Group Managing Director's Report

From Strength to Strength

H.L. KAM
Group Managing Director

2002 was another year of strong achievements for CKI. It was the seventh consecutive year in which the Group has recorded successful results since listing in 1996. With such a solid foundation, CKI expects to maintain this encouraging trend in the years ahead.

Strong Performance in 2002

The Group's strong profit performance in 2002 can be attributed to two main factors:

1. **Organic Growth**
   Hongkong Electric, the electricity company serving Hong Kong Island and Lamma Island in Hong Kong, is a reliable and steady income driver for CKI. This prime asset experienced 4.9 per cent. growth during the year, bringing HK$2.6 billion profit contribution to the Group, accounting for 64 per cent. of the year's profit contribution.

   A substantial increase in revenue was also generated by CKI's power and transportation projects in China. Performance of the Group's largest power investment in China, the Zhuhai Power Plant, exceeded targets; and transportation projects in Guangdong Province reported double digit revenue growth.

   The energy projects in Australia continued to make meaningful contributions to growth. Gas distributor, Envestra Limited; as well as power distributors, ETSA Utilities and Powercor, provided solid, recurring revenue streams during the year. Profit contribution during the year was over HK$700 million.

2. **New Investment**
   The acquisition of Australian electricity distributor, CitiPower, in August generated immediate revenue for the Group upon completion of the transaction, providing an additional profit contribution during the year.

Solid Foundation Built Throughout the Years

The Group's performance in 2002 was the result of building on the sustained business achievements of the past seven years. They were the fruit of making sound investments and managing the Group's operations efficiently and effectively throughout the years.

During the past seven years, the world economy has experienced slowdowns, deflation, major business collapses, financial crises, and other unsettling turmoils. In spite of this challenging global investment climate, CKI has continued to make major investments almost every year. The Group has taken a consistently prudent approach in analysing investments to ensure that the risks are minimised and the returns to shareholders improved. Only prime assets generating secure income and returns were acquired.

CKI took a controlling stake in Hongkong Electric in 1997 and has since then increased its shareholding from 35 per cent. to the current 38.87 per cent. This prime asset has recorded growth every year and has always been a major profit contributor. It has provided CKI with strong, predictable recurrent income, and has strengthened the Group's capital base and financing capacity, which is a key driver for success in the capital intensive infrastructure market.

Privatisation schemes, overseas asset disposals by major US infrastructure companies, and similarities in the regulatory environment with Hong Kong have led CKI to a make a number of quality investments in Australia. Since acquiring Envestra Limited, the largest listed natural gas distributor in the country, in 1999, the Group has followed up with swift investments in two other major prime assets. These were ETSA Utilities, the sole electricity distributor for the State of South Australia; and Powercor, one of the largest electricity distributors for the State of Victoria.

In 2002, CKI, together with Hongkong Electric, acquired CitiPower, the electricity distributor serving Melbourne and the surrounding suburbs in Victoria, Australia at a consideration of HK$6.3 billion. This is another project which contributes steady, secure income for the Group, and another illustration of CKI's prudent investment strategy.

All of the Australian investments have performed better than budget. They widened the Group's steady income base and generated solid, secure revenue for CKI every year. These quality investments also expanded CKI's geographic reach, making a mark for the Group in the international infrastructure arena. CKI together with Hongkong Electric, who co-invested in the electricity distributors with CKI, is now the largest electricity distributor in Australia, reinforcing the Group's major infrastructure player position in the global scene.

The Group's first transportation project outside Hong Kong and Mainland China – the Sydney Cross City Tunnel – was awarded to CKI in 2002. This investment is an important milestone in CKI's development as it signifies the Group's diversification to transportation internationally, and is CKI's first project in the State of New South Wales. This project is expected to generate immediate revenue to the Group upon commencement of service scheduled to take place in 2006, and returns are to be in the high teens.

The Group's total investment in Australia now stands at HK$17 billion.

CKI's investments in China were made in the years of massive demand for infrastructure investments in the country. As China's need for foreign financing decreased and policy changes were introduced, timely divestments were made of some of the Group's projects. These exercises recouped capital for the Group as well as mitigated impacts of uncertainties caused by regulatory changes. In 2002, three projects were disposed – the Zengcheng Lixin Road project achieved an internal rate of return of 20 per cent.; the Shantou Power Plants 10 per cent.; and the Nanhai Road Network about 8 per cent. At the end of the year, projects in CKI's China portfolio amounted to HK$7 billion. They all performed well and provided substantial cash income for the Group.

The infrastructure materials division continued to generate good cashflow for the Group despite the recent sluggish market. The leadership positions of Green Island Cement and Anderson Asia remain intact, and are expected to stay strong in future years.

The three pillars of CKI's business strategy are built on the strong foundations of seven years of achievements:

- reliable, steady income generated year on year from organic growth in the Group's prime assets – the 38.87 per cent. shareholding in the HK$63 billion* Hongkong Electric, the HK$7 billion China projects, and the $17 billion secure and reliable Australian investments are strong revenue streams of the Group;

- timely consolidation of assets and businesses strengthening the Group's asset base; and

- adoption of an aggressive yet prudent approach in making investments –– every major acquisition was made to ensure reliable, secure recurrent income and returns for the Group; over-priced biddings would not be considered.

Growth Trend to Sustain

Going forward, CKI will continue with these proven strategies.

In today's international infrastructure investment arena, many opportunities have arisen due to disposal of overseas assets by infrastructure companies, and privatisation and public private partnership programmes offered by various governments. On the other hand, there are only a few qualified investors with extensive infrastructure investment experience and solid financial capabilities, and CKI is one of them. The Group has now become a prime prospect for major infrastructure programmes worldwide and is frequently invited to participate in tenders and negotiations.

With cash in hand of over HK$7 billion, a roomy balance sheet with "A-" credit rating from Standard & Poor's, and 19 per cent. net debt to equity ratio, CKI is ready to aggressively pursue quality investment opportunities. The Group will not be bound by infrastructure type nor geographic location. In addition to continuously looking for investment opportunities on gas, electricity and toll road projects in Hong Kong, Mainland China and Australia, the Group will also explore opportunities in markets like Europe and North America, and industries like water and airport. At the same time, CKI will continue to ensure that its established portfolio is well-managed through organic growth and will make timely consolidation of assets and businesses if and when appropriate.

The key ingredients are all in place – prime assets in hand, strong financing capacity, competent management and a pool of investment opportunities around the globe. I am confident that despite the prolonged unsettling economic environment, the growth momentum of the Group will be sustained in 2003 and beyond.

H.L. KAM
Group Managing Director

Hong Kong, 13th March 2003

** Market capitalisation of Hongkong Electric as at 31st December, 2002*