A New Chapter for CKI

2004 was another landmark year for CKI as the Group made a significant foray into the United Kingdom (“UK”) market. The successful acquisition of Cambridge Water and the North of England Gas Distribution Network have heralded a two-pronged expansion into two new infrastructure industries – water and gas – in this new geographical market for CKI.
Cambridge Water

CKI acquired 100% of Cambridge Water in April 2004. It is expected that the investment will generate attractive double-digit returns.

Cambridge Water has a long-established pedigree that dates back to 1853. Originally just serving 600 houses, the network now serves approximately 300,000 people. In 1989, when the rest of the water industry in the UK was privatised, Cambridge Water became regulated by the Office of Water Services (“OFWAT”). Prices are reset by OFWAT every five years and a reset has just been completed for Cambridge Water, with prices increasing 11.8% plus inflation from 1st April, 2005.

Cambridge Water possesses an integrated distribution system that includes 7 service reservoirs, 10 water towers and 2,200 kilometres of water mains, in an area that spans over 1,173 square kilometres. The operations are highly efficient, scoring top rank from OFWAT for operating efficiency. Cambridge Water has also achieved a “good” operating performance rating against all of OFWAT’s key performance indicators.

According to the Office of Population, Censuses and Surveys in the UK, population growth within Cambridge Water’s area has been one of the highest in the last two decades, with a cumulative annual growth rate four times the UK’s average. The growth of Cambridge Water’s customer base is expected to be one of the highest in the region. Being one of the largest employment centres in the region with some 80,000 jobs, Cambridge is displaying rapid economic growth, particularly in the knowledge-based businesses around Cambridge University.

As the area of Cambridge flourishes, this water company is forecast to generate sustained growth that outperforms the UK’s national average.

North of England Gas Distribution Network

The North of England Gas Distribution Network is one of the eight regional distribution networks that serve the entire UK market. Its region extends from the Scottish border to South Yorkshire, containing a significant mixture of large cities (Newcastle, Middlesborough, Leeds and Bradford) and a significant rural area including North Yorkshire and Cumbria. This represents a balanced demand portfolio with a large industrial and commercial consumer base accounting for approximately 48% of throughput and a sizeable domestic demand profile centred around the urban areas of Leeds and Newcastle. Growth in consumption over the last ten years in this region has outpaced the average in the UK. Serving a total population of 6.7 million, the extensive North of England distribution system comprises approximately 36,000 kilometres of distribution gas mains.

OFWAT’s key performance indicators include: customers at risk of receiving poor pressure, customers with an unplanned supply interruption greater than 6 hours, percentage of billing queries dealt with in less than 5 days, percentage of written complaints dealt with in 10 days and meter reading performance. The three categories of performance are “good”, “acceptable” and “needs improvement”.

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The North of England Distribution Network will be headed by Mr William Shurniak (left) as Chairman and Mr Basil Scarsella (right) as Chief Executive Officer.
In August 2004, a CKI-led consortium successfully won the tender to acquire the North of England Gas Distribution Network. The transaction will be completed in mid-2005 and is expected to generate attractive cash yields and a good return on equity to CKI. On completion of all related transactions, CKI will hold a 40% stake in the North of England Gas Distribution Network and become the single largest shareholder in the asset. The other shareholders will be Hongkong Electric Holdings Limited (19.9%), Li Ka Shing (Overseas) Foundation (15.2%), United Utilities PLC (15%), Challenger Life No.2 Limited (5.8%) and SAS Trustee Corporation (4.1%).

**The UK and Beyond**

CKI is interested in investing in low risk regulated assets with steady and solid returns. In addition to strengthening our operations in existing markets, we are keen to explore other new markets around the world. CKI is a key player in global infrastructure industries and we will pursue new investment opportunities with vigour. We hope to expand our market penetration and geographical reach through more sound investments.
The UK Gas Industry

The UK represents a market at the forefront of privatising previously state-owned assets. The process of privatisation began in 1984 with the sale of British Telecom and currently there is private financial involvement in all utility and public transportation sectors like airline and train operations. The market has emerged as a sophisticated mix of international investment. Investors from outside the UK have been attracted by consistent regulatory regimes that provide solid low risk returns in a steadily growing market place.

The UK’s gas market is amongst the most developed in Western Europe, comprising a competitive market for the production and supply and sale of gas and a highly developed regulatory framework for transporting gas to consumers.

Gas consumption has doubled over the last 20 years to approximately 1,100 TWh in 2002, and is expected to grow to 1,370 TWh by 2012, making the UK the largest gas market in Western Europe. The gas industry has become an essential part of the British economy, with its share of UK primary energy consumption increasing from approximately 23% in 1983 to 41% in 2002. The growth in gas consumption can be seen in all sectors, from industrial and commercial to domestic. Growth in gas consumption in the industrial and commercial sectors have been driven by increasing levels of economic activity and fuel substitution brought about by the competitive position of gas in relation to other fuels, most notably oil. In the domestic sector, gas consumption continues to grow and over 70% of all homes in the UK are centrally heated by gas.

The gas distribution industry in the UK operates within one of the most highly developed incentive based regulatory frameworks in the world. The regulated monopoly businesses of gas distribution are advanced and transparent, benefiting from a number of factors:

- Consistent application of incentive-based regulation;
- Revenue visibility is expected until at least March 2007, the end of the current price control period;
- Transparent review process for the setting of price controls;
- Underpinning legislation ensures that businesses can finance major capital projects and mains replacement programmes while maintaining credit rating;
- Incentive based regulatory regime which allows companies to keep the benefit of outperformance.

Given the natural monopoly and regulatory aspects of the industry, gas distribution networks in the UK face limited risks and cash flow generation is extremely robust. The regulatory process also provides a clear basis for longer term forecasting due to its transparent and well-tested nature.