash with mixed and sometimes diverging market signals; key among them included rising US interest rates and continuing weakness in the US dollar, the widening gap between the London Interbank Offered Rate ("LIBOR") and HIBOR, and the flood of excess liquidity into the local capital market amid speculation about a revaluation of the Renminbi. Faced with such market uncertainties, the Bank's Treasury and Markets Group ("TMG") played a critical role not only in its liquidity and risk management, but also in coming up with smart yield-enhancement and hedging solutions for retail and corporate customers alike. TMG's sharp market sense and innovative product development skills became its key market differentiators.

Liquidity Management

Maintaining a high liquidity position has always been among the Bank's top priorities. Apart from keeping daily long positions in cash, it also holds a portfolio of high-grade marketable securities with short maturities. This portfolio can be converted quickly into cash in case of a sudden drain of liquidity in the market. Periodic stress tests are performed in conjunction with various departments so as to ensure that the Bank's liquidity position is adequate, even with changes in the market environment.

Guided by the Bank's prudent liquidity management philosophy, TMG has been extending the tenor of the Bank's liability structure by diversifying its funding sources. During the year, it launched a number of Certificates of Deposit ("CDs") issues in the local capital market with maturities ranging from one to five years, drawing a total funding of HK$6.96 billion. For those CDs with embedded derivative structures, TMG neutralised the Bank's risk by selling these structures to other banks. As a result, in addition to increasing the deposit base, TMG was able to generate an attractive fee income for the Bank.

Separately, the Bank's successfully tapped the international Eurobond market with a US$300-million five-year fixed-rate senior debt issue, which, together with the two other outstanding issues - a US$300-million Lower Tier II issue maturing in 2011 and a US$250-million Upper Tier II perpetual issue – helped to significantly strengthen its capital structure on the liability side of the balance sheet. In order to match the interest rate tenor of the Bank's assets, TMG swapped the fixed-rate coupons of the CDs and the Eurobond into floating rate. This enabled the Bank to lock in funding at an attractive credit spread despite last year's bullish capital market environment.

Investment Management

TMG is also active in managing the Bank's diversified investment portfolio of different asset classes. The highest priority is placed on balancing risk and return, where risk factors include interest rate risk, re-investment risk, foreign exchange risk, credit risk and country risk.

In anticipation of rising interest rates, it started to systematically reduce the duration of its fixed-income holdings in 2003 by replacing maturing securities with short maturities, and by putting on hedges to swap fixed-rate coupons for floating-rate income streams. As at the end of 2004, the average duration of the held-to-maturity fixed-income portfolio was less than two years. The Bank is now well-poised to seize opportunities to replace maturing securities over the next two years with higher yielding fixed-income bonds. Against a backdrop of continuing interest rate increases in the foreseeable future until probably the end of 2005, its strategy is to extend the duration of the portfolio by reinvesting in securities with longer duration at higher yields.

Enhanced Vigilance in Risk Management

The foreign exchange and interest rate markets were both highly volatile in 2004. The US dollar showed no signs of arresting its downward trend against other major currencies. The US Federal Reserve embarked on a series of interest rate hikes beginning in June 2004 to bring the US Fed Funds rate from 1% to 2.25% by December 2004. The US bond market responded with a big sell-off in the first half of 2004. Yet, Hong Kong dollar interest rates remained stubbornly low, suppressed by the ample liquidity in the local market; three-month inter-bank deposit rates stood at an unprecedented low range of between 1.2% and close to 0% throughout the year.

In response to this unusual scenario, the Bank has stepped up its vigilance in rigorously controlling its risk exposure to both foreign exchange and interest rates. The Asset and Liability Management Committee ("ALCO") and TMG meet regularly to set limits and review our trading and investment management strategy. An independent Market Risk Management Unit checks and reports on the risk limit utilisation of its trading operation on a daily basis. The implementation of the Value-at-Risk methodology since the third quarter of 2004 has also greatly enhanced its ability to monitor and manage overall market risks.

Infrastructure

The Bank continued to invest in the necessary infrastructure to support its long-term business development during the year. The front office treasury system was upgraded and advanced pricing models were installed. Internal procedures were reviewed and updated periodically to incorporate the most up-to-date information. Sophisticated risk management systems were put in place to ensure that adequate controls were implemented and that full compliance with such controls would not be compromised by the robust growth of its treasury business.

Customer-Driven Business Focus

Another key focus during the year was to transform TMG into a market-oriented, customer-driven trading and distribution arm for WBG and RBG. Significant efforts were made to align its resources to create timely and relevant treasury solutions to meet the varying needs of the Bank's corporate and retail customers. Its success was most evident in the overwhelming response to the Bank's various proprietary yield-enhancement structured products, launched and distributed through the retail branch network.

Meanwhile, TMG also plays a critical role in the Bank's business development task force, where it is spearheading efforts to establish a treasury solutions platform in China, with the goal of supporting onshore business acquisition by the Shanghai branch and Beijing representative office, as well as through CIFC in Shenzhen and other CITIC companies on the Mainland.

Looking ahead, TMG continues to see tremendous potential for value enhancement structured products in 2005 and will strive to strengthen its structuring capabilities to deliver value-added solutions for the Bank's customers. Efforts are also underway for joint marketing by WBG and TMG to offer corporate customers in Hong Kong and China treasury advisory services and customised innovative hedging solutions that will create value for this clientele in times of volatile market and business environments.

CITIC KA WAH BANK LIMITED

Corporate Citizenship

As a home-grown bank with its roots firmly planted in Hong Kong for over 80 years, the Bank has always been conscientious in its responsibility to give back to the community it serves. During the course of 2004, the Bank continued its pursuits to benefit various worthy and charitable causes targeted at nurturing the Chinese youth to become tomorrow's leaders, and providing for the needy in Hong Kong, China and beyond.

Sponsorship

Along the lines of its stated mission to foster youth development, the Bank participated as sole sponsor of a number of meaningful and exciting youth programmes during the year. These included the Youth Volunteer Leaders' Conference, which the Bank sponsored for the second year. Organised by the Hong Kong Federation of Youth Groups for 800 outstanding youngsters who actively participate in voluntary services in Hong Kong, the aim of this event was to equip these young people with the leadership skills required to become youth volunteer leaders.

Separately, it also sponsored the Business Entrepreneur Enhancement Programme. Coordinated jointly by The University of Hong Kong and the Hong Kong Economic Times, the programme targeted and encouraged university and secondary school students to experiment with their entrepreneurial flair in the real business world by giving them a chance to jointly operate stalls at the 2005 Lunar New Year Fair.

Other sponsorships included the *Asian Wall Street Journal's* Hong Kong Education Students Programme, which involved the distribution of 1,600 complimentary student copies of the newspaper in seven local universities on each school day, aiming to cultivate their interest in and knowledge about the latest business news, and the Shanghai Study Exchange Programme, a cultural and intellectual exchange programme organised by the Cambridge University's Hong Kong and China Affairs Society for up to 40 students.

Donations

The Bank's strong commitment to serving the community was also reflected in its continuous support of a number of charitable organisations through donations. In response to the South Asian earthquake and tsunami tragedy, the Bank donated HK$500,000 to the Hong Kong Red Cross South Asia Relief Fund and raised another HK$326,186 through a staff fund-raising appeal for its relief operations in affected areas.

It also donated a batch of old-edition bank notes with a total face value of HK$68,895 to a charity auction held at Yan Chai Hospital's Annual Charity Ball. The auction successfully raised a total of HK$278,000 for Yan Chai Hospital's youth services. In another fund-raising activity, the Bank raised HK$200,000 for the CITIC Lü Se Gong Cheng Ji Jin to finance the second phase of the Huangyangtan Afforestation Project in the Mainland.

Meanwhile, the Bank continued to support Dress Casual Day and the Corporate and Employee Contribution Programme organised by the Community Chest. It also participated in a number of donation-in-kind projects, such as the donation of solar-powered ruler-calculators to students in the poorest regions of the Mainland, and the donation of moon-cake boxes by its staff in support of the Neighbourhood Advice-Action Council's moon-cake box decoration contest, also sponsored by the Bank.

Community Services

The establishment of the Bank's Corporate Volunteer Team in January 2004 underlined its strong enthusiasm for serving the community. To promote youth volunteering, its Corporate Volunteer Team partnered with different youth organisations during the year to visit various institutions operated by charitable organisations, including a centre for the mentally disabled, a nursery home and a centre for the elderly. It also arranged career workshops for university students with a view to giving them better insights into career prospects in the banking industry.

Award

In recognition of its strong commitment to caring for the community and its unfailing endeavours to promote corporate citizenship, the Bank was awarded the "Caring Company Logo" for the second consecutive year by the Hong Kong Council of Social Service in January 2005.

CITIC INTERNATIONAL ASSETS MANAGEMENT LIMITED

CITIC International Assets Management Limited ("CIAM") took on the mission of strengthening the management of the Group's non-performing assets at the end of 2002 when, with the re-organisation of the Group, CIAM was injected with its portfolio of distressed loans and assets. Since then, CIAM has been working diligently to deliver on this mission; it has also allocated resources to earmark direct investments as a key business focus. With its ultimate objective being to support the Group's goal of becoming a financial supermarket, it has been pursuing a two-pronged business strategy: to reduce the pressures of non-performing assets on the Group's earnings, and to explore and pioneer the Group's efforts in new business arena within the financial services sector.

As in past years, CIAM firmly believes that its core values of "Harmony, Creativity and Professionalism" will be important drivers to help it execute its business strategy effectively, and it remains committed to working closely with other CITIC companies to fully leverage synergies within the Group.

Recoveries of Non-Performing Loans and Assets

CIAM made steady progress in its efforts to recover non-performing loans and assets in 2004. Total non-performing loans stood at HK$503 million at the end of December 2004, representing a reduction of HK$22.86 million for the year. Helped by HK$26 million in write-backs and a modest new loan provisioning of HK$3 million, it was able to achieve a net write-back of HK$22 million for the full year, which was a significant improvement over the same period last year. Moreover, it was also able to record a profit of HK$25 million from the successful disposal of a portion of its swapped assets.

Against the backdrop of a steady economic rebound in Hong Kong and coupled with its successful track record in recoveries and management of distressed assets, CIAM expects to deliver sustained performance going forward.

Direct Investments and Structured Loans

In order to more effectively deploy its free funds to optimise potential returns, CIAM seeks to selectively participate in short-term treasury activities.

It has also been actively developing its direct investment business since 2003, and have been stepping up its efforts to identify projects in China which offer attractive prospective returns. In addition, to meet the varying needs of its customers, it also offers integrated financial services, ranging from advisory to structured finance support.

In pursuing direct investment opportunities, CIAM's objective has been to attain a relatively long-term and sustainable return for our shareholders by forming joint venture companies, or invest in funds, with a focus on specific industries or regions in Mainland China where it sees significant growth prospects over a five-year horizon. In 2004, it built its direct investments portfolio largely pursuant to this strategy. Aggregate direct investments made during the year amounted to approximately HK$100 million, including a project in Tianjin, an area which it has earlier identified as offering potential for economic growth.

Meanwhile, its co-invested companies, Shenzhen Guocheng Century Venture Capital Limited and Shenzhen Torch Venture Capital Management Limited, became operational during the period, and have prudently invested in three growing small- to medium-size enterprises that are engaged in telecommunications and network-related businesses. A number of other projects believed to have promising prospects are currently being scrutinised for due diligence work. It is expected that aggregate investments by these co-invested companies will be in the region of RMB40 million to RMB50 million by the end of 2005.

Choosing the appropriate funding, partnership and exit strategies to enhance liquidity and returns for its direct investment portfolio is an important element of CIAM's work. It is in active discussions with various overseas investment institutions and will selectively seek different listing channels for these purposes.

CIAM is committed to continuously look for new investment opportunities through a broad range of investment channels, not only to strengthen its foundation for future growth, but also to work towards its goal of transforming itself into an internationally recognised, China-focused direct investment house.

Raising Professional Standards

To support its growing investment and advisory business, CIAM is mindful of the need to continuously strengthen its professional standards and talent infrastructure. It was pleased to welcome a number of high calibre investment and accounting specialists to its team during the year to enhance its business development efforts, raise its service quality, and assure proper and rigorous risk management controls.

Outlook

Looking ahead, with China's continuous robust economic development and the strength of Hong Kong's economic recovery, we believe that high quality investment opportunities for CIAM remain plentiful. As CIAM works towards contributing to the Group's goal of providing comprehensive one-stop financial services, it will strive to identify opportunities to create value for its business and our shareholders, and in doing so, it will always maintain its professionalism and high customer service standards, as well as seek win-win solutions with its business partners.

CITIC CAPITAL MARKETS HOLDINGS LIMITED

CITIC Capital Markets Holdings Limited ("CCMH") celebrated its second full year of operation in 2004 with a sustained encouraging performance. Pivotal to this continued growth impetus is its commitment to building strong relationships with its clients and to sharing mutual long-term success with them. CCMH's pragmatic China-focused approach, supported by the unique combination of its international expertise and the tremendous resources of CITIC, underscores its edge over the competition.

During the year, a number of corporate exercises were completed that were aimed at strengthening CCMH's corporate structure. In April, the Group acquired from CITIC an additional 25% interest in CCMH, which effectively increased our shareholding in CCMH to 50%. Subsequently in June, the Group and CITIC Pacific Limited made equal contributions to a total capital injection of HK$500 million in CCMH. CCMH's capabilities were also substantiated through its acquisition of CFCR, also in June, to become its fully-owned subsidiary, and through the increase of its stake to a 51% shareholding in the private equity fund vehicle, CITIC Provident Management Limited ("CPML"). These initiatives placed CCMH in a strong position to pursue an aggressive growth strategy going forward.

Investment Banking

On the corporate finance and equity capital markets fronts, CCMH continued to make robust progress in 2004.

CCMH and its subsidiaries ("CITIC Capital") made their mark by acting as the sole sponsor and lead manager for the HK$1.3 billion listing of Weichai Power Company Limited in March. The issue was well received by the market, with an overwhelming over-subscription and a strong post-listing share price performance. In December, it acted as the joint sponsor and joint lead manager for the HK$1 billion listing of Beijing Media Corporation. It was also the sole placing agent for the top-up HK$700 million placement for Chaoda Modern Agriculture (Holdings) Limited. These successful deals helped to lay a solid foundation for CITIC Capital in the Hong Kong equity capital market which is critical to complement other services that it offers locally, such as financial and merger and acquisition advisory services

The year 2004 was also a fruitful one for CCMH's debt capital market business, which generated record revenues against a challenging environment posed by China's austerity measures. The creativity in the deployment of various innovative and flexible structures brought a steady stream of business activity in syndicated loans, structured finance, project finance and financial advisory work.

Asset Management

CCMH's Asset Management business progressed by leaps and bounds in 2004, both in terms of assets under management ("AUM") and product range. The AUM of its Public Market Funds division grew by a significant 156% from US$77 million at the end of 2003 to US$197 million at the end of 2004, while the AUM of its Private Equity Funds division also increased to US$242 million over the same period.

A number of new funds were launched during 2004, including a fund of funds focusing on global emerging markets in Latin America, Eastern Europe and Asia; an equity fund focusing on Greater China stock markets and targeting Korea investors; and a private equity fund aimed at extracting values from investing in Japanese manufacturing companies with prospective benefits from the relocation of their manufacturing bases to lower cost sites in China.

The CITIC Capital China Plus Fund and the CITIC Capital Global Macro Fund achieved returns since inception of 46% and 22% respectively, and were nominated "Best Single Country Fund" and "Best New Fund (excluding Japan)" respectively in the 2004 AsiaHedge Awards.

In December 2004, CCMH partnered with Warburg Pincus and a domestic Chinese institution to acquire stakes of 22.5%, 22.5% and 10% respectively in Harbin Pharmaceutical Group Holding Company Limited ("Hayao Group"), a leading pharmaceutical group in China. The Hayao Group, supported by CCMH and Warburg Pincus, then launched one of the biggest general offers in the history of China to acquire the entire public float of the Shanghai-listed Harbin Pharmaceutical Group Company Limited, a company in which the Hayao Group already had a 34.76% stake in the form of unlisted state shares. It is CCMH's intention to use its investment in the Hayao Group as the foundation of a planned new China private equity fund. .

Separately, in order to capitalise on opportunities arising from the opening of China's financial markets, another new initiative that CITIC Capital embarked on during the year was the development of a fund for managing non-performing loan assets.

Brokerage and Research

Significant inroads were made in the further expansion of CCMH's brokerage clientele. CFCR's insightful stock market research products helped secure a number of reputable institutional clients during 2004. As a result, CITIC Capital's market share of the turnover of the Stock Exchange of Hong Kong continued to grow. High net worth individuals and institutional investors will continue to be the client acquisition focus going forward.

CFCR was quickly able to establish solid market recognition based on its accurate and sound market calls. It was also able to distinguish itself from the competition through the international perspective and rigorous research pertinence of its quality reports on market strategy, sector analysis and stock investment ideas.

Custom research and advisory services for institutional investors will continue to be a major development direction in the years to come. Ultimately, it is CCMH's goal that its investment banking activities will be well-supported by its own enhanced, world-class institutional brokerage and sell-side distribution capabilities.

Outlook

Looking into the future, CCMH will seek to continuously cross-leverage the strength of its different business segments in order to enhance both its investment gains and fee-based income.

As China continues to capture the world's interest as a market with colossal development potential, we are confident that CCMH, in its role as a rising China-focused investment bank, will stand to benefit from the acceleration of two-way capital flows between China and the rest of the world.

RISK MANAGEMENT

The Group has placed a great deal of focus, both internally and with the help of professional consultants, on progressing its risk management infrastructure and processes. Progress made at the Bank in particular is in line with Basel II principles and we are fully confident that it will meet the requirements of the Basel II Standardised Approach by the end of 2006, and that it will have embedded in certain areas tools and methodology that go beyond those requirements.

During 2004, the Bank realigned functional and specialised risk management units into the Risk Management Group, headed by the the Bank’s Chief Credit and Risk Officer, as well as integrated the functions of Inter-bank and Country policy and limit approval, formerly under the International Credit Committee, into the Bank’s Credit Committee.

The Bank has also instituted a number of programmes that are built on close partnerships between its risk and business units, including:

- Review and consolidation of all major credit and risk policies
- Installment of a highly systematic analytical framework and financial model for corporate counter-party risk assessment
- Establishment of an “Early Alert” system for timely identification and management of counter-parties exhibiting potential credit issues
- Adoption of a Value-at-Risk system for managing market risks

Credit Risk Management

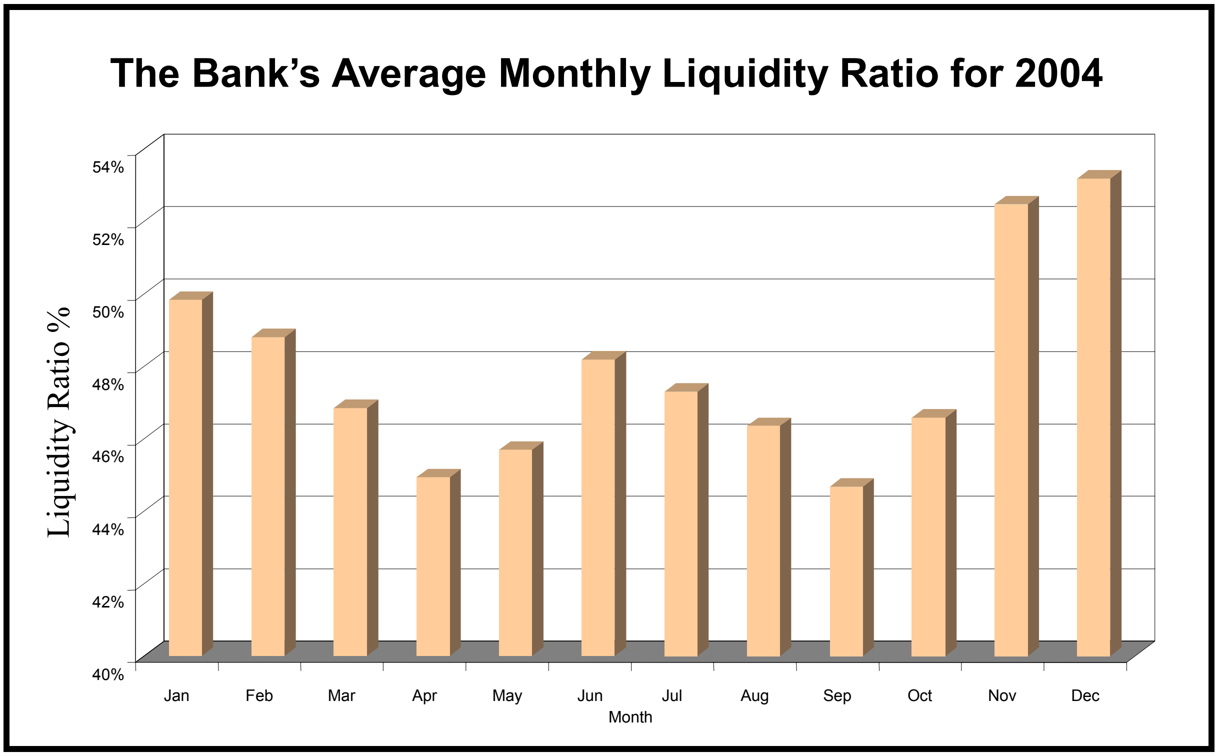
Credit risk is the risk of loss arising from a customer's or counter-party's inability to meet its financial obligations, and stems primarily from the Group’s banking entity. Assessing and managing credit risk to effectively address customer needs, ensure reasonable risk-adjusted returns and secure capital protection are some of the most crucial disciplines of the Bank.

The Bank’s Credit and Risk Management Committee defines and delegates the approval authority to two of its functional committees, namely the Credit Committee and the NPL Committee, which focus on different aspects of the Bank’s credit risk management function. These two committees comprise the Bank’s Chief Executive Officer, its Chief Credit and Risk Officer and other members of its senior management. Within its delegated authority, the Credit Committee approves, *inter alia*, credit policies, credit applications, loan classifications and policy exceptions. The NPL Committee controls and manages all criticised credits and approves specific provisions.

Liquidity Risk Management

Under both normal and emergency circumstances, the Bank must be able to meet all customer claims with regard to liquidity management. In addition, it must also meet all regulatory requirements and comply with statutory liquidity ratios. The Bank has consistently maintained a liquidity ratio well above the regulatory minimum of 25% by sustaining an adequate level of liquid assets. The Bank’s average liquidity ratio in 2004 was 47.91% (2003: 49.18%).

The Bank has adopted proactive liquidity management. It issues long-dated certificates of deposit regularly. The total amount of certificates of deposit issued was HK$6.96 billion, constituting 11.1% of total deposits as of 31 December 2004. The Bank has also arranged re-purchase agreement facilities to enhance liquidity. The liquidity management process is reviewed and monitored by the Bank's ALCO.



Market Risk Management

Market risk for the Group stems mainly from exposure to interest rates and foreign exchange rates through customer transactions and proprietary trading. Other subsidiaries of the Group have also engaged in transactions with exposure to equities and commodities, but these are not significant.

The Group's major market risk exposure rests with its banking entity. With reference to the Bank's risk appetite and expertise, the Board has approved policies and limits, which it then delegates to the Bank's ALCO for it to establish limits for different business units. These are then applied to setting up respective transaction limits by product type and risk type in the form of position, sensitivity and stop-loss limits.

The Bank's Market Risk Management Unit, under its Risk Management Group, monitors and manages its market risk exposure and limits. The Bank's Treasury is the centre point to take on market risk exposure related to customer transaction flows, and positions based on short-term market views and longer-term strategic views. The Market Risk Management Unit ensures that the exposures are within established positions and sensitivity limits. In the second half of 2004, the Market Risk Management unit implemented a Value-at-Risk system for the trading book, which provides information and analysis for reporting to ALCO.

The Group's foreign exchange risk stems from its banking entity's foreign exchange positions as well as its commercial dealing, investment in foreign currency securities and operations of overseas branches. All foreign exchange positions are subject to exposure limits approved by ALCO. The average daily foreign exchange trading profit and loss in the bank's trading book for the year ended December 2004 was a gain of HK$3,000.

It is worth noting that the extensive efforts invested by ALCO and the Market Risk Management Unit in perfecting data-mining for risk assessments and in performing comprehensive "what-if" analyses based on long-dated historical information, have significantly deepened our understanding of the Bank's asset and liability structure, hence giving us a high degree of insight into the sensitivity of our balance sheet to the multitude of market influences – key among these being the likely movement of interest rates in the current environment. This has been particularly critical in aligning product and pricing decisions with their likely impact on the Bank's balance sheet and profitability.

The Bank's Overall Foreign Exchange Position

As of 31 December 2004 (HK$ million)

	US dollars	Renminbi	Other Currency	Grand Total
Spot assets	28,183	351	4,975	**33,509**
Spot liabilities	(29,469)	(119)	(4,652)	**(34,240)**
Forward purchases	7,309	-	2,630	**9,939**
Forward sales	(5,848)	-	(2,944)	**(8,792)**
Net option position*	0.7	-	(0.7)	**-**
Net long position	176	232	8	**416**

* The net option position for 2004 is calculated using the Model User Approach.

Other subsidiaries of the Group have also engaged in investments, albeit with relatively smaller magnitudes. For the year ended 31 December 2004, the Group conducted gold trading via the Bank with an average daily loss of HK$9,000. CIAM conducted equity trading and commodity trading in oil futures with an average daily trading profit of HK$4,000 and HK$5,000 respectively.

Derivative positions stem from transactions with customers, as well as the Bank's own position taking and hedging. The Bank transacts in derivatives that include interest rate swaps, cross-currency swaps, futures, forwards and options in foreign exchange, interest rates, equities and commodities. Most derivative positions are booked under the trading book, from which daily mark-to-market and risk monitoring are performed. However, certain derivatives, mainly interest rate swaps, are booked in the accrual books when they are used to hedge specific interest rate exposure in the investment book or the Bank's own liabilities.

The Bank's involvement in option derivatives is mainly to cater to structured products to meet customer demand; please refer to the section on Off-Balance Sheet Exposures of the Notes on the Financial Statements for the year ended 31 December 2004.

The Group, by itself and via the Bank, has invested part of its excess liquidity in external funds to enhance returns, starting in May 2004. The average daily mark-to-market profit and loss for the year ended December 2004 was a gain of HK$483,000.

Interest Rate Risk Management

The Group, through its banking entity, also has exposure to interest rate risk through interest rate trading. Interest rate trading positions are marked-to-market daily and risk is monitored actively. For the year ended December 2004, the average daily profit and loss from the Bank's trading activities in interest rate risk was a loss of HK$44,000.

The interest rate risk for the Group stems from the banking book of its banking entity. The Bank's ALCO oversees and monitors the Interest Rate Risk for the banking book that arises from the mismatched interest rate profile of the Bank's assets and liabilities. This interest rate risk comprises basis risk among different interest rate benchmarks, yield curve movements and interest rate repricing risk. The Bank's ALCO reviews the interest rate risk of the banking book through gap mismatch reports, sensitivity analysis and various earnings scenario analyses. To mitigate interest rate risk, the Bank has used interest rate derivatives, mainly interest rate swaps, to hedge interest rate exposure.

The Bank had major interest rate risk exposure in the banking book denominated in Hong Kong and US dollars as of 31 December 2004.

Interest rate risk exposure for banking book

As of 31 December 2004 (HK$ million)

	Up to 1 month	Over 1 and up to 3 months	Over 3 and up to 6 months	Over 6 and up to 12 months	Beyond 12 months	Total
Interest-bearing assets						
Cash and short term fund	6,412	0	200	199	0	6,811
Placement with banks and other FIs maturing after one month	0	304	59	0	0	363
Certificates of deposit	100	115	40	666	355	1,276
Held-to-maturity securities	1,360	281	2,978	1,390	15,337	21,346
Advances to customers	31,075	6,501	2,679	227	712	41,194
Total interest-bearing assets	38,947	7,201	5,956	2,482	16,404	70,990
Interest-bearing liabilities						
Certificates of deposit issued	2,274	3,029	128	0	150	5,581
Debt securities issued	0	0	0	0	2,323	2,323
Deposits and balances of banks And other FIs	3,484	0	0	0	0	3,484
Deposits from customers	49,203	3,961	661	464	62	54,351
Loan capital	0	0	0	0	4,276	4,276
Total interest-bearing liabilities	54,961	6,990	789	464	6,811	70,015
Off-balance sheet items						
Long	2,469	2,795	4,264	0	6,758	16,286
Short	4,404	1,227	4,813	800	5,071	16,315
Net Position	(17,949)	1,779	4,618	1,218	11,280	946

The above table lists the interest-bearing assets and liabilities and relevant off-balance sheet items of the Bank in its banking book portfolio. It depicts the interest rate exposures of the accrual book by listing the contractual interest rate reset dates or the final maturity dates, whichever is earlier, for each instrument held.

Operational Risk Management

Operational risk is the risk of losses that the Group may incur as a result of inadequate or failed processes, technology, infrastructure or personnel, or from external events. Operational risk is not new to financial institutions. Significant operational risk events widely reported in recent years have highlighted the need to manage operational risks more effectively by taking a broader, more global view. Technology and operational issues remain critically important, but other areas that could lead to operational losses must be managed as well.

The Bank manages its operational risk through the Operations and Control Committee ("OCC") that comprises the Chief Operating Officer as chairman and other senior staff from various business lines and support functions. One of the committee's key responsibilities is to periodically review, update and test, as necessary, the Bank's operational policies, procedures and contingency plans.

In 2004, the OCC reviewed several operational events affecting other banks in Hong Kong and overseas. These reviews were intended to assess the relevancy of these events to the Bank and ensure that proper internal controls were in place to prevent their occurrence in the Bank. For instance, in light of increased occurrences of fake web sites, an Incident Report Team was formed during the year to deal specifically with this issue.

Other ongoing operational risk management tasks included annual reviews and updates of operations, technology, and human resources policies and manuals to ensure that processes are adequately considered and defined, as well as annual testing of the Bank's disaster recovery and business continuity plans for major events. An electronic library was established during the year to maintain and update all information related to such policies and practices.

To further enhance its efforts, the OCC is developing an Operational Risk Handbook that will contain and better organise references to operational procedures and policies. The scope of the handbook is intended to be broad and all-encompassing, ranging from such areas as product and services launches, insurance and outsourcing, to Basel II-related operational risks.

CIAM's operational risk management is overseen by an independent control team under the supervision of senior management and subject to internal audit of the Group. Major policies, procedures and limits have been laid down in its manuals and handbooks to ensure business continuity and to provide for various contingencies. Regular reports and efforts are made for the proper execution of investment and asset management decisions. Continual review and monitoring on the progress and performance of invested assets are in place and maintained in its database. Back up of such information is vigorous. Skill sets and human talents are also being steadily expanded to strengthen the running of the operation.

CCMH also has substantially increased resources as it builds a best-in-class operations platform to support and sustain the rapid growth of its business. A fundamental risk-mitigating principle of the platform is the proper segregation of duties amongst the front, middle and back offices. At the working level, its Operations Committee, comprising its Chief Operating Officer and the heads of the various business support units, manages and controls the operational risks associated with the business support processes. Its Operations Committee also works to inculcate within CCMH a culture that fosters an optimal balance of risk control and operational efficiency.

Legal Risk Management

The Group remains abreast of all legal and regulatory requirements applicable to its governance and operations, and continuously seeks to develop its people and enhance its systems and processes to create awareness and implement necessary change. Policies and procedures remain under constant review. Continuous training of our people in the areas of the Group's policies and procedures, and applicable laws, rules and regulations remained key to the management of the Group's legal risks in 2004, as in previous years, and will continue to be vital in 2005.

The year 2004 saw important changes at the Bank, including the appointment of a new general counsel and head of compliance in the fourth quarter, new and enhanced systems for the monitoring and prevention of money laundering and the appointment of compliance personnel on the Mainland, including in Shanghai and Shenzhen. The scope and complexity of the Bank's operations on the Mainland grew at an increasing pace throughout 2004 and, with this growth expected to continue, monitoring compliance and legal oversight of those operations will receive increased attention in 2005 as a major priority.

Strategic and Reputational Risks Management

In order to keep pace with the ever-evolving operating and regulatory environment of the Group, the Board places a high priority on ensuring that our business and operational strategies are appropriately defined and executed in a professional and time-relevant manner. Great care is taken to protect our reputation and maximise our brand equity. The Management Committee of the Group meets regularly to monitor and manage the Group's strategic and reputational risks, and is responsible for enforcing high-level policies approved by the Board to identify and assess such risks, as well as to improve controls.