CK HUTCHISON HOLDINGS LTD 01- HK
CHEUNG KONG PROPERTY HOLDINGS LTD 1113 - HK

PORTLAND INVESTMENT COUNSEL™

JUNE 2015

Business Description:

CK Hutchison Holdings (CKH Holdings) is a global conglomerate that owns operating units in over 50 countries, while Cheung Kong Property Holdings (CK Property) is one of the largest property companies listed in Hong Kong. In January 2015, Cheung Kong Holdings Limited (CK Limited) announced its intention to acquire the remaining 50% stake in Hutchison Whampoa Limited to form CKH Holdings in a stock swap transaction valued at approximately US$23.64 billion. Hutchison Whampoa was a leading multinational conglomerate committed to development, innovation and technology in many sectors. Its diverse array of holdings range from some of the world's largest port operators and retailers to property development and infrastructure to the most technologically-advanced and marketing –savvy telecommunications operators. Hutchison Whampoa reported turnover of approximately HKD 421 billion (USD 54 billion) for the year ended 31 December 2014. The company has operations in over 50 countries and approximately 280,000 employees worldwide.

The newly formed entity also consolidated the group's property businesses under CK Property, which was spun off and became a pure play in property market. The transaction was finalized on June 3, 2015.

Overview and Investment Thesis:

- **Large scale in a growing number of territories.** The merger of CK Limited and Hutchison Whampoa is a transformational deal for the conglomerate business, as it creates a dominate position for the newly established firms in many market segments including property, infrastructure, energy, retail, telecommunications and port and related services.

- **CK Property** is one of the largest property companies listed in Hong Kong with leading market share, proven track record, strong penetration in China and international markets. The combined company totals 17 million square feet in rental properties, 170 million square feet in development properties with over 14 thousand hotel rooms.

- **CKH Holdings** is a global conglomerate that owns operating units in over 50 countries. The combined holding company will streamline assets that are co-owned by Hutchison and CK Limited across 4 continents, which includes joint ventures such as Northumbrian Water (water and sewage services in UK), Wales & West Utilities (gas distribution networks in UK), Envestra(one of the largest natural gas distribution in Australia), AVR(largest energy-from-waste company in Netherlands) and Park'N Fly (Largest off-airport car park company in Canada).

- **Financial flexibility.** CK Property and CKH Holdings are expected to obtain and maintain strong investment grade ratings consistent with Hutchison Whampoa's current strong investment grade rating. As a pure property play company, CK Property will have a separate fundraising platform and a clean capital structure with projected Net Debt to Net Total Capital of 13.5%. In addition, CK Property has in place commitments from banks to provide HK$55bn of new debt facility. On the other hand, CKH Holdings' credit and cashflow profile will remain strong with projected Net Debt to Net Total Capital at 18.2%, after the increase of stake in Husky Energy Inc., and consolidation of infrastructure assets including Northumbrian Water, Wales & West Utilities and Envestra.

- **A collection of prized assets from the transaction.** Upon the completion of the acquisition, the group will own one of the world's largest health and beauty retailers A S Watson, who operates 14 retail brands including PARKnSHOP Supermarket, FORTRESS electrical appliances chain, Watson's Wine, Kruidvat, Trekpleister, Superdrug, The Perfume Shop and ICI PARIS XL with over 11,400 stores in 21 countries worldwide. The group will also own approximately 75. 7% of ownership interest in Cheung Kong Infrastructure Holdings Limited (CKI Holdings), who is the largest publicly listed infrastructure company in Hong Kong and one of U.K.'s biggest utilities, owning UK Power Networks, Northumbrian Water and Northern Gas Networks. The group's port development and operations expertise stems from its flagship company, Hongkong International Terminals Limited, which is situated in the Kwai Tsing container port area of Hong Kong – one of the busiest container ports in the world. The group will also own the busiest port in United Kingdom, the Port of Felixstowe.

- **Greater transparency and business coherence.** Clear delineation between CKH Holdings and CK Property helps in our view better align the two entities' respective investor bases and eliminate the investment arbitrage that originates from valuation mismatch. From the group's long-term development, we believe having more streamlined and focused business lines should help in attracting and retaining professional talent which will in turn help the group achieve sustained earnings over an extended period of time.

- **Growing potential on existing Hutchison portfolio.** To enlarge its global presence, CKH Holdings continues to expand the scale and geographical spread of its businesses through investment in organic growth and selective acquisitions. Hutchison Whampoa has made substantial investments in acquiring 3G and 4G Long-term evolution (LTE) licenses and developing mobile telecommunications networks in Europe. In January 2015, it announced to acquire O2 Plc for £10.25 billion, which is the commercial brand of Telefonica U.K. Limited with over 24 million customers and approximately 450 retail stores. After the acquisition, we believe the group will become the largest player with the most dominant pricing power in U.K. mobile market.

- **Robust historical performance from property group.** Between 2012 and 2014, the CK Property's investment properties maintained its occupancy rate at more than 95%, and achieved solid growth in average rental rate, where the CK Property and Hutchison Property Group had a compounded annual growth rate (CAGR) of 8.1% and 10.2% respectively. In the hotel and serviced suite sector, the group has also stabilized their revenue per available room (RevPAR) and occupancy rate. Significant year over year growth came from CK Property, as its saleable area and average selling price increased 24.7% and 65.3% respectively.

- **Potential increase in dividend.** Given the history of persistent dividend distribution from both companies, management team expects that the future dividend and dividend payout ratio from CKH Holdings and CK Property to exceed the levels set by CK Limited and Hutchison Whampoa. Furthermore, due to the incorporation in Cayman Island, payments of dividends on both companies' shares will not be subject to taxation under Cayman law. We believe the well-diversified business model for both resulting firms pertains to long-term stable cash flow generation and distribution.

- **Continuity of experienced management teams.** The resulting leadership teams are selected from the existing management pools which include Fok Kin Ning, who formerly chaired Hutchison Telecommunications Hong Kong Holdings Limited, served as the trustee-manager of Hutchison Port Holdings Trust and HK Electric Investments; and Kam Hing Lam, who had more than 20 years of experience in senior and regional capacities at major U.S. multinational firms such as Johnson and Johnson, American Express and Levi Strauss before becoming an executive director of the company in 1993. The team will be strengthened by guidance from the chairman Li Ka-shing, who is one of the world's most well-known business magnate, investor, and philanthropist.

Industry Growth Drivers/Trends:

- **Underlying global economic recovery.** Central Banks around the world are expected to continue to broaden their monetary stimulus to enhance global economic growth. Mainland China is expected to continue to pursue proactive fiscal and monetary policies, with the goal of pursuing steady economic growth so as to achieve sustainable development. North America is showing signs of favorable economic growth while growth in Europe is expected to remain sluggish in the near term. However, the fall in euro against other currencies is likely to increase the near-term competitiveness of Europe.
- **Growing prospect of infrastructure in Asia.** As Asia-Pacific countries develop and become the global economic powerhouses of the next decade, infrastructure demand is set to emerge as well. Infrastructure spending worldwide is expected to be $78 trillion between 2014 and 2025, where Asia-Pacific will represent nearly 60% of the spending by 2025. The growth will be fueled by the rising urbanization rate and increasing demand for new transportation, utilities, school systems, healthcare and aged care facilities.
- **Consumer brand awareness.** We believe brand reputation continues to serve as one of the most important factors in consuming health and beauty products, especially in developing markets where the guarantee of product quality is limited. Through centuries of operations in Hong Kong and Mainland China, A.S. Watson has already established a highly reputable image via trust worthy brands including Watsons Personal Care Stores and PARKnSHOP.
- **Growth in data traffic.** With the rising usage of smart devices, videos and apps, data traffic is expected to grow exponentially worldwide. According to Cisco, mobile data traffic in Asia-Pacific and Europe (Central and Eastern) will have CAGR (Compounded Annual Growth Rate) of approximately 58% and 71% from 2014 to 2019. In most of the emerging countries, price tends to act as the primary barrier in the adoption of smart devices. Given the availability of lower priced models and rising GDP per capita, it is expected that these devices will rapidly achieve a critical mass. As a result, the increase in data usage is anticipated to ultimately drive up the consumption activities in telecommunication services.
- **Increasing attractiveness in global property investment.** Unprecedented low rate conditions remain in place to benefit real estate as an asset class. Real estate's stable income continues to attract investors looking for higher yield. The potential for real estate to provide diversification across both asset classes and geographies is an added advantage in the current uncertain international political environment.

Competitive Advantages:

- **Size:** Upon completion of the merger deal, CK Property will own 17 million square feet of rental properties, becoming one of Hong Kong's largest landlords in terms of GFA (Gross Floor Area). Its development properties division will become the top property developer in Hong Kong with 170 million square feet. Its hotel division will be the number one listed hotel-operator in Hong Kong with over 14 thousand hotel rooms.
- **Deal execution**: The recent acquisitions of O2 UK (£10.25 billion), Eversholt Rail (£2.5 billion) and up to 60 aircrafts (US$2.63 billion) highlighted the long established track record of successful deal execution from both CK Limited and Hutchison, which is likely to further enhance the international opportunities of CKH Holdings and CK Property.
- **Relationship with regulators:** The government relationships built by the corporation serves to be an important intangible asset to the entity, which allows each of its business operations to operate as one of the most influential players in the market.

Competitors:

- **Retail:** Dairy Farm International Holdings Ltd., Jardine Matheson Holdings Ltd., Alliance Boots Gmbh
- **Telecommunications:** Telefonica SA, Telecom Italia SpA, TeliaSonera AB
- **Property & Hotels:** Sun Hung Kai Properties Ltd., Galaxy Entertainment Group Ltd.
- **Ports & Related Services:** served as quasi monopoly
- **Infrastructure & Energy:** Imperial Oil Ltd., Suncor Energy Inc.

Customers:

- Given the breadth and depth of the group's diversified portfolios of businesses, there is no significant exposure to any single customer at a group level.

Barriers to Entry:

- **Competitive bidding/Regulation:** In order to compete in industries such as port services and telecommunications, a start-up firm would be subject to regulator's approval, which is likely to result in a competitive bidding process with emphasis on the operators' technical expertise and market knowledge.
- **Capital intensive/Economies of scale:** Entry in markets including port services, infrastructure and telecommunications require significant up-front outlays. A long established track record of successful deal execution is likely to help larger companies to achieve economies of scale, where it would be much more difficult for a new firm to duplicate.
- **Brand Recognition:** In telecommunication and retail industries, existing firms tend to have years of operating exposure to its domiciled geographic locations. Consumers may have an established brand loyalty which is likely to provide a barrier to new entrants.

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Officers and Directors:

- **Leadership team for CKH Holdings:** Chairman Li Ka-shing; Deputy Chairman and Group Co-Managing Director, Li Tzar Kuoi (son of chairman); Group Co-Managing Director, Fok Kin Ning; Group Finance Director and Deputy Managing Director, Frank John Sixt.
- **Leadership team for CK Property:** Chairman Li Ka-shing; Deputy Chairman and Group Co-Managing Director, Li Tzar Kuoi (son of chairman); Deputy managing director, Kam Hing Lam.

Corporate Governance:

- **The CKH Holdings board will comprise 19 directors** – of which 7 will be independent non-executive directors.
- **The CK Property board will comprise 14 directors** – of which 5 will be independent non-executive directors.
- As at 31 December 2014, Hutchison's Board comprised 14 Directors, including the Chairman, Deputy Chariman, Group Managing Director, Deputy Group Managing Director, Group Finance Director, two Executive Directors, two Non-executive Directors and five independent Non-executive Directors.
- Despite the weak corporate governance of Chairman Li's entities, investors will be investing alongside the Li Family Trust, which is expected to retain a significant position (approximately 30%) in the two corporations. We believe investors will benefit from co-investing with the Family Trust through its decades of operational experience and established relationships with government officials.
- In 2014, Hutchison's companies garnered hundreds of industry awards and recognitions including those for business practices, environmental achievements and employment practices. In particular, the company was awarded "The Global 2000" by Forbes, and was also recognized as a member of the "10 Years Plus Caring Company Logo" by The Hong Kong Council of Social Service.
- Hutchison Port Holdings Limited ("HPH") together with a few other port operators joined hands in a global environmental initiative named "Recycling Begins & Ends With You". It is the first such high level cooperation amongst the global port operators on an environmental initiative.
- Hutchison's key management personnel remuneration is equivalent to roughly 1.3% of the company's operating income.

Post Transaction Ownership:

- The Li Family Trust will own 30.2%, the former other eligible CK Limited shareholders will own 33.9% and the former other eligible Hutchison shareholders will own 35.9% of CKH Holdings and CK Property combined.
- Existing Hutchison shareholders include: CK Limited 50.0%, BackRock Institutional Trust Company 0.9%, Norges Bank Investment Management 0.9%, The Vangauard Group Inc. 0.6%, Schroder Investment Management 0.5%.

Post Transaction Capital Allocation/Uses:

- Hutchison maintained a strong financial position throughout the past few years. Total cash and other available funds increase by 37% from HK$102,787 million to HK$140,459 million. The main contributors are the Temasek's acquisition of a 24.95% equity interest in A.S. Watson Holdings Limited during 2014, the cash raised from debt capital market of HK$42,030 million, the cash from positive funds from operations of HK$50,836 million (USD$6,518 million) and cash from new borrowings of HK$77,895 (USD$9,986 million).
- On January 23, 2015, Hutchison agreed to acquire O2 PLC (O2), a wireless telecommunications service provider owned by Telefonica SA, for £10.25 billion (USD$15.381 billion). The consideration consists of £9.25 billion (USD$13.881 billion) in cash and up to £1 billion (USD$1.501 billion) in profit-related payments.
- The consolidated net debt of Hutchison is approximately HK$106,408 million, where the consolidated gross interest expense is roughly HK$8,153 million. Reported EBITDA (Earnings before Interest and Tax, Depreciation and Amortization) of HK$98,873 million and FFO (Funds from Operation) of HK$50,836 million for the year covered consolidated net interest expenses and other finance costs 20.4 times and 11.7 times respectively. Total equity amounted to HK$519,062 million, while net debt to net total capital ratio decreased to 16.8% from 20.0% one year ago.
- Hutchison's credit ratings from S&P, Moodys and Fitch are A-, A3, and A- respectively. It also has available committed borrowing facilities amounting to the equivalent of HK$2,861 million.
- Hutchison has been committed to gradually increase its dividend payout over the past few years, where its dividends per share rose from HK$1.92 to HK$2.415 between 2010 and 2014. The current dividend yields 2.2%. The management has indicated that the newly formed entities are expected to continue distributing higher dividends going forward.

Key Ratios and Figures Hutchison Whampoa:

Y/E December 31	2012	2013	2014
EBITDA Margin (%)	15.5	17.6	19.1
Interest Coverage	2.8x	3.8x	4.6x
Return on Invested Capital (%)	5.3	6.0	12.1
Fixed Asset Turnover	1.5x	1.49x	1.55x

Key Pro Forma Figures (CKH Holdings and CK Property):

Y/E December 31, 2014 (HK MM)	CKH Holdings	CK Property
Revenue	427.6	46.6
Total Asset	1,029.7	416
Total Equity	522.1	226.6
Net Debt	118.6	39.4
Net Debt/Net Total Capital (%)	18.2	13.5

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Business Segments Hutchison Whampoa (Years ended December 31):

Business Sector Mix	Revenues (%)		Capital Expenditure (%)		Total Assets (%)	
	2014	2013	2014	2013	2014	2013
Ports & Related Services	8.5%	8.3%	18.5%	23.2%	10.8%	12.2%
Property & Hotels	3.8%	5.9%	0.7%	1.8%	14.0%	11.8%
Retail	37.3%	36.1%	11.4%	7.4%	5.0%	5.6%
Infrastructure	10.8%	10.3%	1.4%	1.4%	15.2%	13.1%
Energy	13.6%	14.4%	0.0%	0.0%	5.4%	6.4%
Telecommunications	20.8%	19.6%	67.1%	65.2%	32.5%	36.2%
Finance & Investments and Others	5.2%	5.4%	1.1%	1.1%	17.1%	14.7%

Geographic Segments Hutchison Whampoa (Years ended December 31):

Geographic Mix	Revenues (%)		Capital Expenditure (%)		Total Assets (%)	
	2014	2013	2014	2013	2014	2013
Hong Kong	15.6%	15.1%	8.7%	6.7%	16.7%	13.1%
Mainland China	10.6%	11.8%	4.2%	5.4%	9.4%	9.9%
Europe	43.4%	41.3%	62.2%	63.4%	40.4%	45.2%
Canada	13.4%	14.4%	0.0%	0.0%	5.1%	5.9%
Asia, Australia and Others	11.8%	11.9%	23.8%	23.4%	11.4%	11.4%
Finance & Investments and Others	5.2%	5.4%	1.1%	1.1%	17.0%	14.7%

Financial Statements Summary Hutchison Whampoa (HK MM except per share items which is HK dollars, years ended December 31):

	2014	2013	2012	2011	2010
Income Statement					
Total Revenue	272,161	256,234	243,089	233,700	209,180
EBITDA	51,852	45,152	37,682	34,131	35,080
Earnings per Share (Diluted)	$15.75	$7.30	$6.07	$13.14	$4.73
Dividend per Share	$2.42	$2.30	$2.08	$2.08	$1.92
Dividend Payout Ratio	15.4%	31.5%	34.3%	15.8%	40.6%
Balance Sheet					
Total Debt	255,613	230,799	266,343	225,056	264,749
Total Equity	466,218	426,609	391,519	359,612	314,033
Total Debt: Total Equity	54.8%	54.1%	68.0%	62.6%	84.3%
Cash Flow Statement					
Operating Cash Flow	47,920	45,052	33,257	39,060	29,867

Sourced from Thomson Reuters and Company Reports

Certain statements included in this document constitute forward-looking statements, including those identified by the expressions "anticipate," "believe," "plan," "estimate," "expect," "intend" and similar expressions to the extent they relate to the business. The forward-looking statements are not historical facts, but reflect the Portfolio Management team's current expectations regarding future results or events. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. The Portfolio Management team has no specific intention of updating any forward-looking statements whether as a result of new information, future events or otherwise. Any opinions expressed are those of Portland Investment Counsel Inc. and do not necessarily state or reflect the views of CK Huchison Holdings Ltd. or Cheung Kong Property Holdings LTD. Publication in this document should not be considered an endorsement by CK Huchison Holdings Ltd. or Cheung Kong Property Holdings LTD.

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel: 1-888-710-4242 • Fax: 1-866-722-4242 • www.portlandic.com • info@portlandic.com

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