

# GROUP MANAGING DIRECTOR'S REPORT



To understand the business of CKI, it is imperative to comprehend the global infrastructure landscape in which we operate. It is CKI's unique competitive advantages, against this backdrop, that explain our growth to date.

## THE ROADMAP OF SUCCESS

### **The Role of Infrastructure**

Over the course of history, the development of infrastructure has been the basis of civilization and fuelled the growth of communities. Infrastructure has brought people together and enabled people to conduct their lives with ease and certainty. As more and more of the world's population now reside in denser sub-urban areas, the need for effective and reliable infrastructure

support has never been greater. Without a doubt, infrastructure underpins economic development and is crucial to the advancement of all communities.

### **The Industry of Infrastructure**

Around the world, infrastructure development is growing rapidly and becoming a much sought-after industry. It has been reported that in just the energy and power sector alone, mergers and acquisitions for 2006 were estimated at over HK\$4.7 trillion.

There is currently an emergence of new infrastructure investment opportunities as more government organizations around the world are outsourcing projects and the Public Private Partnership (or PPP) model becomes increasingly popular. At the same time, the number of investors in this area is also on the rise as more enterprises and funds are drawn to the relatively stable cash returns and inflation-hedge characteristics offered by infrastructure projects.

The barriers to market entry in infrastructure are high – infrastructure projects require capital intensive investment, and accordingly complex risk management and assessment. In addition to being capable of investing large sums of money, infrastructure companies also need to consider a host of factors in their investment market, including the issues of politics, fiscal policy, legal framework, interest rates, currency and foreign exchange, taxation, GDP, consumer purchasing power, availability of capital, and population growth among others.

### **Achieving Success in Infrastructure**

For an infrastructure company to be successful, it should possess very strong financial capabilities to fund investments. Good project management ability is also vital to overseeing often huge, complex and capital intensive projects. In addition, infrastructure investment companies must have a clear policy on how to assess and mitigate risk.

### **CKI – A Decade of Achievement**

In just over ten years of history, CKI has emerged as a major player on the world infrastructure stage. CKI was listed on the Hong Kong Stock Exchange in July 1996 and became a constituent stock of the Hang Seng Index

within a year, quite a record achievement at that time. Shortly after listing, we received an “A-” rating from Standard and Poor’s, which we have maintained ever since.

Over the last decade, year-on-year growth has been recorded across a number of key performance indicators. For the first year after listing, CKI reported profit of HK\$854 million. In 2006, profit reached HK\$3,670 million, representing an increase of over 3 times in the last ten years. Total assets have grown by around 3 times to reach HK\$47.6 billion. The company’s market capitalization has doubled to over HK\$54 billion as of 31st December, 2006.

From being primarily focused on Hong Kong and Mainland China, we have since come of age as an international infrastructure company, with investments also in Australia, the United Kingdom, Canada and the Philippines. Our operations now span electricity generation and distribution, gas distribution, toll roads, water treatment and distribution, infrastructure materials and environmental initiatives.

Our business began with interests in materials, energy and toll roads in Hong Kong and Mainland China. We have invested over HK\$10 billion in a diverse range of projects in Mainland China. Our energy investments have a total electricity generation capacity of approximately 3,000 MW, while our toll road projects span approximately 450 kilometres in different provinces across the country. Our materials business includes cement, asphalt, concrete and aggregates operations. Through the operating companies of Green Island Cement Company Limited and Alliance Construction Materials Limited, CKI is the market leader in Hong Kong’s infrastructure materials industry.



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In 1997, we acquired a controlling stake in Hongkong Electric Holdings Limited, the sole electricity generator and distributor to Hong Kong Island and Lamma Island, with a history dating back to 1889. Hongkong Electric is one of the most reliable electricity suppliers in the world with an exceptionally outstanding supply reliability in excess of 99.999%. This dependable source of electricity has been crucial to the territory's economic development and makes Hong Kong the envy of many major cities in the world that have suffered from power blackouts.

After firmly establishing our businesses in Hong Kong and Mainland China, we commenced our story of diversification and globalization by expanding into new markets and new industries.

We began our expansion programme with the Australian market in 1999 through the acquisition of a 19.97% stake in Envestra Limited, the largest listed natural gas distributor in the country with a distribution network that serves over 970,000 customers and spans approximately 19,100 kilometres. Building on this momentum, we amassed a broad portfolio of electricity assets in Australia, including: ETSA Utilities, the primary electricity distributor in the state of South Australia that serves more than 770,000 customers; Powercor Australia Limited, the largest electricity distributor in the state of Victoria that serves over 660,000 customers and CitiPower I Pty Ltd., which distributes electricity to approximately 295,000 customers across the central business district and inner suburban areas of Melbourne.

These successful investments have made us the largest power distributor in Australia and culminated in the divestment of part of our stake in the electricity businesses to Spark Infrastructure Group and the listing of Spark Infrastructure on the Australian Stock Exchange at the end of 2005. Spark Infrastructure has a current market capitalization of about HK\$12 billion. In addition

to energy projects, CKI also has a stake in the Lane Cove Tunnel in Sydney and a 49% stake in AquaTower, the exclusive potable water supplier of four regional towns in Victoria.

As our Australian investments reached a critical mass, we further diversified our global footprint in 2004 by expanding into the gas sector in the United Kingdom. CKI won the tender for Northern Gas Networks Limited, which serves a population of around 6.7 million. We also acquired a 100% stake in Cambridge Water PLC, a water distributor that supplies a population of approximately 300,000 in Cambridgeshire.

Overall, the total net asset value of CKI's investments are approximately HK\$20 billion in Hong Kong, HK\$5 billion in Mainland China, HK\$9 billion in Australia and HK\$4 billion in the United Kingdom.

## Reasons for Success

CKI has maintained a leading position in the markets that we operate due to five major achievements:

### 1) Diversified Portfolio

We have built up a quality asset portfolio across a number of infrastructure industries around the world. This has helped to diversify our risk profile.

### 2) Global Network

CKI's strategy has been to devote our resources and time into building and growing our expertise in each market we operate in, starting with Hong Kong and Mainland China, then Australia and now the United Kingdom. By clustering our investments, we have been able to attain more synergies between our businesses and magnify our market leadership position. In addition, as part of the Cheung Kong Group, which has businesses in 56 countries across the globe, we are able to leverage on synergies with

our sister companies. As one of the largest foreign investors, the strong presence and market position of the Cheung Kong Group in CKI's key markets has been highly beneficial in accelerating our development.

### **3) Secure Investments**

When it comes to selecting which projects to invest in, we favour those investments that offer regulated cashflow. Currently around 90% of earnings come from regulated businesses in developed markets. Providing us with stable earnings and calculated risks that we are comfortable with, CKI's preference is to invest in existing projects which can provide immediate cashflow rather than greenfield projects which tend to be riskier in terms of construction risks and time delay. Our prudent investment philosophy is well-respected throughout infrastructure and investment circles.

### **4) Expertise**

Our management approach to an international business is to think global and act local. Our success in the markets in which we operate lie in our commitment to local expertise. The CKI team comprises many talented and loyal individuals with an international perspective and transferable expertise. In our operating companies, we have nurtured local talent and promoted them within our ranks.

### **5) Strong Balance Sheet**

We have acquired a decade of experience in making sound investments, gathering extensive market understanding and establishing important connections with experts in the fields of finance, regulation, construction and operation. In the last few years, CKI has been invited to participate in almost

all major infrastructure projects available in the market. With our strong financial platform, over HK\$7.7 billion cash on hand and a net debt to equity ratio of 4% (as at 31st December, 2006), we are in an excellent position to pursue more investment opportunities and participate in more new projects in the future.

CKI has achieved more than a decade of continued growth by focusing on delivering long-term, predictable cash flow. With a reputation for thorough due diligence and innovative deal structures, we are well placed to sustain our market leading position. We are probably one of the few infrastructure companies in the world that is able and willing to participate in some of the mega-infrastructure projects available. We have been posting achievements in various areas of business, including acquisitions, organic growth, consolidations and divestments.

### **The Roadmap for the Future**

Looking forward, the opportunities in the global infrastructure industry are immense. As well as generating organic growth in our existing businesses, we will continue to pursue new investments that accord with our prudent investment criteria. CKI will also explore new corporate finance initiatives and divestments to further enhance the value of our business.

With our strong market position and formidable financial might, we are well placed to generate continued growth and returns in the future. We are highly confident of maintaining our growth momentum in the coming ten years and beyond.

### **H L Kam**

Group Managing Director

Hong Kong, 15th March, 2007