Operations Review

Energy, Infrastructure, Finance and Investments

A Husky staff member verifies temperature setpoint on an asphalt heater. Regulating temperature along any given point in the process ensures a high-grade end product.

The energy, infrastructure, finance and investments division includes the Group's 84.6% interest in Cheung Kong Infrastructure ("CKI"), a leading investor in the infrastructure sector in Hong Kong, the Mainland and Australia, and a 34.75% interest in Husky Energy, one of Canada's largest integrated energy and energy related companies.

1 Australia
2 The Philippines
3 Hong Kong
4 Mainland China
5 Thailand
6 Luxembourg*
7 Libya
8 Canada

* finance & investments

Also reported in this division is the finance and investment income, derived from the Group's treasury operations which manage its substantial pool of cash and other liquid investments. Turnover for the energy, infrastructure, finance and investments division for 2003 totalled HK$30,676 million, an 18% increase from last year and EBIT totalled HK$15,317 million, a 15% increase. The aggregate net increase is mainly due to the effect of increased commodity prices at Husky Energy.

Powercor of Australia serves 622,000 customers in the State of Victoria with an electricity distribution network covering an area of over 150,000 square kilometres.

Cheung Kong Infrastructure

The Group has an 84.6% interest in CKI, which is listed on the SEHK. CKI announced turnover of HK$3,454 million, a decrease of 4%, and profit attributable to shareholders of HK$3,349 million, an increase of 1% compared with last year. CKI is currently engaged in the development, ownership, operation and management of infrastructure businesses, including power plants, electricity distribution networks, gas distribution networks, toll roads, toll bridges and tunnels in Hong Kong, the Mainland and Australia. CKI is also engaged in the infrastructure materials business in Hong Kong, the Mainland, Canada and the Philippines, including the production, distribution and sales of cement, concrete, asphalt, aggregates and spray coating materials. CKI has developed an environmental business in areas related to recycling waste materials, reduction of natural resources usage and reduction of emissions to the environment.

CKI holds a 38.9% interest in Hongkong Electric Holdings ("HEH"), which is the largest contributor to CKI's results. HEH, which is listed on the SEHK and is the sole provider of electricity to Hong Kong and Lamma islands, announced a profit attributable to shareholders of HK$6,057 million, a decrease of 9% compared to last year, mainly due to a change in accounting rules relating to deferred tax, an increase in the corporate tax rate and a soft domestic economy caused by the SARS epidemic. CKI's other infrastructure businesses recorded increased profits reflecting improved contributions from the Mainland and Australian energy projects. CKI's cement, concrete, asphalt and aggregates businesses in Hong Kong and the Mainland continued to experience another difficult year and a decline in profits.

Husky Energy

The Group has a 34.75% interest in Husky Energy ("Husky"), a listed Canadian based integrated energy and energy related company. Husky announced turnover of C$7,658 million, 20% above last year and net earnings of C$1,321 million, 64% higher than the previous year, mainly attributable to stronger US dollar commodity prices partially offset by a fall in value of the US dollar, foreign exchange gains on US dollar denominated debt translation and lower tax provisions due to Canadian federal and provincial tax rate reductions. In July, Husky declared a special C$1 per share cash dividend from which the Group received C$147 million in October.

In 2003, Husky's gross production volume averaged approximately 312,500 barrels of oil equivalent ("BOEs") per day compared to 300,200 BOEs per day during 2002, a 4% increase. In the upstream operations, the Wenchang oil field offshore Southern China, which commenced production in July 2002 increased Husky's average daily production in 2003 by approximately 22,400 BOEs, above expectations.

In October, Husky acquired Marathon Canada and the Western Canadian assets of Marathon International Petroleum Canada ("Marathon Canada") for a net acquisition cost of C$400 million. The addition of the Marathon Canada properties added 39.8 million BOEs to proved reserves of which over 75% was natural gas.

At the end of 2003, Husky's total proved oil and gas reserves amounted to 887 million BOEs, giving a proved reserve life of almost eight years. In western Canada, Husky replaced 111% of production in 2003, mainly through heavy oil additions and the acquisition of Marathon Canada. Internationally, a revision of 30 million BOEs reflected the uncertain status of achieving an extension to the production sharing contract for the Madura block in Indonesia. Husky anticipates that the future proved reserves will be booked for the White Rose project and the Tucker and Sunrise (formerly named Kearl) oil sands projects. Husky has offshore development and exploration opportunities with one of the largest working interests in the Jeanne d'Arc basin offshore the east coast of Canada and development and exploration opportunities in the South China Sea and East China Sea.

The White Rose development is progressing on schedule and first oil production is expected by late 2005 or early 2006. Construction of the "Floating, Production, Storage and Off-loading" ("FPSO") vessel for the White Rose development is underway and is expected to sail to the White Rose field in the second half of 2005. The peak production of White Rose

Husky's Bolney/Celtic project northeast of Lloydminster, Saskatchewan plays a key role in its heavy oil production strategy.

is expected to be approximately 92,000 barrels per day and Husky's share (72.5% interest) of production would average approximately 66,700 barrels per day.

In February 2003, Husky submitted a commercial application to provincial regulators for the Tucker oil sand project requesting approval to construct a 30,000 barrels per day thermal in-situ project. Approval is anticipated during the first half of 2004. At Husky's major oil sands project at Sunrise, feasibility studies are underway regarding project size, timing, utilities and transportation options as well as environmental issues. Husky expects to submit the commercial project application by mid-2004.

Husky's midstream operations comprise a portfolio of assets strategically located in western Canada which include the heavy oil upgrader facility at Lloydminster, marketing and infrastructure activities consisting of pipeline systems, commodity marketing, thermal and electrical generation and

A technician carries out a regular inspection of a turbine generator as part of Hongkong Electric's continuous, preventive maintenance schedule. This constant attention to detail underpins the company's impressive record of 99.999% supply reliability.

crude oil and natural gas storage and processing. The refined products operations include a network of 552 branded retail outlets, providing a full range of services and petroleum products, as well as the marketing of asphalt products.

Group Capital Resources and Liquidity

The Group's total shareholders' funds increased 11% to HK$247,515 million at 31 December 2003 compared to HK$222,145 million at the end of last year.

Net debt of the Group was HK$87,602 million (2002 – HK$50,229 million) and the net debt to net capital ratio was 23% (2002 – 16%). This ratio is a combination of the net debt to net capital ratio of the established businesses of approximately 11% (2002 – 14%) and of the 3G start-up operations of approximately 35% (2002 – 19%). The Group will continue to benefit from the steady and growing cashflow and also the low net debt levels of its existing core businesses during the start-up phase of its 3G businesses. Consolidated EBITDA amounted to HK$33,873 million (2002 – HK$33,273 million) and funds from operations ("FFO"), before capital expenditure and changes in working capital, amounted to HK$17,221 million (2002 – HK$20,836 million). EBITDA and FFO from the Group's established businesses, excluding the start-up 3G operations increased 30% to HK$45,812 million (2002 – HK$35,110 million) and HK$30,959 million, an increase of 35% (2002 – HK$22,939 million) respectively. EBITDA and FFO from established businesses excluding the start-up 3G operations, after adjusting for interest income, covered the related net interest expense 17.3 and 11.1 times respectively. Including start-up 3G losses and interest expense in this calculation, these coverage ratios are 5.4 and 2.3 times respectively (2002 – 13.6 times and 7.8 times).

At 31 December 2003, the Group's cash, liquid funds and other listed investments totalled HK$185,542 million (2002 – HK$130,267 million) of which 7% were denominated in HK dollars, 76% in US dollars, 6% in Pounds Sterling, 9% in Euros and 2% in other currencies. During the year the Group's remaining holdings of Vodafone Group and Deutsche Telekom were disposed for a total cash consideration of HK$37,548 million and a total profit on disposal of HK$2,627 million was recorded.

The Group's total borrowings at 31 December 2003 were HK$273,144 million (2002 – HK$180,496 million) of which HK$53,235 million (2002 – HK$24,691 million) relates to the borrowings of the 3G UK and Italy operations. Total borrowings include US$2,657 million principal amount of 2.00% exchangeable notes which were repaid on the maturity date in January 2004. The significant financing activities during the year were as follows:

- In February 2003, issued ten year, fixed interest rate, US$1,500 million notes to repay a portion of exchangeable notes due in September 2003;
- In March 2003, issued five year, floating interest rate, A$800 million notes to repay three of the Australian telecommunication operations' bank loans totalling A$796 million;
- In March 2003, extended the £3,252 million project financing facilities of Hutchison 3G UK by one year to mature in March 2005;
- In March and May 2003, issued two ten year fixed interest rate notes of US$1,000 million each, to repay a

portion of the exchangeable notes due in September 2003 and early 2004;

- In July 2003, issued ten year fixed interest rate, €1,000 million notes to repay a portion of the exchangeable notes due in September 2003 and early 2004;

- In July 2003, borrowed a five year floating interest rate, HK$3,800 million bank loan to partially refinance a floating interest rate, HK$4,400 million syndicated bank loan; and

- In November 2003, issued fixed rate notes of an aggregate principle amount of US$5,000 million, which included seven year notes of US$1,500 million, ten year notes of US$2,000 million and thirty year notes of US$1,500 million, to refinance certain indebtedness falling due in the near term which would provide an economic benefit upon early repayment.

The Group's borrowings at 31 December 2003 were denominated as to 16% in HK dollars, 46% in US dollars, 12% in Pound Sterling, 16% in Euros and 10% in others currencies.

The Group's borrowings at 31 December 2003 are denominated and repayable as follows:

	HK$	US$	£	€	Others	Total
Within 1 year	2%	8%	–	–	3%	13%
In year 2	3%	–	8%	–	–	11%
In year 3	4%	–	1%	2%	2%	9%
In year 4	2%	3%	–	2%	1%	8%
In year 5	5%	–	–	1%	3%	9%
In years 6 to 10	–	22%	1%	11%	–	34%
In years 11 to 20	–	7%	2%	–	–	9%
Beyond 20 years	–	6%	–	–	1%	7%
	16%	**46%**	**12%**	**16%**	**10%**	**100%**

The non-HK dollar and non-US dollar denominated loans are either directly related to the Group's businesses in the countries of the currencies concerned, or the loans are balanced by assets in the same currencies.

As at 31 December 2003, approximately 49% of the Group's borrowings bear interest at floating rates and the remaining 51% are at fixed rates. The Group has entered into various interest rate agreements with major financial institutions to swap approximately HK$106,350 million principal amount of fixed interest rate borrowings to effectively become floating interest rate borrowings. In addition, HK$6,062 million principal amount of an infrastructure related, floating interest rate borrowing was swapped to a fixed interest rate borrowing. After taking into consideration these interest rate swaps, as at 31 December 2003, approximately 86% of the Group's borrowings bear interest at floating rates and the remaining 14% are at fixed rates.

At 31 December 2003, shares of Hutchison 3G UK and Hutchison 3G Italy owned by the Group were pledged as security for their respective project financing facilities. The assets of these two companies totalled HK$165,732 million (2002 – HK$119,812 million). In addition, HK$17,628 million (2002 – HK$22,238 million) of the Group's assets were pledged as security for bank and other loans of the Group. Committed borrowing facilities available to Group companies, but not drawn at 31 December 2003, amounted to the equivalent of HK$39,997 million (2002 – HK$58,573 million), of which HK$38,730 million (2002 – HK$55,748 million) related to 3G operations.

The Group's capital expenditures, excluding expenditures for properties under development and for sale, totalled HK$36,393 million (2002 – HK$38,543 million), of which HK$24,557 million (2002 – HK$29,842 million) related to 3G operations. Capital expenditures are shown by business segment in Note 3 to the consolidated accounts. The capital expenditures for the 3G operations were primarily funded by project financing facilities and also shareholder equity contributions. The Group's remaining capital expenditures were funded primarily from cash generated from operations, cash on hand and to the extent required, by borrowings.

Treasury Policies

The Group's overall treasury and funding policies focus on managing financial risks, including interest rate and foreign exchange risks, and on cost efficient funding of the Group and its companies. For synergies, efficiency and control, the Group operates a central cash management system for all its unlisted subsidiaries in Hong Kong. Except for listed and certain overseas entities, the Group generally obtains long-term financing at the Group level to on-lend to its subsidiaries and associates to meet their funding requirements. For overseas subsidiaries and associates and other investments, which consist of non-HK and non-US dollar assets, the Group generally endeavours to hedge its foreign currency positions with the appropriate level of borrowings in those same currencies. For transactions directly related to the underlying businesses, forward foreign exchange contracts and interest and currency swaps are utilised when suitable opportunities arise and, when considered appropriate, to hedge against major non-HK and non-US dollar currency exposures as well as assist in managing the Group's interest rate exposures.

Contingent Liabilities

At 31 December 2003, the Group had provided guarantees for banking and other borrowing facilities granted to associated companies and jointly controlled entities of HK$13,193 million (2002 – HK$11,696 million). At 31 December 2003, the Group had contingent liabilities in respect of guarantees related to the procurement of 3G handsets of HK$11,592 million (2002 – HK$14,116 million), procurement of 3G infrastructure of HK$2,425 million (2002 – HK$2,036 million), and other guarantees totalling HK$5,005 million (2002 – HK$2,103 million).

Community Relations And Employees

Community Relations

The Group has always given staunch support to a variety of charitable educational and other community causes. The Group's total donations for the year amounted to HK$142 million (2002– HK$64 million).

A notable contribution to the community during the year was the Group's efforts in contributing support to those in need as a result of SARS. During the SARS period, the Group took the lead to pool together concerted efforts from various Group companies to provide support for the patients, their families as well as front-line medical workers in the fight against this unprecedented epidemic. The Group, together with other companies in the Li Ka-shing group, raised and contributed over HK$6 million for this cause.

Twenty-six subsidiaries and associates within the Group were named "Caring Companies" by The Hong Kong Council of Social Service in recognition of the Group's support and care for the community as well as its staff. One of the community care programmes was the reaching-out service by the Hutchison Volunteer Team, which was officially launched in November. The volunteer team has now enrolled a total of over 300 Group staff members.

During the year, the Group continued to provide funds for a wide range of medical programmes including the Children's Cancer Foundation and Cambridge University to construct a cancer research centre. To show its support for arts and culture, the Group also sponsored the Hong Kong Arts Festival and the Hong Kong Philharmonic Society.

The rollout of the Hutchison Chevening Scholarships has achieved overwhelming success. This scholarship programme provides 63 scholarships each year, for four years, for Hong Kong and Mainland Chinese postgraduate students to study in the UK.

Employee Relations

At 31 December 2003, the Company and its subsidiaries employed 126,250 people (2002 – 117,843 people) and the related employee costs for the year, excluding Director's emoluments, totalled HK$20,011 million (2002 – HK$15,100 million). Including the Group's associated companies, at 31 December 2003 the Group employed 172,653 people of whom 29,704 are employed in Hong Kong. All of the Group's subsidiary companies are equal opportunity employers, with the selection and promotion of individuals based on suitability for the position offered. The salary and benefit levels of the Group's employees are kept at a competitive level and employees are rewarded on a performance related basis within the general framework of the Group's salary and bonus system, which is reviewed annually. The Company does not have a share option scheme for the purchase of ordinary shares in the Company. A wide range of benefits including medical coverage, provident funds and retirement plans and long service awards are also provided to employees. In addition, training and development programmes are provided on an on-going basis throughout the Group. Many social, sporting and recreational activities were arranged during the year for employees on a Group-wide basis. Group employees also participated in community orientated events.

Summary

The results for the year reflect challenging economic conditions, particularly in the first half of the year from SARS, the Iraq war and poor consumer sentiment, particularly in Asia. Despite these conditions, the Group's established businesses continue to be strong and steady. The Group's 3G operations in the UK, Italy and Australia commenced operations during the year. Although a lack of handset supply adversely affected these businesses, ample handsets are now being delivered and we are confident that the 3G operations will grow into solid businesses in 2004. Despite these challenges and the exceptional write-off of HK$3,111 million after the unforeseen regulatory blocking of the Global Crossing acquisition, the Group's net profit after tax was HK$14,378 million, in line with last year's profit.

The Hutchison Volunteer Team, launched by Group Chairman Mr Li Ka-shing, reaches out to serve the community with their enthusiasm.

These results were achieved through the strong efforts and the focused dedication of the Group's employees and I would like to join our Chairman in thanking them for their continuing support and hard work throughout the year.

FOK Kin-ning, Canning

Group Managing Director

Hong Kong, 18 March 2004