Chief Executive Officer's Review

In this review, I present the core elements of CLP's financial results in 2002, review the progress in implementing our business strategy and underscore CLP's commitment to prudence in our business operations and the management of our financial resources.

Year 2002 Results

In 2002, earnings per share for recurring operations increased by 16.3% to HK$2.71 per share compared to the previous year. The Scheme of Control (SoC) earnings for the year ended 31 December 2002 grew 7.2 % to HK$5,814 million, as a result of CLP Power's ongoing investment in the electricity supply system. Earnings from non-SoC activities increased from HK$461 million to HK$890 million, reflecting the contribution from power projects outside Hong Kong.

Total earnings for 2002 were HK$7,079 million, compared to HK$7,257 million for 2001. These took into account property profits of HK$546 million arising from the Group's share of profits of the Hok Un redevelopment and the gain from disposal of a former staff quarters site in Kowloon. By comparison, the property profit in 2001 was HK$1,468 million. The total earnings per share in 2002 were HK$2.94, an increase of 0.7%.

While we are encouraged by the strong growth recorded for the past year by our non-SoC activities outside Hong Kong, it should be noted that the risk/reward profile of these investments is more volatile than that of the SoC business.

Business Strategy

CLP's business strategy is well-known to shareholders and has remained largely the same since 1998. It may, however, be helpful to recap the three key elements of our strategy. These are to:–

- Continuously enhance our core Hong Kong electricity business;
- Develop our portfolio of electricity businesses in the Chinese mainland and the Asia-Pacific region; and
- Pursue selective opportunities to expand our activities beyond our conventional electricity business, by leveraging off our existing businesses, assets, expertise and relationships.

Each of these is discussed below in more detail.

Hong Kong Electricity Business

CLP's electricity business in Hong Kong, regulated through the SoC Agreement with the Government of the Hong Kong Special Administrative Region (the Government), continued to perform well and to generate a major part of the Group's earnings – 86.7%

of earnings from recurring operations in 2002. During the year, CLP invested HK$5.9 billion in the Hong Kong electricity business.

These figures demonstrate the importance of this business within the CLP Group. The current SoC Agreement concludes in 2008 and effective management of regulatory issues is essential to CLP's continued success. To this end, in 2002, we maintained our efforts in enhancing the quality of this business, in terms of tariff management, productivity and efficiency gains, reliability and customer service. In doing so, we both discharge our responsibility to our customers and earn the community's trust as the ongoing and long-term provider of this essential public service.

The SoC provides for an interim review in 2003 when modifications may be requested to any part of the Agreement. However, since the SoC Agreement was reviewed in 1998 and will expire in five years' time, we do not believe that the 2003 Interim Review would entail major modifications to the Agreement as it currently stands.

Discussions with the Government on any revision and extension of the SoC beyond 2008 will be of more fundamental importance. The Government has indicated that it will conduct a review of the electricity market with a view to drawing up, in good time, a broad framework for the development of the electricity supply sector, to succeed the current SoC Agreement. For its part, CLP has been devoting considerable management resources to a thorough understanding of the implications of different regulatory systems for our Hong Kong electricity business. This exercise, coupled with the observed experience in England and Wales, New Zealand, Australia, California and Ontario, has highlighted:–

- The shortcomings and risks of rapid and radical change to established regulatory regimes;
- The great care which must be taken in the pace and extent of regulatory change, including recognition of the specific characteristics of each electricity system, and the importance of designing a stable and lasting regime so as to support long-term investment; and
- The comparative merits of the SoC as a durable regulatory system, which strikes a fair balance between the interests of shareholders and customers.

The selection of an appropriate framework for Hong Kong's power sector after 2008 should be made in the context of the benefits provided by the existing regulatory scheme – near universal access in our service areas, reliable supply, environmental stewardship, reasonable tariff and reasonable return on investment. As a responsible and experienced service provider, CLP will contribute its knowledge and expertise to the discussion of the future of our industry. CLP expects that the legitimate interests of the Company, its shareholders, its employees, and the community it serves, will be given balanced consideration to assure that the benefits provided over a century of service in Hong Kong will be retained.

Electricity Businesses in the Chinese Mainland and the Asia-Pacific Region

The increasing maturity of CLP's Hong Kong electricity business, evidenced by the slowdown of the growth in electricity demand in recent years, coupled with a degree of regulatory uncertainty post-2008, has led us to diversify the Group's activities. We are doing so through the application of our skills and competencies to investments and projects in the electricity sector in the Chinese mainland and the Asia-Pacific region.

Chinese Mainland

Economic growth and electricity demand remain strong in the Mainland. However, the recent power sector reform has created increased risks and uncertainties for private investors in China. The break-up of the State Power Corporation will lead to increasing competition between the newly created five national generating companies and other independent power producers (IPPs) such as CLP. There has also been considerable downward pressure on electricity tariffs paid to generating companies. The central authorities are seeking to preserve tariff levels to customers, whilst re-allocating a larger share of total electricity revenues to the transmission and distribution sectors, which are in urgent need of substantial investment.

The combination of:–

- The availability of funding in the Mainland domestic capital markets for investment in the electricity industry;
- Generating assets becoming available for acquisition as a result of power sector reform; and
- The perception of continuous growth in electricity demand

may create a "sellers' market" for existing generating assets and other greenfield projects. Notwithstanding the underlying regulatory risks and tariff uncertainties, foreign and domestic IPPs may jockey for market share and bid for assets at prices which do not properly reflect the risks involved over the long periods required to earn a meaningful return on their investments.

CLP will remain extremely selective in its choice of new investments in the Mainland. In the short to medium term, CLP is prepared to slow the pace of investments, rather than compromise on their quality. Over a longer period, CLP expects that the market will become clearer and more settled, and it will be possible to assess with greater confidence the long-term value of assets in relation to their prices in the market.

Asia-Pacific Region

CLP has established a significant presence in the private sector power industry of a number of countries in the Asia-Pacific region, notably Taiwan, Australia, Thailand and India. This early-stage development must now be translated into building sustainable businesses in our selected markets and improving investment returns to meet the expectations of the Company and its shareholders.

For this reason, we will concentrate on improving the quality and returns of our existing businesses, if necessary, by additional incremental investment or joint ventures, rather than on new investments which are not complementary to our existing interests or in countries where CLP is not yet present.

Electricity-Related Activities in Hong Kong and the Chinese Mainland

CLP's skills, experience and competencies are those of an electric utility. Though we are alert for opportunities to leverage off our existing business, we recognise that these are likely to be closely related to our primary function as an electric service provider. We shall pursue only those opportunities which are compatible with CLP's expertise and resources. In 2002, CLP substantially reduced its involvement in the Hong Kong telecommunications business by withdrawal from the retail telecommunications business previously carried on under the "Oxygen" brand. Our original investment in this business was the result of a perceived opening in the Hong Kong telecommunications market, making use of CLP's existing customer relationships. We wanted to strengthen our customer links and did not wish to ignore opportunities presented by the "new economy".

Our involvement in the telecommunications business has not been a successful one. There are lessons from this, in terms of any future diversification by CLP into other non-electricity activities and, for that matter, in the expansion of our electricity businesses in the Mainland and the Asia-Pacific region. These lessons include:–

- The importance of conservative assessment of the value of synergies and the costs of capturing those synergies;
- Careful measurement of the leverage value of CLP's assets against the power of incumbent competitors; and
- Potential cultural misfit between new activities and CLP's culture as a steady paced, risk-averse utility.

The experience gained has reinforced the wisdom of staying close to what we know best. Nonetheless, as the revenues from the Hok Un redevelopment and the sale of the site at Ellyridge have illustrated, selective exploitation of CLP's assets for non-electricity purposes can generate significant earnings for our shareholders.

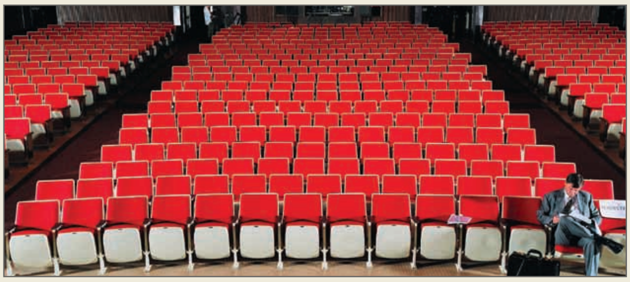
Funding and Liquidity

CLP's business strategy relies on the long-term availability of funding and the maintenance of appropriate levels of liquidity. Details of the Company's liquidity as at 31 December 2002 are provided on page 74. The electricity business is highly capital intensive and returns are generated over the long term. We closely monitor CLP's cash management and resources, including contingent liabilities that might call on those resources. We maintain a conservative capital reserve, emphasise that capital is expensive and prioritise competing claims on capital. These prudent policies have, in the past, led to comments that CLP is over-cautious, under-geared and adopts a sub-optimal capital structure. However, recent global corporate experience shows how businesses fail when they run out of cash, even if the underlying business model may be sound and their assets have value. Such experience, and the importance of maintaining CLP's status as a sound utility stock in a depressed and difficult share market environment, has indicated the benefits of prudence.

Our firm intention is to ensure that cash flow from our established businesses remains sufficient to fund dividends to shareholders and potential new investments, whilst continuing to maintain a strong financial position.

Andrew Brandler

Andrew Brandler
Hong Kong, 24 February 2003



Preparing to give...

...a staff briefing on CLP's performance and business direction