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*

CKI AR-2002

BUSINESS REVIEW

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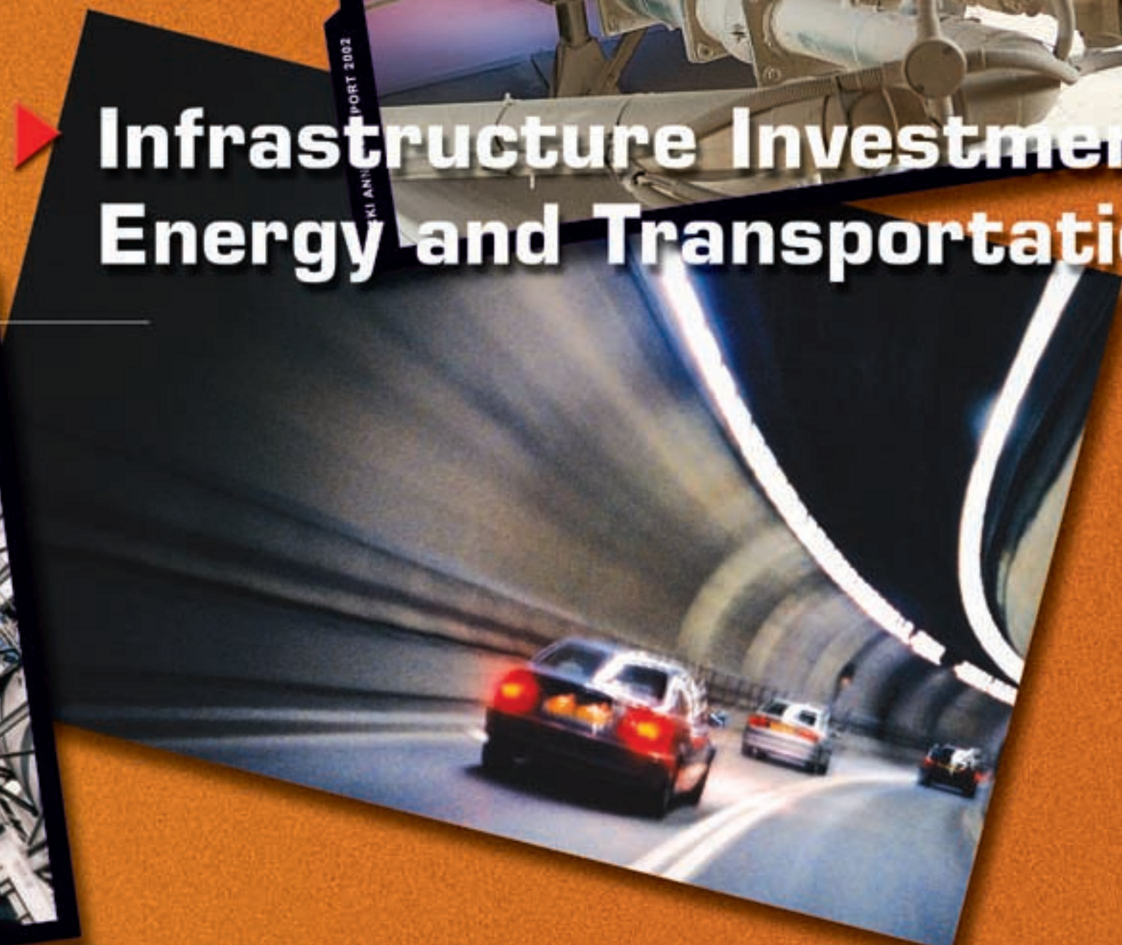
BUSINESS REVIEW

Infrastructure Materials and Infrastructure-related Businesses

Investment in Hongkong Electric

Infrastructure Investments Energy and Transportation



CKI AR-2002

Investment in Hongkong Electric

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Hongkong Electric has been a premium asset for CKI, providing reliable cash income and stable earnings over the years. It is one of the two electricity suppliers in Hong Kong, serving Hong Kong Island, Ap Lei Chau and Lamma Island. CKI currently holds a 38.87 per cent. stake in the company.

>> Hongkong Electric imports coal to its power station from diverse sources.

Hongkong Electric

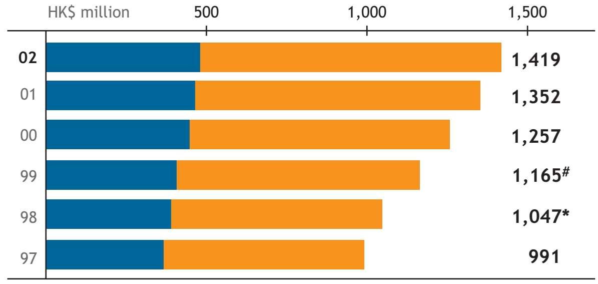
In 2002, Hongkong Electric reported a net profit of HK$6,827 million, a 4.9 per cent. increase over 2001. The investment of the 38.87 per cent. stake in Hongkong Electric accounted for over 60 per cent. of CKI's profit contribution.

The strong growth and significant contribution were attributable to stable income from Hongkong Electric's domestic business under the Scheme of Control, as well as significant returns from its overseas investments in Australia, including the continued outstanding performance of ETSA Utilities and Powercor, and the immediate contribution from CitiPower upon completion of the acquisition in August 2002.

>> The turbine hall of Lamma Power Station

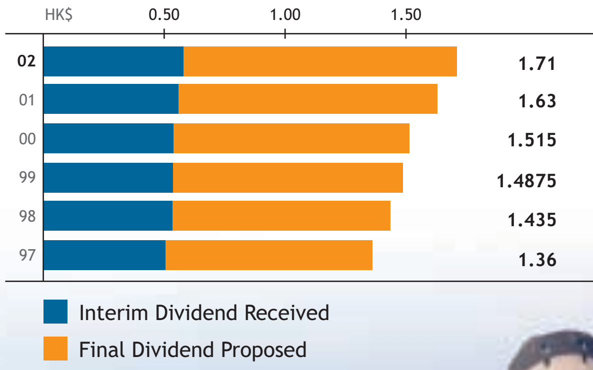
>> Bird's-eye view of Hongkong Electric

Total Dividend Entitlement from CKI's Investment in Hongkong Electric



\# Interim and final dividends in form of scrip (FY99)
* Final dividend in form of scrip (FY98)

Dividends per Share Declared by Hongkong Electric



In line with its prudent development policy, Hongkong Electric has deferred the commissioning of the Lamma extension project. As a responsible corporate citizen, the company has always been careful to adjust its development policy in line with domestic electricity demand growth. This policy enabled the company to freeze power tariffs in 2003. On the other hand, through improved productivity and stringent cost control, Hongkong Electric has achieved significant savings in operating expenses and will continue to realise its objective of generating good investment returns for shareholders. During the year, the company continued to achieve a 99.999 per cent. level of reliability in power supply - the seventh consecutive year of attaining this exceptionally high standard for a power generation and distribution network serving customers in Hong Kong.

>> Hongkong Electric continued to achieve a 99.999 per cent. level of reliability in power supply.

CKI AR-2002

Infrastructure Investments – Energy

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CKI's energy investments in both Australia and China have achieved significant milestones in the year 2002. In Australia, together with Hongkong Electric, CKI successfully completed the acquisition of CitiPower I Pty Ltd (CitiPower) in August 2002, which generated additional income upon completion of transaction. In China, the Zhuhai Power Plant has generated electricity in excess of the contractual minimum power purchasing quantity, achieving an excellent investment return for shareholders.

CitiPower

CitiPower is the electricity distributor serving 265,000 customers in the central business district and inner suburban areas of Melbourne, Victoria. CKI and Hongkong Electric acquired CitiPower for a consideration of A$1,418 million. Upon completion of the transaction, Standard & Poor's upgraded CitiPower's credit rating to "A-" from "BBB+" with "Stable" outlook.

Following the earlier acquisitions of Powercor in Victoria, and ETSA Utilities in South Australia, CKI, in partnership with Hongkong Electric, has a total power investment of approximately A$7 billion in Australia and serves a total of 1.65 million customers. This makes CKI/Hongkong Electric the largest electricity distributor and one of the biggest overseas investors in Australia.

In February 2003, CitiPower successfully completed an A$675 million refinancing programme in tenors of four, seven and 10 years via the domestic capital markets.

>> About 18,000 new customer connections were made by Powercor in 2002.

>> CitiPower is the electricity distributor serving the central business district and inner subsurban area of Melbourne, Victoria.

Powercor

Strong housing growth in the State of Victoria contributed to an enlarged customer base and increased power demand for Powercor. About 18,000 new customer connections were made in 2002, representing organic growth of 3 per cent. Additional profits were generated from January to May as a result of fulfilling the one-year transitional services to the purchaser of Powercor's retail business.

Powercor has provided an outstanding power distribution service in Victoria in terms of reliability, productivity and customer services, and it is a low risk and high yield investment for CKI.

ETSA Utilities

ETSA Utilities is CKI/Hongkong Electric's first power investment in Australia. The privatisation of South Australia's power industry gave CKI the opportunity to establish a presence in Australia's electricity distribution business back in 2000. ETSA Utilities serves the entire State of South Australia with ownership of over 90 per cent. of the state's power distribution network. It is a secure and premium long-term investment for the Group.

Envestra

CKI's investment in natural gas began with Envestra Limited, which it acquired in 1999. Envestra is the largest listed natural gas distributor in Australia, serving 900,000 customers nationwide and capturing approximately 30 per cent. of Australia's total gas consumption. While contributing to CKI a high cash yield of almost 11 per cent. p.a., Envestra is characterised by the low risk and steady income profile, features common to all CKI's regulated business investments.

In 2002, through Envestra's share purchasing programme, CKI maintained the largest shareholder position with a 19.14 per cent. stake, and an aggregate investment of A$118 million.

China Power

2002 was the first full year of operations for the Zhuhai Power Plant's 2 x 700MW coal-fired units. In addition to setting a record of "over 300 days of safe operations" in the Guangdong power network, the plant generated an amount of electricity in excess of the minimum purchase requirement of 6.8 billion kWh stipulated in the power off-take contract. The safe, reliable and efficient operation of the Zhuhai Power Plant is a key driving force behind the economic development in the Zhuhai City hinterland and the Pearl River Delta Region.

from top to bottom:
>> ETSA Utilities is CKI/Hongkong Electric's first power investment in Australia.

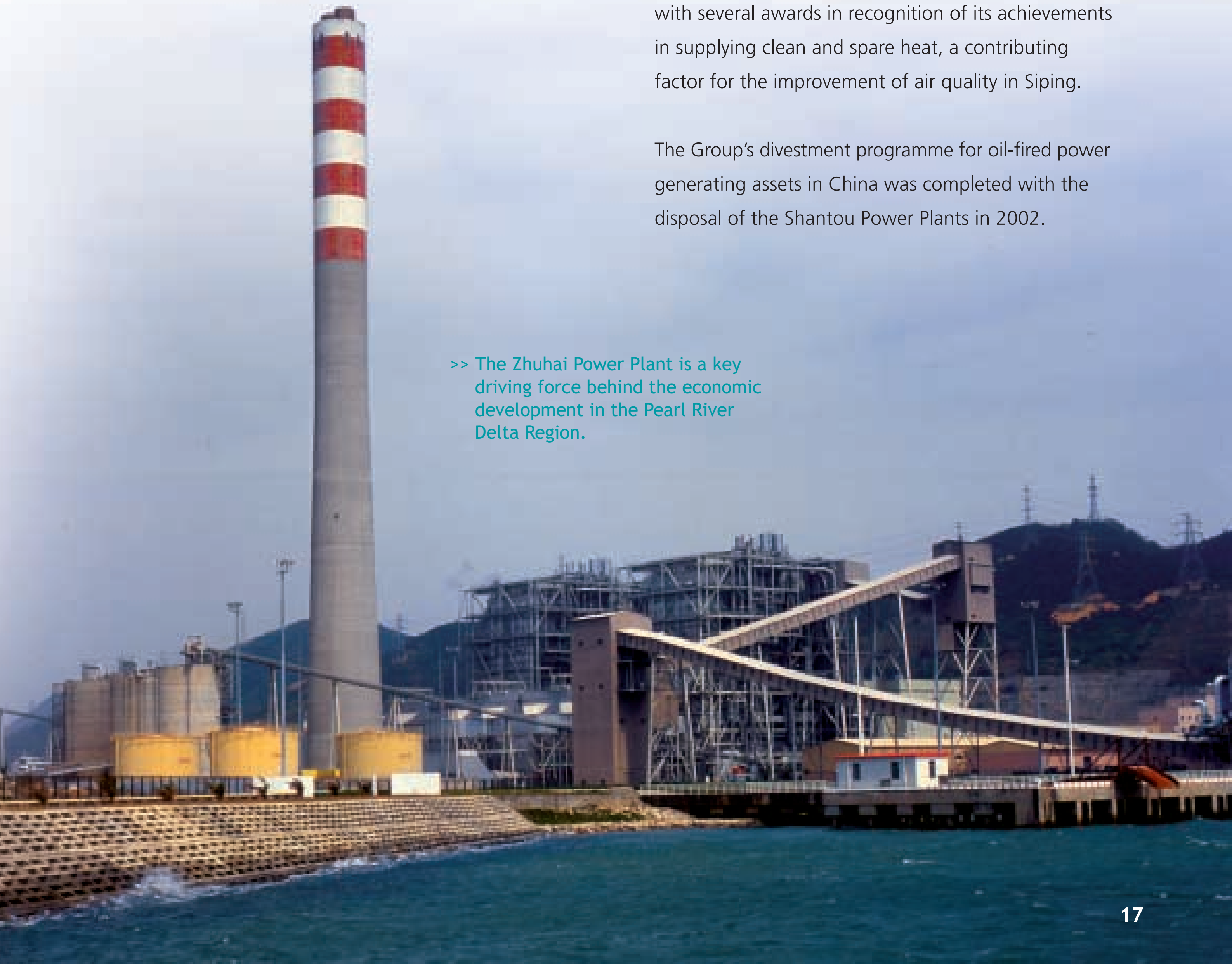
>> CKI currently owns a 19.14 per cent. stake in Envestra Limited.

>> CKI's cogen power plant investment in Siping, Jilin.

The Zhuhai Power Plant is CKI's largest power investment in the Mainland. Apart from being able to generate enough cash revenue to service the Japanese export credit and the syndicated commercial loans, the investment has provided shareholders with a high return and accounted for 9 per cent. of CKI's 2002 profit contribution.

CKI's other power projects in China also performed well, with all units operating safely and smoothly throughout the year. Power output from the Fushun Cogen Power Plants increased by 6.4 per cent. over 2001, while the Qinyang Power Plants' electricity generation was about 17 per cent. more than required under the contractual power off-take agreement. In addition, the Siping Cogen Power Plants was honored with several awards in recognition of its achievements in supplying clean and spare heat, a contributing factor for the improvement of air quality in Siping.

The Group's divestment programme for oil-fired power generating assets in China was completed with the disposal of the Shantou Power Plants in 2002.



>> The Zhuhai Power Plant is a key driving force behind the economic development in the Pearl River Delta Region.

Infrastructure Investments – Transportation

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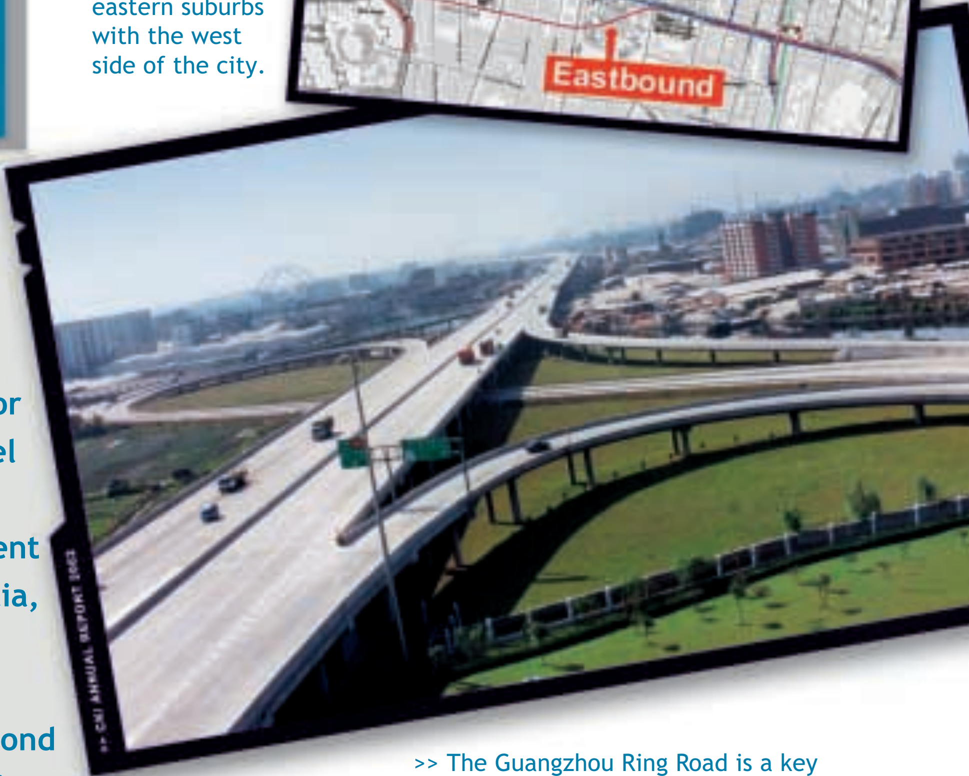
>> The Cross City Tunnel will be linking Sydney's eastern suburbs with the west side of the city.



>> The Guangzhou Ring Road is a key expressway surrounding the eastern, southern and western areas of the Guangzhou City.

An exciting milestone achievement of CKI Transportation in 2002 was the winning of the tender for the Sydney Cross City Tunnel project. The tunnel is CKI's first infrastructure investment in New South Wales, Australia, and is also the Group's first step in expanding its transportation portfolio beyond Hong Kong and Mainland China. The transportation division has followed the successful formula of the energy division by diversifying its business and expanding geographically. Apart from roads and bridges, the Group has explored other transportation investments such as airports and cable-car transit systems.

The Sydney Cross City Tunnel

In December 2002, the Cross City Motorway Consortium, in which CKI has a 50 per cent. interest, was awarded the Cross City Tunnel project in Sydney by the New South Wales Government. Construction work began in early 2003 and is targeted for completion in 2006.

The A$1 billion toll tunnel will be over two kilometers long, linking Sydney's eastern suburbs with the west side of the city. It is expected to carry about 90,000 vehicles per day at opening, forming a vital part of Sydney's future transportation planning.

The financing of the investment was arranged with 55 per cent. non-recourse project loans, and shareholders' equity was funded by guaranteed project loans. According to this financing model, no funding cost will be carried by the Group during the construction period. This investment is expected to be another premium asset for CKI, delivering a favourable investment return upon completion.

Road Projects in Guangdong

The spectacular growth and development of Guangdong, particularly in the Pearl River Delta, has led to an increase in privately-owned vehicles and goods transportation activities. All the toll roads and bridges owned and operated by CKI have benefited from increased economic activities and the consequent growth in traffic flow, resulting in double digit increment in toll revenue.

Other Transportation Projects in Mainland China

Government policies and major road rehabilitation programmes were introduced on transportation projects outside Guangdong. Nevertheless, CKI's investment targets for these projects were largely met.

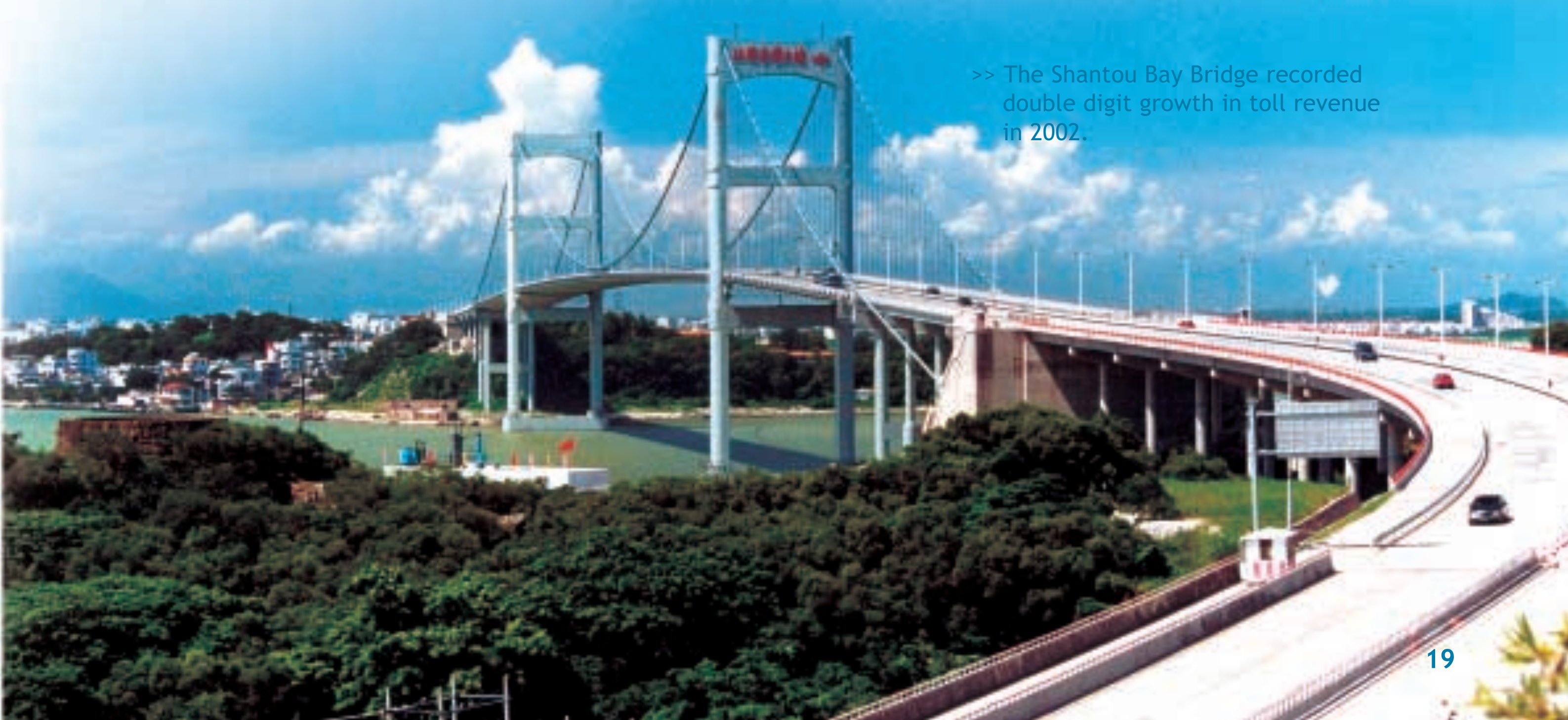
Consolidation of China Infrastructure Portfolio

During the year, the Zengcheng Lixin Road was sold for HK$132 million and generated a gain of approximately HK$50 million; disposal of the Nanhai Road Network was also largely completed with about HK$1.4 billion recouped.

The Group's consolidation strategy also includes the impending sales of the Shenyang Roads and Bridges and the Jiangmen Jianghe Highway, which are expected to be concluded in 2003. In accordance with new government regulations, some of the Group's assured-return contracts will be converted into new joint-venture contracts on risk sharing basis. CKI's consolidation of its infrastructure investments in China will soon be completed.

Hong Kong Eastern Harbour Crossing Tunnel

In Hong Kong, the Group took a 50 per cent. stake in the Eastern Harbour Crossing Company Limited, which owns the rail tunnel connecting eastern Hong Kong and eastern Kowloon. During the year, the tunnel generated satisfactory returns as well as stable cash flow for the Group.



>> The Shantou Bay Bridge recorded double digit growth in toll revenue in 2002.

CKI AR-2002

Infrastructure Materials and Infrastructure-related Businesses

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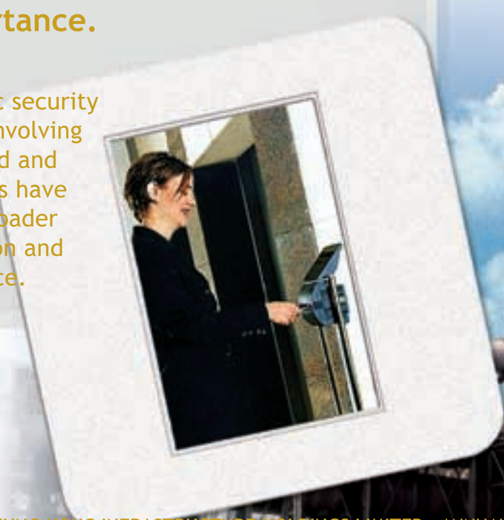
Infrastructure Materials and Infrastructure-related Businesses encompass both the Group's on-going operations in infrastructure materials and new initiatives in environmental and electronic infrastructure. While Green Island Cement and Anderson Asia are well recognised market leaders in the domestic cement and concrete industries, the Group's ventures in selective infrastructure-related businesses, such as environmentally friendly hydrogen system technology and electronic infrastructure initiatives are also growing in importance.



>> Electronic security systems involving smart card and biometrics have gained broader recognition and acceptance.

Infrastructure Materials

As a result of the deflationary environment and declining property market, both domestic consumption of and prices for cement, concrete and aggregates suffered further declines in 2002. The slowdown of public housing works and the recent decision to stop all government ownership-housing programmes are expected to further dampen infrastructure materials prices and volumes in 2003.

In such a challenging market, Green Island Cement and Anderson Asia have continued to impose stringent cost control measures, while striving to deliver the best possible customer service and most reliable product supply for users. Though profit contribution further reduced and represented a modest percentage of CKI's total profit contribution, both Green Island Cement and Anderson Asia maintained strong cash balances due to slim capital expenditure programmes and strong cash inflow from non-cash items such as depreciation expenses.

As with the Hong Kong domestic market, Green Island Cement's infrastructure materials business in Mainland China also faced strong price pressure and so saw a further reduction of profit margin. An over-supply situation continued in many cities amid a slowdown in construction activities.

During the year, Anderson Asphalt continued to maintain its market share and contributed a satisfactory profit as budgeted. The order book on

>> Green Island Cement is the market leader in the domestic cement industry.

>> Hydrogen generation and supply system for hydrogen vehicle fuelling.

hand remains healthy and the business is expected to continue to be profitable in 2003.

Environmental Commitments

During the year, the Group continued to focus on environmental initiatives in waste handling and recycling, waste to energy conversion and clean energy.

Waste Material Recycling

Green Island International has been working with the Hong Kong University of Science and Technology on a 24-month pilot programme to study "integrated co-combustion cement manufacturing facility for waste minimisation and energy optimisation". The research programme studies waste handling via a thermal process at 1,200 degree Celsius, an extremely high temperature made possible using a burning kiln rather than a conventional incinerator. The heat generated can also be picked up and converted into electricity to drive cement production facilities, and the residual ash can be recycled as raw material for cement manufacturing.

Water Treatment

In China, CKI has a water treatment joint venture committed to providing quality water supply in Yueyang, Hunan Province. The tariff was raised in 2002.

Polymer Modified Asphalt

In Canada, CKI has a 63.4 per cent. stake in Polyphalt Inc., a technology company that develops and commercialises polymer modified asphalt products and technology for North American and international markets. During the year, the Liaohe Refinery in Liaoning Province started polymer modified asphalt production as planned.

>> CKI's water plant investment in Yueyang, Hunan.

Hydrogen Energy

While new shares were issued for the acquisition of Vandenborre Technologies, N.V., CKI's investment in Stuart Energy Systems Corp., the leading global developer and supplier of integrated hydrogen solutions, was slightly diluted to around 9 per cent. Other than conventional industrial hydrogen applications, the alternative clean energy will also cover distributed energy and hydrogen fuelled vehicle markets.

In addition to the equity investment, CKI also holds an exclusive distribution right for the hydrogen fuelling technology in Asia Pacific until 2012.

Electronic Infrastructure

Electronic security systems involving smart cards and biometrics have gained broader recognition and acceptance as a result of increasing concerns about security. The Group has been working with different technology providers to develop and deliver one-stop security solutions by integrating different electronic biometrics and security technologies.

Financial Review

Financial Resources, Treasury Activities and Gearing Ratio

The Group's capital expenditure and investments were funded from cash in hand, internal cash generation, syndicated loans, notes issued and other project loans.

As at 31st December, 2002, total borrowings of the Group amounted to HK$12,645 million, which included Hong Kong dollar syndicated loan of HK$3.8 billion, foreign currency borrowings of HK$8,754 million and RMB bank loans of HK$91 million. Of the total borrowings, 18 per cent. were repayable in 2003, 66 per cent. repayable in 2004 to 2007 and 16 per cent. repayable beyond 2007. The Group's financing activities continue to be well received and fully supported by its bankers.

The Group adopts conservative treasury policies in cash and financial management. To achieve better risk control and minimise the cost of funds, the Group's treasury activities are centralised. Cash is generally placed in short-term deposits mostly denominated in Hong Kong dollars, U.S. dollars or Australian dollars. The Group's liquidity and financing requirements are reviewed regularly. The Group will consider new financing while maintaining an appropriate level of gearing in anticipation of new investments or maturity of bank loans.

As at 31st December, 2002, the Group maintained a gearing ratio of 19 per cent. which was based on its net debt of HK$5,454 million and equity of HK$28,853 million. This ratio was higher than the gearing ratio of 16 per cent. at the year end of 2001 due to drawdown of a short-term Australian dollars bridging loan of HK$1,823 million for the acquisition of CitiPower I Pty Ltd. during the year. For potential project financing requirements from business growth, the Group issued foreign currency fixed rate notes totalling HK$1,813 million in March 2002 under the Group's US$2 billion medium term note programme established in March 2001. In addition, the Group entered into a syndicated loan facility agreement of HK$3.8 billion in May 2002 which was fully drawn in September 2002 to refinance the HK$3.1 billion syndicated loan.

To minimise currency risk exposure in respect of its investments in other countries, the Group has a policy of hedging those investments with the appropriate level of borrowings denominated in the local currencies of those countries. As at 31st December, 2002, the Group has swapped the floating interest rates of its borrowings totalling HK$6,539 million into fixed interest rates. The Group will consider entering into further interest and currency swap transactions to hedge against its interest rate and currency risk exposures, as appropriate.

Charge on Group Assets

As at 31st December, 2002:

- certain of the Group's land and buildings and other assets with carrying values totalling HK$78 million were pledged to secure bank borrowings totalling HK$24 million; and
- the Group's interests in an affiliated company with carrying value of HK$1,982 million were pledged as part of the security to secure bank borrowings totalling HK$4,778 million granted to the affiliated company.

Contingent Liabilities

As at 31st December, 2002, the Group was subject to the following contingent liabilities:

HK$ million	
Guarantees in respect of bank loans drawn by affiliated companies	1,031
Performance bonds	25
Total	**1,056**

Employees

The Group, including its subsidiaries but excluding affiliated companies, employs a total of 1,898 employees. Employees' cost (excluding directors' emoluments) amounted to HK$370 million. The Group ensures that the pay levels of its employees are competitive and that its employees are rewarded on a performance related basis within the general framework of the Group's salary and bonus system.

Preferential subscription of 2,978,000 new shares of the Company was given to those employees who had submitted the pink application forms to subscribe for shares of HK$1.00 each in the Company at HK$12.65 per share on the flotation of the Company in 1996. The Group does not have any share option scheme for employees.