Our financial performance in 2003 was characterised by an improved contribution to Group earnings from each of our three major business streams.

Financial Performance

Consolidated Financial Results

The financial results in 2003 incorporate two significant changes when compared to 2002:

(a) the consolidation of Yallourn Energy and GPEC as a result of their reclassification from jointly controlled entities to subsidiaries of the Group following the acquisition of Powergen's remaining interests in these two companies in the first half of 2003; and

(b) the adoption of Hong Kong Statement of Standard Accounting Practice (SSAP) No. 12 (Revised) "Income Taxes" which became effective from 1 January 2003.

The consolidation of Yallourn Energy and GPEC has a significant impact on a number of the Group's balance sheet items such as fixed assets, trade and other receivables and total borrowings. The Group earnings have incorporated the effect of the additional shareholdings we acquired in 2003 of 18.4% and 20% in Yallourn Energy and GPEC respectively. Their revenues and expenses are included in the Group's consolidated turnover and respective expenditure items as from the date of each becoming a subsidiary.

The adoption of SSAP No. 12 (Revised) represents a change in accounting policy which has been applied retrospectively so that the comparative figures presented have been restated to conform to the changed policy. The main effect of the adoption on the Group arises from the restatement of assets to fair value on acquisition, withholding taxation on retained profits of overseas investments and tax losses carried forward.

CLP Group's Financial Results and Position at a Glance

Cash Flow For The Year (Consolidated Cash Flow Statement for the year ended 31.12.2003)

	HK$M
2 Cash inflow from operating activities	6,436
Dividends paid less dividends received	(1,078)
3 Net outflow for acquisition of subsidiaries	(354)
4 Investments in/advances to affiliates	(983)
Capital expenditure	(5,451)
5 Proceeds from realisation of surplus retirement benefit plan assets	1,155
Net increase in borrowings	457
Other net inflow, including exchange effect	89
Net increase in cash	271
Cash & cash equivalents at 31.12.2002	516
Cash & cash equivalents at 31.12.2003	787

Last Year's Balance Sheet (Restated) (Consolidated Balance Sheet as at 31.12.2002)

	HK$M
Assets	
Fixed assets	36,550
Investments in affiliates and securities	20,695
Employee retirement benefit plan assets	1,138
Cash & cash equivalents	516
Other current assets	1,994
	60,893
Shareholders' Equity and Liabilities	
Share capital, premium & reserves	15,624
1 Retained profits	21,264
Borrowings	9,297
Development Fund	3,372
Other SoC reserve accounts	1,128
Deferred tax liabilities	3,610
Other liabilities	6,598
	60,893

Earnings For The Year (Consolidated Profit and Loss Account for the year ended 31.12.2003)

	HK$M
6 Turnover	28,248
Expenses	(21,636)
Operating profit	6,612
Net finance costs	(640)
7 Share of profits of affiliates	3,792
Profit before taxation	9,764
Taxation	(1,712)
Profit after taxation	8,052
8 Transfers under SoC	(365)
9 Total earnings	7,687

Earnings Retained (Consolidated Retained Earnings for the year ended 31.12.2003)

	HK$M
Balance as at 1.1.2003	21,176
Income taxes adjustments	88
Balance as at 1.1.2003, restated	21,264
Total earnings	7,687
Dividends paid for the year	
2002 finals	(1,782)
2003 interims	(2,962)
Share of reserves of jointly controlled entity	(40)
Balance as at 31.12.2003	24,167

Today's Balance Sheet (Consolidated Balance Sheet as at 31.12.2003)

	HK$M
Assets	
10 Fixed assets	54,157
11 Goodwill	(1,017)
Investments in affiliates and securities	16,289
Deferred tax assets	952
Cash & cash equivalents	787
12 Other current assets	4,664
	75,832
Shareholders' Equity and Liabilities	
Share capital, premium & reserves	16,074
Retained profits	24,167
Minority interest	393
13 Borrowings	18,697
14 Development Fund	2,960
Other SoC reserve accounts	647
Deferred tax liabilities	4,614
15 Other liabilities	8,280
	75,832

1. As a result of the adoption of the SSAP No. 12 (Revised) "Income Taxes", the balance sheet as at 31.12.2002 was restated with an increase in retained profits by HK$88 million. Details of the effect of adopting this revised standard are set out in Note 1(Q) to the Accounts.

2. The Group's SoC operations continued to be our main source of cash inflow.

3. Total cash consideration paid for the acquisitions of Powergen's remaining interests in Yallourn Energy and GPEC was HK$836 million, whereas cash and cash equivalents of Yallourn Energy and GPEC at acquisitions were HK$482 million.

4. Investments in affiliates included investment in BLCP (HK$107 million) and advances to CAPCO (HK$860 million).

5. Proceeds from realisation of retirement benefit plan assets represented the surplus assets of the previous schemes which were wound up after establishment of a new scheme.

6. Turnover represented primarily sales revenue from the Hong Kong electricity business and from Yallourn Energy and GPEC between the date of becoming subsidiaries and 31.12.2003.

7. Profits before taxation of affiliates were mainly contributed by CAPCO (HK$1,716 million), GNPJVC (HK$827 million) and Hok Un (HK$291 million).

8. Transfers to Development Fund and rate reduction reserve were HK$572 million and HK$287 million respectively. Transfer from special provision account was HK$494 million.

9. Earnings after taxation amounted to HK$7,687 million, which comprised SoC earnings of HK$6,281 million, non-SoC earnings of HK$1,600 million, Hok Un redevelopment profit of HK$240 million, offset by unallocated net finance costs and unallocated Group expenses of HK$434 million.

10. The consolidation of Yallourn Energy and GPEC as subsidiaries has a significant impact on the Group's balance sheet. As at 31.12.2003, these subsidiaries brought in fixed assets of HK$14,687 million. During the year, the Group invested HK$5,594 million in fixed assets, mainly by CLP Power Hong Kong on its transmission and distribution network.

11. The net negative goodwill resulted from the acquisitions of interests in Yallourn Energy and GPEC during the period 2001-2003.

12. Included in the other current assets are the trade and other receivables of Yallourn Energy and GPEC of HK$3,153 million.

13. After the incorporation of Yallourn Energy and GPEC's borrowings of HK$8,051 million, total borrowings increased to HK$18,697 million. The Group's gearing, measured as total debt over total capital, was 31.5%.

14. Development Fund represents a liability of the Group. Its purpose is to assist in the acquisition of SoC fixed assets.

15. Other liabilities included customers' deposits (HK$2,878 million) and trade and other payables (HK$3,994 million).

The contributions of the Group's principal activities to the consolidated results are as follows:

	Turnover		Profit/(Loss) Before Financing and Taxation[1]	
	2003	2002	**2003**	2002
	HK$M	HK$M	**HK$M**	HK$M
Electricity business in Hong Kong	**25,739**	25,844	**8,027**	8,719
Electricity business in Chinese mainland	**–**	–	**1,145**	968
Electricity business in Asia-Pacific region	**2,310**	35	**1,415**	347
Electricity-related and other activities	**199**	255	**188**	362
Unallocated Group expenses	**–**	–	**(371)**	(200)
	28,248	26,134	**10,404**	10,196

1 Profit/(Loss) Before Financing and Taxation is stated after taking into account the Group's share of profits less losses of jointly controlled entities and associated companies.

Group Earnings

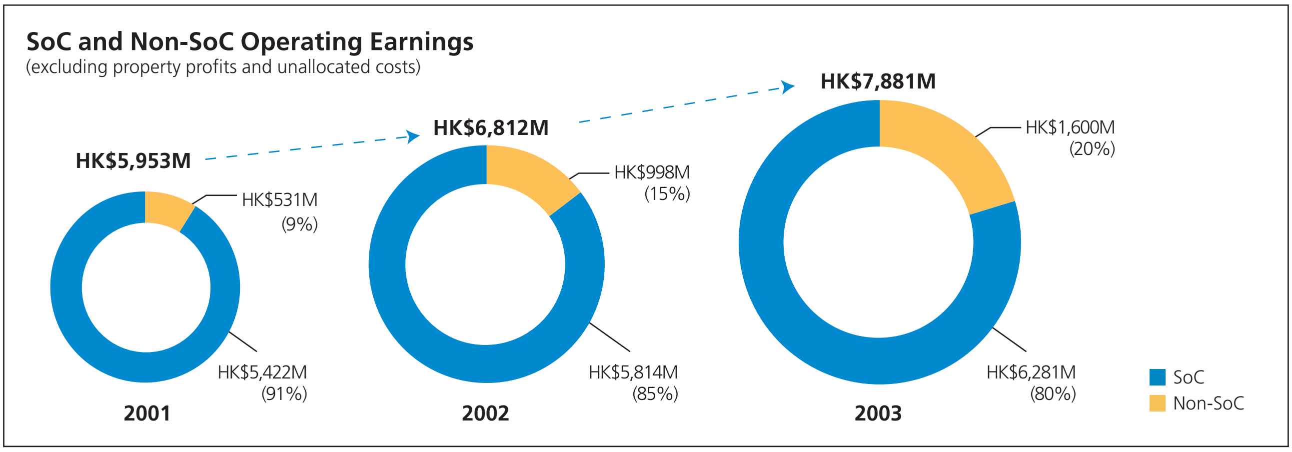
Total operating earnings of the Group increased by 13.6% to HK$7,447 million. The SoC business continues to provide stable earnings growth, with earnings increased by 8% to HK$6,281 million. Earnings from the non-SoC activities increased by 60.3% to HK$1,600 million, reflecting a growing contribution from overseas power project investments. It should be noted that the achieved results incorporated provisions for receivables and impairment of assets.

Total earnings, which include Hok Un redevelopment profit and property disposal gain, increased by 8.1% to HK$7,687 million. Contribution from property sales further decreased, reflecting primarily the tailing off of earnings from the Hok Un redevelopment project.

As the following table illustrates, the Group's financial results in 2003 translate into an increase in earnings per share for recurring operations of 13.6% to HK$3.09 per share. Total earnings per share were HK$3.19 per share, an increase of 8.1%.

Earnings Attributable to Shareholders	2003		2002		Increase
	HK$M	**HK$M**	HK$M	HK$M	**%**
SoC earnings		**6,281**		5,814	**8.0**
Non-SoC operating earnings					
Sales to Chinese mainland	**82**		64		
Power projects in Chinese mainland	**935**		827		
Power projects in Asia-Pacific region	**710**		348		
Electricity-related and other activities					
Telecom business	**(86)**		(182)		
Other businesses	**(41)**		(59)		
		1,600		998	**60.3**
Unallocated net finance costs		**(63)**		(54)	
Unallocated Group expenses		**(371)**		(200)	
Total operating earnings		**7,447**		6,558	**13.6**
Hok Un redevelopment profit/property disposal gain		**240**		546	
Group earnings attributable to shareholders		**7,687**		7,104	**8.1**
Weighted average number of shares in issue, million shares		**2,408.25**		2,408.78	
Earnings per share, HK$					
Excluding Hok Un redevelopment profit/ property disposal gain		**3.09**		2.72	**13.6**
Including Hok Un redevelopment profit/ property disposal gain		**3.19**		2.95	**8.1**

Our major source of earnings is from the electricity business in Hong Kong. In 2003, approximately 80% of the Group operating earnings before deduction of unallocated expenses came from this segment.



Effective Tax Rate

The Group's effective tax rate for the year was 17.5% compared to 12.9% in 2002. The increase in the effective tax rate was principally due to the change in Hong Kong profits tax rate from 16% to 17.5% in 2003 and increased provision for withholding and dividend distribution taxes on retained profits of our overseas affiliates.

Dividends

During the year, three interim dividends each of HK$0.41 per share were paid, totalling HK$1.23 per share. The Board has recommended that a final dividend of HK$0.65 per share and a special final dividend of HK$0.10 per share be proposed for approval at the forthcoming Annual General Meeting, making a total of HK$1.98 per share for the year.

Electricity Business in Hong Kong

	2003 HK$M	2002 HK$M
Turnover	**25,739**	25,844
Profit before Financing and Taxation		
– Sales of electricity	**6,311**	7,147
– Share of CAPCO's profit before taxation	**1,716**	1,572
	8,027	8,719
Transfers under SoC	**(365)**	(1,643)
Earnings		
– SoC earnings	**6,281**	5,814
– China sales	**82**	64
Fixed Assets and Investments		
– Fixed assets	**39,262**	36,279
– Investment in CAPCO	**5,983**	5,109
Development Fund	**2,960**	3,372
Special Provision Account	**176**	670

Turnover

Total unit sales increased by 3.9% to 31,043GWh for the year ended 31 December 2003, and comprised 28,035GWh sold to Hong Kong customers and 3,008GWh to customers in the Chinese mainland. As there was no basic tariff increase in 2003, the slight decrease in turnover by 0.4% to HK$25,739 million was mainly due to fuel clause adjustment as a result of lower composite fuel price for the year.

Electricity sales to customers in Hong Kong grew by 1.2% in 2003, with increased contributions from the Residential and Infrastructure and Public Services sectors. Sales to the Residential sector increased by 3.6%, in line with the increase in the number of customers. The Infrastructure and Public Services sector (formerly described as Government and Others sector) recorded sales growth of 3.8%, which was supported by the new infrastructure projects in 2003. Low sales growth in the Commercial sector was mainly due to the effect of the outbreak of SARS in the second quarter. Sales to the Manufacturing sector recorded a 7.4% decrease, resulting from Hong Kong's continuing transformation from a manufacturing to a services-based economy. The Manufacturing sector now accounts for less than 10% of total sales.

Sales to the Chinese mainland increased by 38.3% and represented 9.7% of the total sales in 2003. They consisted of 2,165GWh (2002: 1,429GWh) sold to Guangdong Guang-Dian Power Grid Group Company Limited and 843GWh (2002: 746GWh) to the Shekou Industrial Zone.

The total export sales of 3,008GWh in 2003 (2002: 2,175GWh) were the highest sales to the Chinese mainland in a year since 1996 and were the result of the strong economic growth and hot weather in Guangdong during the year. The export sales assist Guangdong to meet its electricity demand and provide additional revenue that will offset costs for our Hong Kong customers. They also contribute to shareholder earnings as the profits from such sales are allocated on an 80/20 basis between customers and shareholders.

Electricity Sales	Number of Customers '000	Year ended 31.12.2003 GWh	Increase/ (Decrease) over 2002 %	Average Annual Sales Change over 1999-2003 %
Residential	1,833	7,180	3.6	1.5
Commercial	177	10,698	0.3	3.0
Infrastructure and Public Services	70	7,301	3.8	5.5
	2,080	25,179	2.2	3.2
Manufacturing	38	2,856	(7.4)	(4.8)
Total local sales	2,118	28,035	1.2	2.2
Export sales	–	3,008	38.3	37.6
Total sales	2,118	31,043	3.9	3.8

Operating Expenses

Operating expenses of the Hong Kong electricity business, including finance costs and CAPCO's operating expenses and profit, increased by 3.9% to HK$19,522 million.

	2003 HK$M	2002 HK$M	Increase/ (Decrease) %
Operating costs	2,817	2,752	2.4
Fuel	2,901	3,268	(11.2)
Purchases of nuclear electricity	5,134	4,976	3.2
Depreciation	3,439	3,164	8.7
Operating interest	459	617	(25.6)
	14,750	14,777	(0.2)
Deferral premium	494	96	
CAPCO's profit before taxation	4,278	3,917	
	19,522	18,790	3.9

Operating Costs

Operating costs increased by 2.4% to HK$2,817 million in 2003, in line with the increase in unit sales.

Fuel

Fuel expense decreased by 11.2% to HK$2,901 million in 2003 due to lower composite fuel price. The average fuel cost for the year was about HK¢12.20 per unit generated, HK¢1.99 per unit lower than in 2002.

Purchases of Nuclear Electricity

During the year, we purchased 10,069GWh (2002: 9,881GWh) of power from GNPS under the offtake contract covering 70% of GNPS's output. Total purchases amounted to HK$5,134 million, an increase of 3.2% compared to 2002.

Operating Interest

Lower operating interest was mainly due to lower interest rates and lower loan balances after ongoing repayments of CAPCO's loans.

Deferral Premium

This represents the payment for the additional costs incurred by vendors for deferred delivery of the generating plants for Units 7 and 8 of the Black Point Power Station. A special provision account (as discussed below) has been set up to absorb this expense.

CAPCO's Profit Before Taxation

This represents CAPCO's share of the SoC profit and China sales profit before taxation. It forms part of CLP Power Hong Kong's power purchase cost from CAPCO.

Profit Before Financing and Taxation

The profit before financing and taxation of the Hong Kong electricity business in 2003 amounted to HK$8,027 million, a decrease of HK$692 million compared to 2002. This was mainly due to the payment of deferral premium of HK$494 million in 2003.

Transfers under Scheme of Control

Transfers under the SoC requirements totalled HK$365 million in 2003. The transfer to the Development Fund, representing the difference between the SoC profit and the permitted return, was HK$572 million. The transfer from the special provision account of HK$494 million is to offset the amount of deferral premium charged to operating expenses. The transfer to the rate reduction reserve amounted to HK$287 million, which represented a charge of 8% per annum on the sum of the average balances of the Development Fund and the special provision account.

Transfers under SoC	2003 HK$M	2002 HK$M
To Development Fund	**(572)**	(1,420)
From special provision account	**494**	96
To rate reduction reserve	**(287)**	(319)
	(365)	(1,643)

Earnings

The SoC net return, including our share of CAPCO's net return, amounted to HK$6,281 million, an increase of 8% over last year. This resulted from the combined effect of on-going investments in capital work programmes to meet new demand and to enhance services to customers and lower interest cost to shareholders. In addition, the increase in sales to the Chinese mainland raised the China sales profit to HK$82 million (2002: HK$64 million).

Fixed Assets and Investments

During the year, CLP Power Hong Kong invested HK$5,125 million (2002: HK$4,923 million) in the transmission and distribution networks as well as in customer services and other supporting facilities. Capital expenditure incurred by CAPCO was HK$2,148 million (2002: HK$938 million), an increase of 129% from last year. This was for the construction of Units 7 and 8 of the Black Point Power Station as well as improvement works on existing generating plants.

CLP Power Hong Kong's investment in CAPCO amounted to HK$5,983 million, an increase of HK$874 million as a result of the increase in advances to CAPCO. CLP Power Hong Kong provides funds to CAPCO as shareholders' advances in the form of interest-free loans. As at 31 December 2003, CLP Power Hong Kong's advances to CAPCO amounted to HK$5,768 million (2002: HK$4,934 million).

Development Fund

The Development Fund balance as at 31 December 2003 was HK$2,960 million (2002: HK$3,372 million). The decrease resulted from tariff rebates made to customers being more than the transfer from profit and loss account during the year. The Development Fund balance represented 4.6% (2002: 5.5%) of the SoC average net fixed assets of CLP Power Hong Kong and CAPCO.

The Development Fund represents a liability of the Group and does not accrue to the benefit of shareholders. Its main purpose is to assist in financing the acquisition of SoC fixed assets.

Special Provision Account

CLP Power Hong Kong and CAPCO agreed with the Hong Kong Government in December 1999 to further defer construction of Units 7 and 8 of the Black Point Power Station. A total of HK$803 million was set aside from the Development Fund to a special provision account to absorb the deferral premium payments. Up to 31 December 2003, HK$627 million has been transferred from the special provision account to offset the deferral premium charges.

Electricity Business in the Chinese Mainland

	2003 HK$M	2002 HK$M
Profit before Financing and Taxation	1,145	968
Earnings		
– GNPJVC	696	676
– PSDC	67	70
– Other projects	172	81
	935	827
Investments		
– Investments in affiliated companies	6,400	6,291

Earnings

Our electricity business in the Chinese mainland achieved encouraging results in 2003, with its contribution to our operating earnings increasing by 13.1% to HK$935 million.

Our share of profit from GNPJVC was HK$696 million, an increase from the 2002 level of HK$676 million due to higher generation. Earnings from PSDC were HK$67 million, a slight decrease from 2002 due to the impact of depreciation on the fixed assets value.

Earnings from other projects in the Chinese mainland totalled HK$172 million, an increase of HK$91 million compared to 2002. Contributions from CLP Guohua and Shenmu increased by over 40% mainly due to higher sales volume. Earnings from SZPC were slightly higher than the 2002 level due to the commissioning of Heze II in 2003. Anshun II, which is in trial operation, is expected to generate meaningful earnings to the Group starting in 2004. For Huaiji, the collection of electricity charges from the offtaker remains slow.

The income from this business is derived from joint ventures. In accordance with generally accepted accounting principles in Hong Kong, their revenues are not consolidated in the Group's turnover.

Investments

In accordance with the joint venture agreements for the Anshun II project, we are required to contribute by stages a total share capital of RMB440 million. The amount paid by the end of 2003 was approximately RMB154 million, with the remainder to be paid by April 2004.

Electricity Business in the Asia-Pacific Region

	2003 HK$M	2002 HK$M
Turnover	2,310	35
Profit before Financing and Taxation	1,415	347
Earnings	710	348
Fixed Assets and Investments		
– Fixed assets	14,693	8
– Investments in affiliated companies	2,951	7,735
– Investment securities	–	264
– Other investments	–	671

Turnover

Turnover represents primarily the revenue of Yallourn Energy and GPEC as from April and June 2003 respectively, when each became a subsidiary company of the Group.

Yallourn Energy operates as a merchant plant in Australia's National Electricity Market and bids its output into the pool. In order to provide volume and price stability, it negotiates a range of hedging contracts under which around 85% to 90% of its expected generation output is protected against pool price volatility. For the full year 2003, the total units sold by Yallourn Energy were 10,350GWh.

GPEC sells all its output to GEB through a long-term power purchase agreement, which enables it to recover fixed costs and profits providing the plant achieves the necessary level of availability. During the year, GPEC achieved a high level of availability and operated in accordance with despatch instructions from GEB.

Earnings

Our electricity business in the Asia-Pacific region achieved another year of strong earnings growth. Earnings from this segment doubled to HK$710 million as a result of the enhanced contribution from each of the following investments:

- GPEC's financial results improved considerably as GEB agreed in late 2003 to utilise the proceeds from the Rupee 4,000 million (approximately HK$680 million) bond issued in early 2004 to settle a significant portion of the overdue receivables. Earnings from GPEC increased by HK$143 million to HK$341 million in 2003.
- Yallourn Energy achieved good operational performance and contributed earnings of HK$142 million in 2003 (2002: HK$100 million). The strong Australian dollar and our additional shareholding acquired during the year also contributed to the increase.
- Our share of profit from Ho-Ping increased significantly in 2003 since this was its first full year of operation after commissioning.
- The increase in earnings from EGCO reflected higher generation revenue and its share of profit from new investment activities, together with favourable exchange rates.

During the year, we sold our 5% shareholding in YTL Power in Malaysia for a total consideration of HK$659 million and recorded a loss of HK$12 million.

Fixed Assets and Investments

During the first half of 2003, we acquired Powergen's remaining interests in BLCP, Yallourn Energy and GPEC for a total consideration of HK$875 million. Pursuant to the Equity Contribution Agreement relating to the BLCP power project, we are required to make further equity contributions of US$145 million by 2007.

Fixed assets as at 31 December 2003 amounted to HK$14,693 million, and comprised primarily the generating plants and other assets of Yallourn Energy and GPEC of HK$11,430 million and HK$3,257 million respectively. Capital expenditure by Yallourn Energy since acquisition in April 2003 was HK$460 million, with major projects including the upgrade of power station instrumentation and control systems and the development of new areas of the captive coal mine. GPEC has invested HK$2 million in plant and equipment since June 2003.

With higher than expected capital expenditure requirements over the next few years, Yallourn Energy forecasts that in order to meet the debt service cover ratios as stipulated in the relevant loan agreements, it may require contingent equity support to be provided by its shareholders. For 2004, the total equity support required by Yallourn Energy is estimated to be about A$60 million based on a 100% ownership.

Electricity-Related Business

	Property Business		Telecom Business		Other Activities		Total	
	2003 HK$M	2002 HK$M	**2003 HK$M**	2002 HK$M	**2003 HK$M**	2002 HK$M	**2003 HK$M**	2002 HK$M
Turnover	**17**	30	**25**	71	**157**	154	**199**	255
Profit/(Loss) before								
Financing and Taxation	**291**	595	**(86)**	(182)	**(17)**	(51)	**188**	362
Earnings/(Losses)	**240**	546	**(86)**	(182)	**(41)**	(59)	**113**	305
Investments	**862**	1,123	**84**	150	**19**	23	**965**	1,296

The Group's share of profit from the sale of residential units and parking spaces in the Hok Un redevelopment amounted to HK$240 million (2002: HK$233 million). Losses from the telecommunications business, including the provision for impairment, were substantially reduced to HK$86 million after transferring our retail business to PowerCom in 2002 and stringent cost control over the ChinaLink business.

Financial Position

Fixed Assets and Capital Expenditure

As at the end of 2003, fixed assets of the Group amounted to HK$54,157 million (2002: HK$36,550 million) and comprised HK$39,258 million (2002: HK$36,273 million) from the SoC business and HK$14,899 million (2002: HK$277 million) from the non-SoC business. The significant increase in non-SoC fixed assets was due to the consolidation of Yallourn Energy and GPEC.

During the year, the Group invested HK$5,594 million (2002: HK$4,935 million) in fixed assets, of which HK$5,125 million (2002: HK$4,923 million) was invested by CLP Power Hong Kong in the SoC business and HK$462 million by Yallourn Energy and GPEC.

Capital expenditure contracted but not provided for in the accounts as at 31 December 2003 amounted to HK$2,984 million (2002: HK$3,056 million), of which HK$310 million was for Yallourn Energy and GPEC. These contracted amounts are primarily for enhancing our transmission and distribution systems in Hong Kong and the power station control system upgrade and mine development in Yallourn Energy.

Goodwill

Acquisitions of interests in Yallourn Energy and GPEC during the period 2001-2003 resulted in net negative goodwill of HK$1,081 million, which is being amortised over the economic lives from the respective dates of acquisition. As at 31 December 2003, the Group had unamortised net negative goodwill of HK$1,017 million.

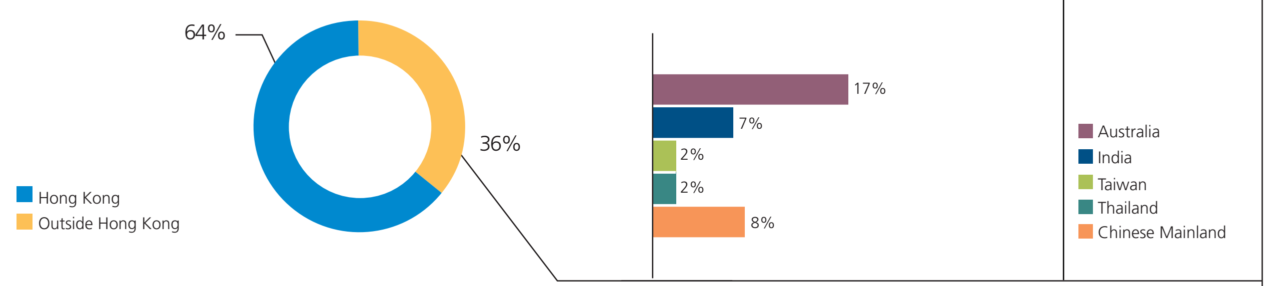
Interests in Jointly Controlled Entities, Associated Companies and Investment Securities

The summary of the Group's interests in each geographical region is shown below:

	2003 HK$M	2002 HK$M
Electricity Business		
Asia-Pacific region	**2,951**	8,670
Chinese mainland	**6,400**	6,291
Hong Kong	**5,983**	5,109
	15,334	20,070
Property and other businesses	**965**	1,296
	16,299	21,366

The decline in interests in the Asia-Pacific region in 2003 resulted from the reclassification of Yallourn Energy and GPEC from jointly controlled entities to subsidiaries of the Group as well as the disposal of our shareholding in YTL Power.

Total Assets by Geographical Locations



Deferred Tax Assets and Liabilities

In August 2002, the Hong Kong Society of Accountants issued SSAP No. 12 (Revised) "Income Taxes" which became effective from 1 January 2003. The revised SSAP No. 12 requires deferred taxation to be provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statement.

Previously, in the SoC business, we fully recognised deferred taxation arising from timing differences attributable to accelerated depreciation at the taxation rate in force in the year in which the differences arose. In the non-SoC businesses, deferred taxation was provided only if the deferred tax liabilities would be crystallised within the foreseeable future.

On 1 January 2003, we adopted SSAP No. 12 (Revised) "Income Taxes". The adoption of this standard represents a change in accounting policy and where appropriate comparative figures were retrospectively restated, including recognition of deferred tax assets. Details on the effect of the adoption of SSAP No. 12 are set out in Notes 1(Q) and 29 to the Accounts of this Annual Report.

The deferred tax assets of HK$952 million as at the year-end related to Yallourn Energy and GPEC and represented principally the net tax losses that could be utilised in the future.

The deferred tax liabilities increased from HK$3,610 million to HK$4,614 million during the year, mainly due to (i) the change in Hong Kong profits tax rate, (ii) provision for dividend distribution tax and withholding tax for investments outside Hong Kong and (iii) temporary difference caused by accelerated tax depreciation.

Current Assets and Liabilities

As at 31 December 2003, the Group had liquid funds of HK$787 million (2002: HK$516 million), of which 64% were denominated in foreign currency mainly held by Yallourn Energy and GPEC. The remainder was in Hong Kong dollars. Trade and other receivables increased from HK$1,256 million to HK$4,424 million, of which HK$3,153 million was attributed to Yallourn Energy and GPEC.

Total current liabilities as at 31 December 2003, including deposits from our Hong Kong electricity customers of HK$2,878 million, amounted to HK$8,905 million. With the projected cash flow from operations and credit facilities arranged, the Group anticipates that it will have sufficient funds to meet these liabilities.

The Group has no significant operating lease commitments or sale and leaseback arrangements.

Shareholders' Funds

The shareholders' funds as at 31 December 2003 increased 9.1% to HK$40,241 million (2002: HK$36,888 million). The increase was mainly attributable to the retained profits of HK$2,943 million after dividend payments and an increase in reserves of HK$369 million arising from translation of overseas investments to Hong Kong dollar.

In 2002, CLP Holdings undertook a restructuring of its balance sheet by the transfer of approximately HK$10 billion from the share premium account to the distributable reserves of the Company. The increase in distributable reserves will provide greater flexibility for CLP Holdings in terms of its dividend or share repurchase policies. As at 31 December 2003, the distributable reserves of CLP Holdings amounted to HK$16,323 million (2002: HK$16,340 million).

Borrowings

Total borrowings increased from HK$9,297 million to HK$18,697 million, of which Yallourn Energy and GPEC accounted for HK$8,051 million. Details of the Group's borrowings and capital resources are provided in the "Financing/Funding" section.

We adopt a prudent approach to all our financial arrangements.

Financing/Funding

Borrowings and Capital Resources

Our business expansion, in particular, capital expenditure programmes by CLP Power Hong Kong and CAPCO for our Hong Kong electricity business, is funded by bank loans, debt securities and cash flow from operations.

Financing facilities totalling HK$28.0 billion were available to the Group, including HK$9.8 billion for Yallourn Energy and GPEC. Of the available facilities, HK$18.7 billion had been drawn down, of which HK$8.1 billion was by Yallourn Energy and GPEC. Facilities totalling HK$15.4 billion were available to CAPCO, of which HK$9.8 billion were drawn down.

Our total debt to total capital as at 31 December 2003 was 31.5% and interest cover was 12 times. The increase in gearing ratio over year 2002 was due to the consolidation of the debts, which are without recourse to CLP Holdings, of Yallourn Energy and GPEC.

Financing

We adopt a prudent approach to all our financial arrangements, while at the same time aiming to achieve cost efficient funding. In June and September 2003, CLP Power Hong Kong issued two tranches of fixed rate notes due 2013 of HK$500 million each, with coupon rates at 4.45% and 5% respectively, through its wholly-owned subsidiary CLP Power Hong Kong Financing Limited. These issues were made under the Medium Term Note (MTN) Programme set up by CLP Power Hong Kong Financing Limited in 2002. Under the MTN Programme, notes in an aggregate amount of up to US$1.5 billion may be issued and will be unconditionally and irrevocably guaranteed by CLP Power Hong Kong. As at 31 December 2003, about HK$3,340 million notes have been issued under the MTN Programme. In January 2004, CLP Power Hong Kong issued another tranche of HK$500 million fixed rate notes due 2014 with coupon rate at 4.93% under the MTN programme.

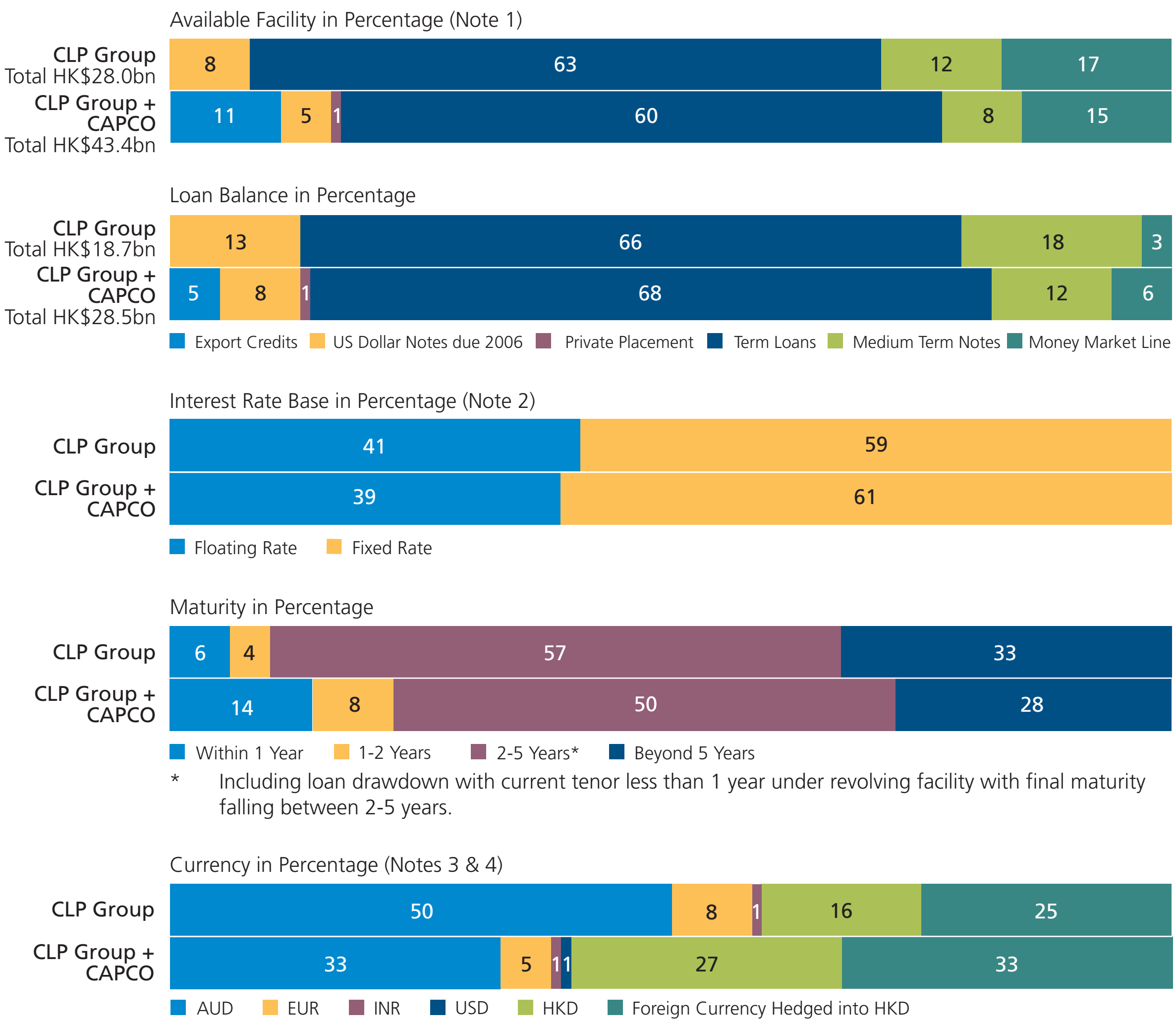
In September 2003, CLP Power Hong Kong took advantage of the liquidity in the Hong Kong bank market to arrange a HK$3 billion 5-year revolving credit to refinance its shorter maturity existing loan at an attractive interest rate margin.

In November 2003, CAPCO concluded a HK$2,340 million 8.5-year loan for refinancing its US dollar export credit facilities previously arranged for financing Black Point Power Station Units 7 and 8. Apart from achieving interest savings, the refinancing also eliminated the US dollar exposure related to the project loan and interest of the original facilities.

The financial obligations of the Group, CAPCO and PSDC, and the Group's share of the financial obligations of the jointly controlled entities and associated companies as at 31 December 2003 are shown on pages 74 and 75.

Debt Profile

The type, interest rate, maturity and currency profiles of borrowings of the Group and CAPCO as at 31 December 2003:



Note (1): For the Medium Term Note Programme, only the amount (HK$3,340 million) of the Notes issued as at 31 December 2003 was included in the total amount of Available Facility.

(2): 82% of Yallourn Energy and GPEC's combined loans are at fixed or swapped to fixed rates. With the consolidation of these two subsidiaries, the percentage of fixed rate loans in the CLP Group is 59%, compared to 41% if borrowings of Yallourn Energy and GPEC were not included.

(3): The Australian dollar loans were mainly incurred by Yallourn Energy to refinance its project debts in 2001 and by CLP Holdings to hedge against currency exposure of the Group's investment in Yallourn Energy.

(4): The loans in Euros and Indian Rupees were drawn by GPEC.

Credit Rating

The Group's financial strength is reflected in ratings assigned by Standard & Poor's (S&P) and Moody's. On 16 October 2003, Moody's upgraded the foreign currency ratings of CLP Holdings and CLP Power Hong Kong from A3 to A1 in line with its decision to upgrade Hong Kong's foreign currency rating from A3 to A1 on the same day. The outlook for Hong Kong, CLP Holdings and CLP Power Hong Kong was changed by Moody's from positive to stable.

These credit ratings are supported by the strong cash flow generating ability and prudent financial structure of the Group. Our premier credit ratings can facilitate and enhance our position in local and overseas business activities, including fund raising, investment and new business opportunities of the Group.

The current credit ratings of CLP Holdings and CLP Power Hong Kong are set out below:

	CLP Holdings		CLP Power Hong Kong		Hong Kong Government	
	S&P	Moody's	S&P	Moody's	S&P	Moody's
Long-term Rating						
Foreign currency	A+	A1	A+	A1	A+	A1
Outlook	Stable	Stable	Stable	Stable	Stable	Stable
Local currency	A+	Aa2	A+	Aa1	AA-	Aa3
Outlook	Stable	Stable	Stable	Stable	Negative	Stable
Short-term Rating						
Foreign currency	A-1	P-1	A-1	P-1	A-1	P-1
Local currency	A-1	–	A-1	–	A-1+	–

Cash Flows – Group

Net cash provided by operating activities amounted to HK$6,436 million, a decrease of HK$517 million mainly due to larger rebates to customers being provided by CLP Power Hong Kong in 2003.

Cash used in investing activities included the capital expenditure of CLP Power Hong Kong and Yallourn Energy as well as investments in power projects in the Asia-Pacific region and advances to CAPCO. This was partly offset by dividends received from investments and profits received from the Hok Un joint venture. Cash was also received from the realisation of surplus assets upon winding up of the previous retirement schemes in Hong Kong after establishment of a new scheme.

Net cash used in financing activities in 2003 primarily resulted from the payment of dividends, partly offset by increase in borrowings.

	2003 HK$M	2002 HK$M	**Change HK$M**
Cash provided by/(used in):			
Operating activities	**6,436**	6,953	**(517)**
Investing activities	**(1,911)**	(4,509)	**2,598**
Financing activities	**(4,287)**	(2,008)	**(2,279)**
	238	436	**(198)**

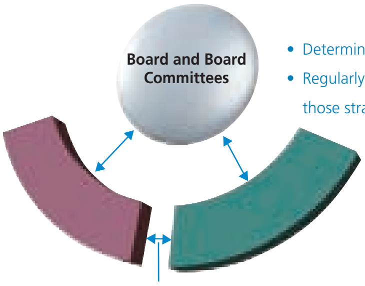
The cash flow generated from our Hong Kong operations has been and is expected to continue to be our principal source of liquidity.

The management and mitigation of risk is a constant task and a shared responsibility.

Risk Management

Management of risks is the responsibility of the Board, Management and staff, with Group Internal Audit playing a key monitoring role.

This section of the MD&A identifies CLP's current major risks and outlines some of the measures taken to address those risks. The purpose of this section is not to identify each and every risk applicable to CLP's business, but to provide shareholders with a suitable degree of confidence that the Board and Management actively review the risks arising from the Company's activities and take steps to mitigate such risks.



- Determines policies for risk management and control within CLP
- Regularly reviews CLP's strategies and risks and controls associated with those strategies

Group Internal Audit

- Audits all aspects of CLP's activities and internal controls
- Reports on the effectiveness of risk management measures
- Liaises with External Auditors on quality of system of internal control

Management and Staff

- Identify risks
- Design risk mitigation measures
- Operate and monitor the processes to support effective implementation of CLP's strategies

Manage risks including:

Financial Risks, such as

- Reliance on a single earnings source
- Cash flow and liquidity
- Accounting and financial reliability and integrity
- Pension obligations
- Foreign currency risks
- Interest rate risks
- Off-balance sheet financial instruments

Market Risks, such as

- Market reform
- Uncertain China sales from Hong Kong
- Increased competition
- Mainland power tariffs
- Electricity sales and purchase risks
- Collection of receivables

Operational Risks, such as

- Supply reliability
- Fuel supply
- Availability of generating units
- Environmental regulations
- Physical damage and liabilities
- Technology developments

Financial Risks

Reliance on a Single Earnings Source

Reliance on the Hong Kong's electricity business as the sole source of our earnings would expose the Company to "single market risk" through vulnerability to slowing electricity demand growth in Hong Kong and potential adverse regulatory change. CLP has developed businesses in the Chinese mainland and Asia-Pacific region, so as to move the Group away from dependence only on earnings from the existing Hong Kong business. Outside Hong Kong, we have sought to establish a meaningful presence in a number of countries, as opposed to focusing on any one country only and thereby creating a substantial financial exposure to regulatory and market risks in that country.

Cash Flow and Liquidity

The electricity business is highly capital intensive and returns are generated over a long term. It is important that CLP guards against the risks arising from cash flow and liquidity problems. We closely monitor our cash management and resources, including contingent liabilities (see chart on page 74) that might call on those resources. We maintain a conservative capital reserve, emphasise that capital is expensive and prioritise competing claims on capital. We act prudently to ensure the cash flow from our established businesses remains sufficient to fund dividends to shareholders and potential new investments, whilst maintaining a robust financial position.

Accounting and Financial Reliability and Integrity

Corporate failures in Europe and the United States have emphasised the risks to companies of inaccurate and improper financial reporting and accounting. Even the perception of misdoing can lead to a massive and irreversible loss of market confidence. No company can ever be free from the shadow of individual misdeeds, but CLP does everything reasonably possible to protect itself and its shareholders against such risks. The "Corporate Governance" section of this Annual Report describes our commitment to ethical business standards and the structures that are in place to make good this commitment, including the necessary checks and balances.

Pension Obligations

We are aware of the long-term financial exposure which can arise from under-funded pension obligations owed to our employees, particularly as a result of poorly performing stock markets and the levels of investment returns in recent years. CLP has managed this risk by transferring all of its employees in Hong Kong (representing more than 80% of our total workforce) from defined benefit schemes (where the level of pension benefits is, in effect, guaranteed by CLP irrespective of the performance of the underlying investments) to a defined contribution scheme (where the contributions by employer and employee are defined, the investment decisions are made by the employees and the final level of benefits payable is determined by the actual performance of the underlying investments).

Foreign Currency Risks

The Group's foreign currency exposures mainly arise from the loan repayment/interest payment obligations, purchases of goods and services, fuel-related payments and overseas investment activities. Apart from using forward foreign exchange contracts, currency swaps and options to manage the currency exposure, we also adopt an approach of financing our investments by borrowings of matching currency where appropriate to mitigate the currency risk.

During the year, CLP Power Hong Kong arranged further US dollar forward purchases of approximately HK$30.3 billion equivalent to hedge significantly its US dollar exposure.

Interest Rate Risks

The Group mainly uses interest rate swaps as instruments to manage its interest rate risk within a preferred interest rate mix. Our Australian subsidiary, Yallourn Energy, also employed forward rate agreements and interest rate swaptions to adjust the interest rate mix within pre-determined parameters. As at 31 December 2003, there were no forward rate agreements and interest rate swaption contracts outstanding.

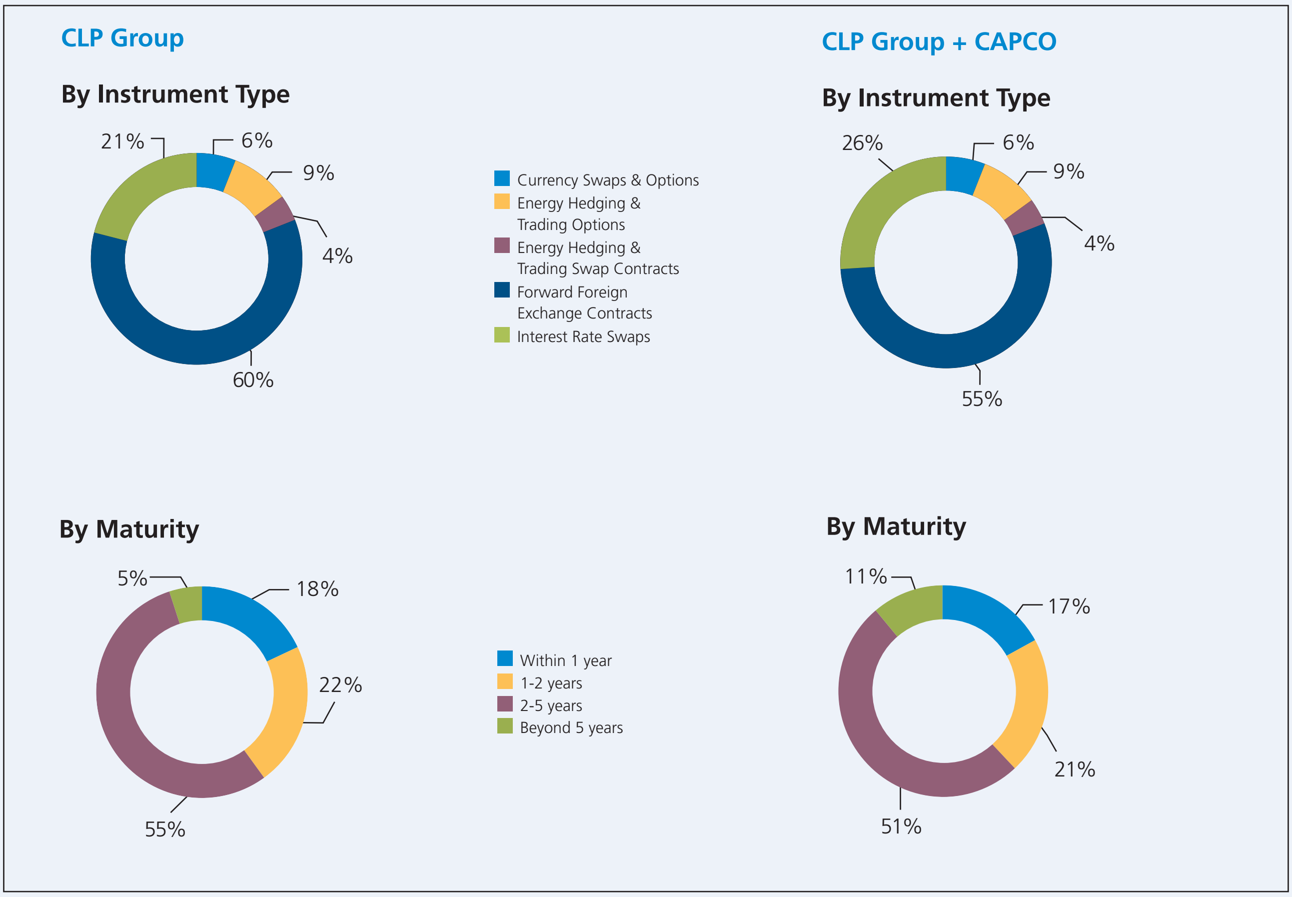
Off-Balance Sheet Financial Instruments

The Group uses different derivative instruments to manage its exposure to foreign currency, interest rate risks, and price risks associated with the sales and purchases of electricity in Australia, with an objective to minimise the impact of exchange rate, interest rate and electricity price fluctuations on earnings, reserves and tariff charges to customers. All transactions are made with counter-parties with acceptable credit quality and a limit is assigned to each counter-party for monitoring the credit exposure. Other than certain limited electricity trading activities engaged by Yallourn Energy, all derivative instruments are employed solely for hedging purposes.

The fair value of the Group's outstanding derivative instruments as at 31 December 2003 was at deficit of HK$194.8 million (HK$327.9 million deficit for the Group and CAPCO combined), which represents the net amount we would pay if these contracts were closed out at 31 December 2003. The deficit was largely caused by a significant year-end decline in the forward currency markets for the US dollar. The fair market value of Yallourn Energy's energy trading activities was at surplus of HK$1.2 million.

As at 31 December 2003, we had gross outstanding derivative instruments amounting to HK$76.2 billion (HK$80.8 billion for the Group and CAPCO combined), out of which HK$0.4 billion was energy trading contracts. The breakdown by types and maturity profile of the Group's derivative instruments are shown in the charts below:

Types and Maturity Profile of Off-Balance Sheet Financial Instruments as at 31 December 2003



Market Risks

Market Reform

In Hong Kong, CLP faces regulatory risk in the form of possible adverse regulatory change post-2008 and more stringent environmental control. These risks are being addressed by a range of measures including:

- continued competent and effective operation of the Hong Kong electricity business as measured, for instance, through supply reliability, tariff control and quality of customer service. This demonstrates the merits of the current regulatory regime and reinforces our reputation as a responsible and trusted public service provider;
- engagement with our stakeholders, so that they have a realistic and informed appreciation of our performance under the existing regulatory regime and the risks and implications of alternative regulatory structures; and
- proactive participation in the management of Pearl River Delta air quality issues, such as by the development of long-term gas supply to our generating plants in Hong Kong and responsible environmental performance.

The "Business Outlook" section of this MD&A explains the business risk associated with the reform of the Mainland electricity market. We intend to measure and control the risks associated with continued investment in the China power sector by cautious and selective pursuit of investment opportunities where the risks and rewards conform to our established investment criteria.

The restructuring of the Thai electricity industry could challenge the value of our investment in EGCO, if the outcome of that reform fails to provide a level playing field for private sector participation. We are working actively with the Thai authorities, EGAT and Banpu Public Company, our partner in the BLCP project, to promote and achieve a result which safeguards EGCO's future, avoids conflicts of interest between EGCO and EGAT and makes use of our existing relationship with Banpu. The pace and scale of our presence in Thailand will be measured against regulatory clarity.

Uncertain China Sales from Hong Kong

Our sales of electricity to the Mainland may be subject to early termination or downward tariff pressure and Guangdong Guang-Dian Power Grid Group Company Limited may not take the expected level of supply if reliable supplies are provided from other sources. Against these risks, we:

- have designed a tariff structure providing an aligned interest for CLP and our Mainland customers;
- provide reliable power to those customers and maintain an excellent working relationship with them; and
- are looking for alternative opportunities to participate in the supply of power to the Mainland.

Increased Competition

Competition for our electricity business in Hong Kong might come in a number of forms:

- competition from gas suppliers in the domestic and commercial sectors;
- development of alternative generation technology such as microturbines and fuel cells, wind turbines, solar thermal or solar photovoltaic systems; and
- loss of business to electricity competitors, whether domestic or from Guangdong, for major contestable customers in the event of regulatory change in Hong Kong.

In the face of such risks, we:

- aim to provide a quality service which ensures that our customers would choose to do business with CLP, even if alternative energy suppliers were or became available;
- make considerable efforts in product development and the promotion of the "all electricity" concept for commercial and residential customers;
- have strengthened our account management for all strategic customers. We plan to extend our account management services to small- and medium-sized enterprises, offering creative and cost-effective energy solutions which address their specific business needs; and

- educate stakeholders on the challenges in introducing competition to Hong Kong, given the supply situation in southern China and physical constraints within Hong Kong.

Mainland Power Tariffs

A key risk in the China market is the need to agree tariffs with the relevant authorities for each new generating plant as it is commissioned and thereafter for tariff levels to be reviewed and approved by the authorities on a regular basis. This tariff risk can be addressed through:

- careful pre-investment analysis to ensure that the cost of generation from the proposed asset (whether greenfield or existing) will be competitive in the market to which electricity will be supplied. This also involves consideration of the supply/demand balance in that market, so as to provide assurance that the plant will actually be despatched to an extent and at prices which will be economically viable;
- on-going cost control disciplines, including with respect to fuel procurement, to enable the asset to continue to deliver shareholder value, notwithstanding future downward tariff pressure; and
- establishing and maintaining a good relationship with the tariff approval authorities, based on a reputation for responsible and efficient plant operation.

Electricity Sales and Purchase Risks

Yallourn Energy's revenue is predominantly derived from the sale of electricity into Australia's National Electricity Market (NEM). There are risks in the Australian electricity sector resulting from price volatility and the possibility of continuing low pool prices. We aim to manage these risks by:

- maintaining Yallourn Energy's position as a low-cost electricity generator;
- entering into electricity energy contracts, including forward electricity pricing contracts, swaps and options contracts to help reduce the impact on earnings of the volatility of NEM pool prices;
- engaging in limited energy trading activities;
- strengthening the controls and procedures within Yallourn Energy to ensure trading and marketing activities are conducted within a clear and appropriate framework; and
- seeking to diversify from ownership of a single generating asset towards a broader-based Australian business including, over time, a possible presence in the distribution and retail sectors.

Collection of Receivables

The key risk in the Indian market is associated with the financial position of the state-owned electricity boards which purchase the output of the IPPs. During 2003, progress was made in the mitigation of this risk, both at country level through the introduction of the Electricity Act and at project level where a revised PPA was agreed between GEB and GPEC. GEB issued a bond to assist in the payment of outstanding electricity charges due to GPEC. We do not intend to increase our exposure to the Indian market until and unless our experience with our GPEC investment has satisfied us that the risks are manageable and that sustainable value can be created.

Operational Risks

Supply Reliability

A major risk for an electricity supplier, and one to which the community would rightly be extremely sensitive, comes through the possibility of prolonged shutdown of generating plant due to critical plant systems breakdown or high unplanned outages and abnormal voltage deviations. Amongst the many steps taken by CLP in Hong Kong in response to these risks are:

- Hazard and Operability (HAZOP) and Re-HAZOP studies of plant systems; for example, in 2003 more than 10 plant systems were assessed;
- backup systems for critical process control;
- continued identification and implementation of supply reliability and quality improvement projects such as the installation of line arrestors on 132kV and 400kV overhead lines and the introduction of the Power Quality Management System;
- close monitoring of 11kV voltage by enhancing the online monitoring function of our Disturbance Monitoring System; and
- a future assessment of the potential risks that might be caused by rapid development in the South China Grid. Improvements such as revising the under-frequency decoupling scheme have been implemented on the interconnection to reduce system risks.

Availability of Generating Units

The environment for private sector operators in the Thailand and Taiwan markets that sell their output to the state-owned generators under long-term PPAs is favourable and we see a generally cautious approach being taken to further reform. The main risk is the need to achieve high availability of the generating units in order to earn the planned revenue. We are an experienced power plant constructor and operator. Our core industry skills form the basis for our management of this risk.

Fuel Supply

Continuous and adequate supply of fuel to our generating plant in Hong Kong is essential to sustain a reliable electricity supply to our customers. The risks associated with fuel supply can include matters such as the loss of the gas supply from the Yacheng-13 field, inability to maintain adequate coal stocks and a significant increase in fuel costs. Relevant mitigation measures include:

- maintaining a diversified fuel mix of coal, natural gas and nuclear;
- optimising our coal procurement contracting strategy by balancing the use of term and spot contracts;
- proactive supplier management and development;
- maintaining a strategic coal and oil reserve;
- flexible operations at Castle Peak and Black Point Power Stations (including the potential for plant to operate on dual fuel sources such as coal/gas and gas/oil); and
- maintaining multiple fuel sources, to guard against the risk of reliance on a single supply source, for example, the Mainland (where coal shortages started to occur in 2003).

Although the individual circumstances vary, similar disciplines are in place for coal procurement for our investments in the Mainland, Taiwan and, in due course, the BLCP project in Thailand. Our main mitigant for coal supply risk is to enter into long-term supply contracts that provide certainty of price and availability for a significant part of our total requirement for a defined period. A typical long-term contract will have a defined amount of firm and fully committed supply and a further amount available under priced options. We do not contract all of our coal requirement through such long-term contracts because we need operational flexibility for variations in demand and plant availability. Yallourn Energy has a dedicated mine to meet its coal needs. GPEC has entered into a long-term contract for the supply of natural gas.

Environmental Regulations

Our power generation and distribution operations in Hong Kong, the Chinese mainland and Asia-Pacific region are subject to laws and regulations relating to environmental performance and safety. Operations may be affected by mitigation measures such as those required under the Kyoto Protocol which addresses increasing concerns about greenhouse gas emission and global climate change. We mitigate these risks by:

- close monitoring of the environmental aspects of our business at all levels of the Group – from front-line staff to the Board;

- analyzing and addressing environmental issues at all stages of our activities – from pre-investment due diligence through to on-going operations;
- aiming for continuous improvement in environmental performance across the range of our assets, including those in which we have less than a majority stake;
- investigation and, where feasible, adoption of technology to improve environmental performance; and
- willingness to make the additional investment required to enhance environmental performance, recognising that this will be to the long-term benefit of our asset.

The introduction of emissions charges in the Mainland places an increased emphasis on environmental controls and performance. New coal-fired plant will generally need flue gas desulphurisation and low nitrogen oxide combustion systems. These requirements must be factored into the analysis of the cost of construction and operation, such that the economic risk of environmental levies is properly assessed and accounted for.

The "CLP and our Environment" section of this Annual Report and our Social and Environmental Report 2003 set out specific examples of how CLP addresses these issues.

Physical Damage and Liabilities

CLP uses its Operations Integrity Management System (OIMS) as a framework for the disciplined and proactive management of operational risk. The framework includes 11 broad management principles (for example, that inherent safety can be enhanced by using sound standards, procedures and management systems for facility design, construction and start-up activities) and 60 requirements (for example, that a quality control and inspection system must be in place to ensure that facilities meet design specifications and that construction is in accordance with the applicable standards).

OIMS includes a process of Operations Integrity Assessment and Improvement to assess the degree to which requirements are met, to improve operations integrity and maintain accountability. These assessments are conducted by multi-disciplinary teams including expertise from outside the immediate unit.

The OIMS framework was first applied by CLP to its facilities in Hong Kong and forms part of the disciplines applied at our assets elsewhere to manage risk to personnel, facilities, the public and the environment.

Technology Developments

Technology development can present both risks and opportunities for us. The early identification and management of technologies, trends and influences relevant to our business is provided by CLP Research Institute. This was established in 2001 to strengthen our innovation capabilities with the intent of increasing the economic, social and environmental value of our products. In 2003, CLP Research Institute was engaged in a wide range of initiatives including the launch of renewable energy research projects, the development of an energy efficiency research project based on combined generation, heating and cooling at a customer site and exploring customer services technology such as Internet-based intelligent building and load recognition.

Looking ahead, CLP Research Institute has perceived two major change drivers in our service areas – competitive pressure and environmental concerns (including climate change). In addition to building knowledge for us to manage these issues, CLP Research Institute will contribute by:

- proactively bringing emerging issues to the attention of Management, thereby expanding our global perspective on emerging technologies;
- growing the practice and means of knowledge sharing;
- demonstrating a culture of innovation and learning in critical areas; and
- building and maintaining productive relationships with the academic and research communities.

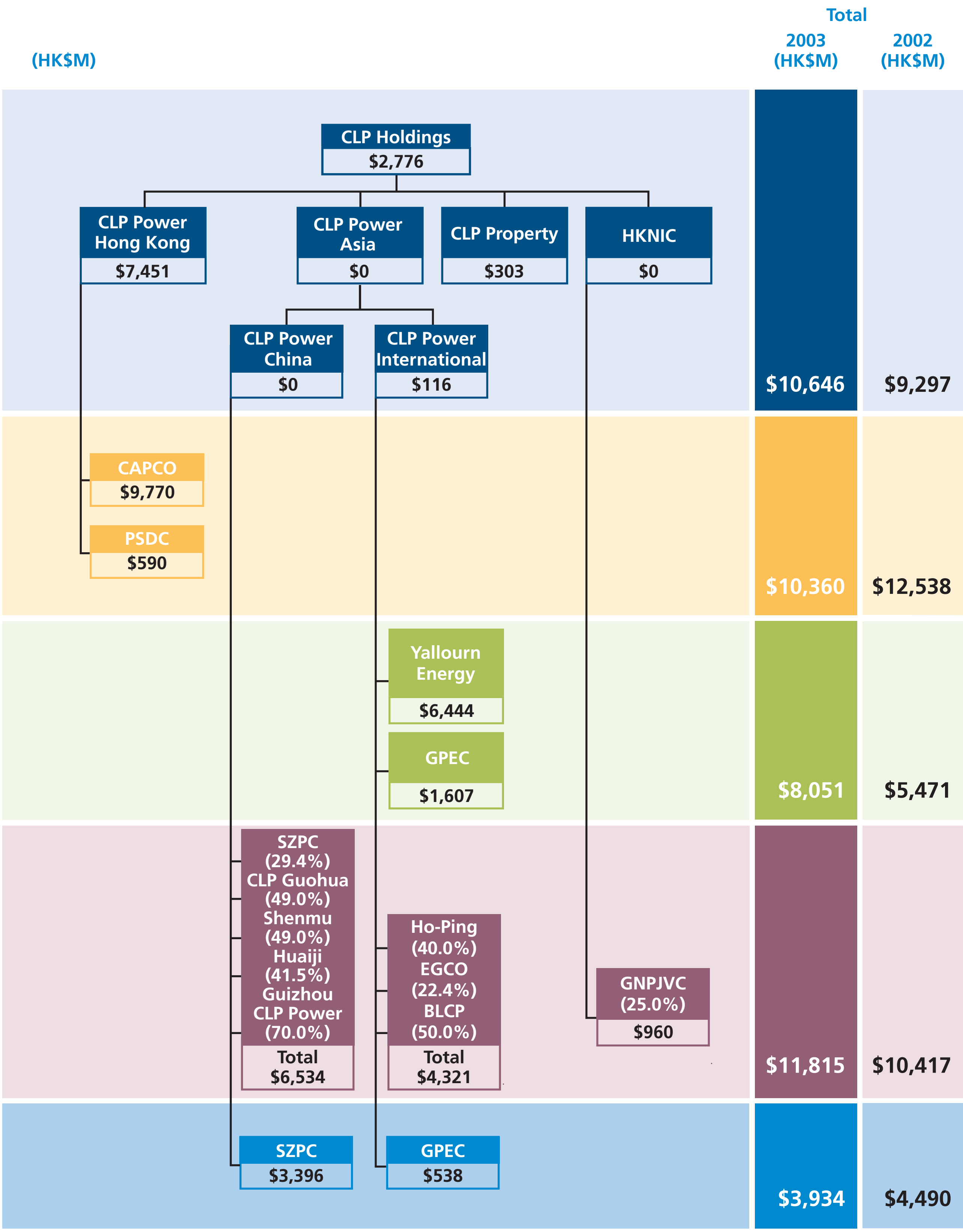
CLP Group's Financial Obligations at a Glance as at 31 December 2003

In recent years, market concerns have grown regarding the financial risks associated with borrowings and unconsolidated financial obligations of listed companies. It is our policy to adopt a prudent approach to such matters. The purpose of the following chart is to explain the total financial obligations of the CLP Group by classifying them into five categories according to their degree of recourse to CLP Holdings.

Category

Category		
1	**Borrowings of CLP Holdings & principal subsidiaries**	Debts of the Company and its principal subsidiaries.
2	**Borrowings of CAPCO & PSDC**	100% of the debts of CAPCO and PSDC. Although the Group holds only a 40% interest in CAPCO and a 49% interest in PSDC, CLP Power Hong Kong has commitments to these companies through power purchase and service agreements, which are further explained in the Scheme of Control Statement on page 142 and Note 33 to the Accounts.
3	**Borrowings of Yallourn Energy & GPEC**	During 2003, the Group acquired Powergen's remaining interests in Yallourn Energy and GPEC and reclassified them as subsidiaries of the Group. These debts are non-recourse to the Company.
4	**Share of debts of major affiliates***	Share of debts of jointly controlled entities and associated company. These debts are non-recourse to the Company and its subsidiaries.
5	**Contingent liabilities**	Contingent liabilities of the Company and its subsidiaries, arising from undertakings given to third parties. Details of these are set out in Note 32 to the Accounts.

* In respect of Category 4, the share of debts are calculated by reference to the Group's shareholding in the relevant affiliated companies


Total
2003 (HK$M)
2002 (HK$M)
(HK$M)
CLP Holdings
$2,776
CLP Power Hong Kong
$7,451
CLP Power Asia
$0
CLP Property
$303
HKNIC
$0
CLP Power China
$0
CLP Power International
$116
$10,646
$9,297
CAPCO
$9,770
PSDC
$590
$10,360
$12,538
Yallourn Energy
$6,444
GPEC
$1,607
$8,051
$5,471
SZPC (29.4%) CLP Guohua (49.0%) Shenmu (49.0%) Huaiji (41.5%) Guizhou CLP Power (70.0%)
Total $6,534
Ho-Ping (40.0%) EGCO (22.4%) BLCP (50.0%)
Total $4,321
GNPJVC (25.0%)
$960
$11,815
$10,417
SZPC
$3,396
GPEC
$538
$3,934
$4,490

We are open about the challenges ahead and confident of our ability to meet them.

Business Outlook

This section of the MD&A describes the outlook for the CLP Group and each of our three major business streams, in every case setting out our plans and activities for 2004 as well as those envisaged for the medium to longer term.

CLP Group

The core of the CLP Group's activities remains the electricity business in Hong Kong, currently regulated under the SoC. The increasing maturity of this business, evidenced by the slowdown of the growth in electricity demand, coupled with a degree of regulatory uncertainty post-2008, has led us to diversify the Group's activities through investment in the power sector in the Chinese mainland and Asia-Pacific region. In the past we have been able to leverage off our skills and assets to create value for shareholders through other activities, such as the Hok Un property redevelopment. However, we do not expect in the foreseeable future to pursue businesses other than those closely related to our primary function as an electricity service provider.

Against this background, the CLP Group's objectives for 2004 and beyond are to:

- operate the Hong Kong electricity business effectively and achieve a satisfactory and viable post-2008 regulatory regime;
- develop substantial and sustainable earnings from our electricity businesses in the Mainland and Asia-Pacific region, both by improving the returns from our existing assets as well as making additional investments. The ability to maintain our earnings per share growth will depend critically on our success in making incremental investments generating quality earnings; and
- enforce cost control disciplines, including in respect of corporate overheads, across the entirety of our activities.

We believe that we have the skills, competences and financial and human resources required to achieve these objectives.

We will continue to implement a prudent financial strategy that balances shareholder value enhancement with reasonable financial risk. We aim to retain a conservative capital structure which ensures sufficient liquidity to fulfill our on-going dividend policy, whilst maintaining adequate "fire power" for financing investment for future growth and, as and when appropriate, to effect share repurchases as a complement to our dividend policy.

Environmental considerations have a steadily growing impact on the commercial, financial and operational aspects of our business, as well as influencing the quality of our relationships with key stakeholders such as customers, communities and governments in all of the countries in which we operate. The "CLP and our Environment" section of this Annual Report, together with our Social and Environmental Report 2003, demonstrates CLP's awareness of the importance of environmental issues and how this is translated into action.

Electricity Business in Hong Kong

Following the completion of the SoC Interim Review in 2003, we do not expect there to be any changes to the regulatory regime applying to our Hong Kong electricity business before the expiry of the current SoC Agreement on 30 September 2008.

During the intervening period, there will be increasing discussions between CLP and the Hong Kong Government regarding the post-2008 electricity regulatory regime. It will be in the interests of all concerned, whether CLP, its shareholders, the Government, electricity customers or the community as a whole, that a viable and sustainable electricity regulatory regime is determined with certainty prior to the expiry of the existing SoC.

At this juncture, we are unable to predict the outcome of discussions with Government on the post-2008 regulatory regime. This reflects, amongst other considerations, the likelihood of a political dimension to the debate about the regulation of our industry. This debate may be influenced by broader political trends in Hong Kong, including in the context of the elections for the Legislative Council in 2004 and 2008 and of a new Chief Executive in 2007.

Irrespective of the nature and timing of discussions with Government on regulatory issues, CLP will continue to strive for world-best practices in all aspects of its business and to ensure the provision to our customers in Hong Kong of an electricity supply which meets their needs and legitimate expectations. In doing so, we not only meet our on-going responsibilities to our customers and the community at large, but also strengthen CLP's reputation as a corporate citizen which has earned and continues to deserve the trust of the community as the provider of an essential public service.

In line with our responsibilities, during 2004 we will focus on the following major plans and activities in Hong Kong:

- maintaining high levels of customer service and, in particular, meeting and where possible exceeding the customer service targets set out in our performance pledges, details of which are set out on our website and sent each year to all our customers;
- implementing capital expenditure programmes in line with business needs. An associated task will be the submission to Government in 2004 of a Financial Plan for the period through to 2008. Under the SoC, this Financial Plan will set out information regarding projections of CLP's revenue and capital budgets, financing plans and tariff levels. The Financial Plan is reviewed by Government and the outcome of that review is put before the Executive Council for approval;
- maintaining our efforts to deliver high performance and flexibility from our generating assets. The construction and commissioning of the remaining two units at the Black Point Power Station to schedule and within budget will be a major exercise for our generation business;
- applying information technology to improve productivity and efficiency. Systems under development and enhancement include those in respect of energy data management and purchasing processes; and
- proactively managing environmental issues, such as our contribution to the improvement of air quality in the Pearl River Delta, emission trading studies and the implementation of our Renewable Energy Initiative.

In the medium to longer term, local electricity sales growth is forecast to be around 2% to 3% for the next three years, largely as a result of new town developments and new infrastructure projects. It is expected that sales of electricity to the Mainland will continue, although the timing and extent of such sales remain hard to predict.

CLP has an excellent track record of cost control and tariff management. There has been no tariff increase since 1998. CLP will continue to make strenuous efforts to avoid or minimise tariff increases. This serves our customers' interest, underlines the merits of the current regulatory regime and illustrates the responsible manner in which we fulfill our regulatory obligations.

Our Chairman speaking at the launching ceremony for the Fangchenggang project

Continuous coal shipment unloader being installed at Castle Peak Power Station

On-going capital expenditure in our electricity infrastructure will be required across our business, whether in respect of generation, transmission, distribution or customer services. This is essential in order to maintain the quality of electricity supply to which our customers are accustomed and which they expect to receive. CLP and our shareholders will be looking to Government to provide a suitable degree of assurance and clarity about the post-2008 regulatory regime. This will give the Company, our shareholders and lenders the level of confidence necessary to make investments such as those required to improve the environmental performance of coal-fired plant at Castle Peak Power Station and to make the arrangements necessary for a long-term natural gas supply to replace, during the next decade, the gas now supplied from the Yacheng-13 gas field in the South China Sea.

We remain confident that the combination of:

- the competence and responsibility which we have demonstrated in supplying electricity to the Hong Kong community since 1903;
- our legitimate interests and expectations as the owner of the electricity infrastructure in our supply area; and
- Government and public awareness of the dangers of ill-conceived regulatory change,

will lead to the development and agreement of a post-2008 electricity regulatory regime which continues to strike the right balance between the interests of all stakeholders.

Electricity Business in the Chinese Mainland

The business environment for our electricity business in the Chinese mainland is strongly influenced by the following factors:

- The massive increase in electricity demand, in line with the current boom in economic development in the Mainland, in particular the northern, eastern and southern regions. Electricity demand grew by 15.4% in 2003.
- Power shortages as the Mainland's electricity infrastructure, in terms of both generating and transmission capacity, struggles to keep pace with rapidly rising demand. This was manifested by the outages which occurred in Shanghai during summer 2003, as well as electricity shortages and restrictions elsewhere in China.
- The subsidiaries of the five national generating companies, created by the recent reform of the Mainland power industry, have a significant competitive advantage through the preferential acquisition of generating assets from their parent companies. This creates difficulties for other players seeking to build a business of sufficient scale to compete effectively. The national generating companies also have access to a highly receptive capital market and, in their pursuit of growth, may be highly aggressive in acquiring new projects.
- The continued downward pressure with respect to "on grid" tariffs. This reflects the efforts being made by the

Chinese authorities to hold down tariff levels to customers, whilst reallocating a larger share of total electricity revenues to the transmission and distribution sectors. These urgently need massive investment in order to respond to the demand for electricity and to facilitate the wheeling of power from the point of generation (increasingly in the hinterland and the west of China) to the point of consumption (notably along the Southern and Eastern coastal belt).

- In 2003, the Chinese authorities announced that environmental discharge fees would be imposed on emissions from power generation facilities. Although the method of detailed application of these fees is not yet clear, this potentially impacts the economics of all PRC generation projects.

The CEO's Review in our Annual Report 2002 commented on the combination of the availability of funding in the Mainland's domestic capital markets, generating assets becoming available for acquisition as a result of power sector reform and expectations of continuous growth in electricity demand. This risked to create a market where, notwithstanding underlying regulatory and market risks and tariff uncertainties, foreign and domestic IPPs might bid for assets at prices which did not properly reflect the risks involved over the longer term and the need to earn meaningful returns on investments. This assessment has proved to be largely valid and, in the latter part of 2003, was also reflected in the high price/earnings ratios at which the shares of domestic IPPs have been trading and those obtained on the IPOs of new listed subsidiaries.

Recognising this business environment, the outlook for our activities in the Chinese mainland remains as expressed in last year's Annual Report, namely that we will be extremely selective in our choice of new investments. Over the short to medium term, we are prepared to slow the pace of investment, rather than compromise on its quality.

During 2004, therefore, our focus will largely be on the effective management of our existing investments, such as:

- the full takeover of the two 300MW coal-fired generating units at Anshun II;
- achieving full commercial operation of the 2 x 600MW coal-fired units at Liaocheng;
- restructuring the Huaiji hydro project to improve financial performance;
- continued development of the 2 x 600MW coal-fired units at Fangchenggang, Guangxi province; and
- pursuit of renewable energy opportunities such as hydro power in Sichuan province and wind power generation at locations on the southern China coastline, including work on site studies and data collection.

A challenge for 2004 and likely for succeeding years, is maintaining appropriate tariff levels for those generating assets in which we hold an interest. Although all such stations are currently subject to approved and implemented tariffs, discussions are underway with the relevant authorities for Shandong, Anshun II and Panshan to set the tariff levels for 2004. A satisfactory outcome to those discussions is supported by ongoing efforts in cost control at those stations and the support of CLP's investment partners in those assets.

In the medium to longer term, CLP considers that power shortages may continue for the next two to three years due to continuing rapid growth in electricity demand. However, mismatches between electricity demand and the timing and volume of the introduction of new generating capacity may lead to significant and sharp swings in the electricity supply/demand balance on a regional or provincial basis. The reorganisation and changes in asset ownership resulting from reform of the Mainland power industry may also have implications for some of our existing partnerships. Nonetheless, we are confident that the increase in private sector activity that this reform is bringing to the Mainland power industry, together with the Mainland's continuing strong economic growth, will provide new opportunities for us.

Given this developing situation, our objective will be both to grow our existing assets and partnerships as well as pursue new project opportunities. We intend to focus on strengthening our presence in the South China grid region, where high growth in electricity demand should create opportunities for further greenfield projects. We are also exploring the possibility of tapping into the Mainland's domestic debt and equity markets to fund future expansions and to lower our cost of capital so that we may compete more effectively with Mainland generating companies.

Electricity Business in the Asia-Pacific Region

Electricity markets across the Asia-Pacific region have very differing and individual characteristics. However, it is possible to identify two broad trends which affect the outlook for our business in the region:

- Market reform towards privatisation of state-owned assets and the development of competitive markets has slowed across the Asia-Pacific region. Industry reform in the region is proceeding cautiously and at a slow pace. There are opportunities for private sector involvement, but these are typically within the context of highly state-managed power sectors.
- Economic growth is returning to the Asia-Pacific region and is being reflected in increases in electricity demand which will rapidly take up any existing excess generating capacity.

Australia

Foreign investors have continued to exit the Australian power sector, mostly due to business and financial challenges in their home markets. This creates opportunities for vertical integration between generators and retailers to build a more robust business model and horizontal integration of generators to reduce the risk associated with single asset positions. However, all such proposals are subject to scrutiny against Australia's competition laws.

At present, CLP's presence in Australia is limited to its 92% shareholding in Yallourn Energy. Owing to continuing low pool prices and accelerated capital expenditure, Yallourn Energy may have difficulty in meeting its debt service cover ratio in 2004. As a result, part of A$200 million of shareholders standby funding may have to be injected into Yallourn Energy in 2004. Our objective is to improve Yallourn Energy's liquidity position within an overall restructuring of its debt. While the medium-term contract market has continued to deliver reasonable pricing for Yallourn Energy, spot pool prices have been low in 2003. Our view is that spot prices in the Australian markets are at levels that are unsustainable and that there should be some recovery in prices in 2004. It is likely that any recovery in spot prices will lead to higher pricing levels in the contract market.

Our objective in Australia has been to build a more diversified asset portfolio and move beyond our current single asset position. This will mitigate the risk of market volatility and offer opportunities for increased earnings. In line with this objective, in 2004 we aim to sell down part of our shareholding in Yallourn Energy to a strategic partner and then apply the proceeds of sale towards potential acquisition or merger opportunities in Australia.

Our goal in the medium to longer term is to establish a multi-asset, self-financing Australian business portfolio with stand-alone financial strength and flexibility and with the potential to create shareholder value through an IPO on the Australian market.

Thailand

The Thai electricity sector is going through a period of change. The state-owned EGAT is being prepared for an IPO, albeit that it is likely to remain as the major electricity generator in Thailand and the owner and operator of the transmission and distribution entities in the country. The Thai Government has recently approved a regulatory regime which will establish an independent electricity sector regulator, who will be responsible for tariff setting as well as new project awards under a forthcoming Thai power development plan. This plan will likely include a sharp upward revision for capacity expansions during the period to 2011.

The consequences of this regulatory change on CLP's existing investments in Thailand (our shareholding in EGCO and interest in the BLCP greenfield project) are not yet clear. Our current assessment is that the Thai Government will want to ensure an appropriate measure of competition for EGAT and that other players have an opportunity to develop new projects. In January 2004, with the support of the Thai authorities, we entered into a Memorandum of Undertaking (MOU) with EGCO, EGAT and Banpu Public Company which would have seen EGAT withdrawing from EGCO and being replaced by Banpu as a major shareholder. Although implementation of the MOU has been stopped by local issues, largely related to the privatisation of EGAT, our view is that an arrangement on these lines would be positive for all concerned.

In 2004, our objectives in Thailand will be to:

- manage the construction of the BLCP project effectively, within budget and towards the planned commercial operation dates of 2006 and 2007; and
- closely monitor the emerging details of electricity regulatory change and support the strengthening of EGCO's position, including in respect of its shareholding and management structures, to operate effectively in the developing Thai electricity sector.

Depending upon the outcome of regulatory reform, CLP's existing presence in Thailand and our good relationships with EGCO and Banpu, put us in a position to take advantage of opportunities to participate in the future expansion of generating capacity in Thailand and possibly in the Mekong region.

Taiwan

Taiwan is currently experiencing low growth in electricity demand. This limits greenfield investment opportunities in the near future. Although there is the possibility of privatisation of state-owned Taipower, no definite timetable or structure has been set. It would be inappropriate to plan on the basis of such a privatisation occurring in the short to medium term.

For these reasons, our focus in Taiwan in 2004 will be on continuing to develop the operational capabilities of Ho-Ping Power Station. Ho-Ping entered commercial operation in 2002. Whilst its operations have been satisfactory, we consider that scope exists for further improvements in reliability and availability.

In the medium to longer term, our strong relationship with Taiwan Cement, our partner in the Ho-Ping project, and the experience gained in Taiwan through constructing, commissioning and operating Ho-Ping mean that CLP can exploit opportunities for asset acquisition or greenfield projects as and when these arise.

India

Although electricity demand is strong in India, with an installed capacity which is only one-third of that in the Chinese mainland, the timely collection of electricity charges for generators continues to be a major issue, due to the poor financial condition of the various state electricity boards. The Electricity Act passed in 2003 is a significant step towards a more flexible business environment for private sector participation. Eventually, we expect the possibility to materialise of power sales directly from private sector generators to private sector retailers. This is a business model which may enable our Indian activities to grow in the future.

With respect to CLP's existing investment in GPEC, the primary tasks in 2004 will be to pursue the full implementation of the amended power purchase agreement signed in 2003 with GEB and maintain the high standards of reliability, availability, safety and environmental performance achieved at GPEC.

In the longer term, CLP's continued presence in India will be determined by:

- the progress and success of reform of the Indian electricity sector;
- the performance of our existing investment in GPEC, which serves as a practical test of the viability of external investment in the Indian power industry; and
- development of suitable local partnerships for future investment opportunities.

Depending upon the status of these three criteria, CLP could envisage cautiously reviewing new opportunities with local strategic partners, including an expansion at the GPEC site.

Ho-Ping Power Station

Site work at BLCP