Southeast Asia and Taiwan

BLCP Power Station, Thailand

How did we do in 2006?

CLP commenced development efforts in the region in 1994. Through investments in Thailand and Taiwan, we have built a significant presence in the regional electricity generation sector. In order to move forward our business in the region, CLP's objective has been to establish a regional power company which consolidates our existing investments and brings in a regional partner to share the risks, rewards and capital investment required for growth. In line with this strategy, the major focus of our regional activities in 2006 has been:

- establishment of our regional joint venture, OneEnergy;
- consolidation of existing investments;
- management of existing assets;
- pursuit of opportunities for growth; and
- an improved earnings contribution to the Group.

Establishment of OneEnergy

Major progress was made towards implementing a regional business model through the formation of the regional joint venture OneEnergy, with Mitsubishi Corporation. This joint venture draws on our combined resources, experience, local connections, market positions and financial strengths in order to grow its business. During the course of the year, a management team comprising executives from both partners was put in place. Governance and control systems, staffing and offices were established. The joint venture is now fully operational, with the capacity both to oversee the management of its existing assets and to bid for further projects and assets.

Consolidation of Regional Investments

In March 2006 CLP completed the injection into OneEnergy of its 22.4% interest in EGCO. We also reached agreement for CLP to sell its 50% stake in BLCP to EGCO in October 2006. The result of these transactions has been to make EGCO the exclusive vehicle for OneEnergy (and, therefore, CLP) in the Thailand power market.

Arrangements are being finalised for the injection into OneEnergy of CLP's 40% interest in Ho-Ping. It is expected that this asset injection will be completed by the end of the first quarter of 2007. It is also envisaged that Mitsubishi Corporation's 21% interest in the 1,200MW in Ilijan project in the Philippines will be injected into OneEnergy. However, the timing of that potential injection is uncertain, given the impending sale of Mirant Asia Pacific Limited, a joint venture partner with Mitsubishi Corporation in Ilijan, and the contractual pre-emption arrangements included in the Ilijan shareholders agreement.

Management of Existing Assets

The levels of utilisation and availability achieved in 2006 at those power stations in which CLP holds an interest were as follows:

Station	Rating (MW)	Generation (GWh)		Utilisation (%)		Availability (%)		Operating Hours	
		2006	2005	**2006**	2005	**2006**	2005	**2006**	2005
Ho-Ping	1,297	**7,276**	8,477	**64**	75	**68 ***	86 *	**5,610**	6,536
EGCO/Rayong (REGCO)	1,232	**6,030**	6,393	**56**	59	**93**	94	**4,894**	5,189
EGCO/Khanom (KEGCO)	824	**5,527**	6,274	**77**	87	**81**	95	**6,708**	7,614

* Guaranteed hours

The performance of Ho-Ping was affected by a blade failure in the Unit 1 turbine in November 2005. Substantial repair work was required, which led to an extended outage until May 2006. The unit was restored to service with a slightly reduced output, and is now operating at full capacity after installation of new blades in February 2007. Discussions with insurers continue to finalise the insurance claims.

Ho-Ping was able to mitigate most of the impact of high spot coal and shipping costs in 2006 due to a favourable adjustment in the energy charge rate under the PPA with Taipower, as well as the protection afforded by existing long-term coal supply and shipping contracts. The rebuild of the first of the three coal storage domes damaged during strong typhoons in 2004 and 2005 has been progressing well and will be completed in May 2007. The design and preparation work for the rebuild of the remaining two domes is underway, with completion scheduled for late 2007 and 2008. Agreement has been reached on insurance and equipment warranty claims.

With regard to those stations in which CLP holds its interest through EGCO, the operation of REGCO and KEGCO has been satisfactory with high levels of availability. Construction of the 1,468MW combined-cycle gas-fired Kaeng Khoi 2 power station project, in which EGCO holds a 50% interest through its investment in the Gulf Electricity Company, remains largely on schedule with a view to commercial operation of the two units starting in 2007 and 2008. EGCO also owns 25% of the 1,070MW Nam Theun 2 hydro project in Laos, which will sell the majority of its output to Electricity Generating Authority of Thailand (EGAT). Construction work is underway, with the objective of operations commencing in 2009.

Construction of the 1,434MW coal-fired project at BLCP has progressed ahead of schedule and within budget. Following a fatal accident in February 2006 to a contractor's employee we redoubled our efforts to enforce a safety culture at the site. Pre-commercial operation started in mid August for the first 717MW unit and in mid November for the second unit, around seven weeks and eleven weeks ahead of their respective full commercial operation dates of 1 October 2006 and 1 February 2007 under the terms of the PPA. BLCP reached an agreement with the off-taker, EGAT, in respect of the early generation, which benefited both parties. CLP has acted as construction manager for the BLCP project, under contract to BLCP, and has thus met its key responsibilities in this respect.

The operating company for BLCP is Power Generation Services Company Limited (PGS), which is a separate 60/40 joint venture between CLP and Banpu (the shareholding in BLCP, prior to the sale of our interest to EGCO, was 50/50 between CLP and Banpu). PGS has been recruiting and training its staff, and putting in place the necessary operating systems, during the course of construction. It took over responsibility for operation and maintenance of the first unit and the second unit in October 2006 and February 2007 respectively.

As the following table explains, all of our operating assets in the region benefit from long-term PPAs with creditworthy off-takers. These agreements were honoured in 2006 both by the relevant generating company and by the off-takers.

Station	Off-taker	Off-take Arrangement	Duration
Ho-Ping	Taipower	PPA	25 years
BLCP	EGAT	PPA	25 years
REGCO	EGAT	PPA	20 years
KEGCO	EGAT	PPA	15/20 years
EGCO/ Kaeng Khoi 2	EGAT	PPA	25 years
EGCO/ Nam Theun 2	EGAT	PPA	25 years
EGCO/ small power projects	EGAT and industrial customers	PPAs with EGAT and commercial contracts with industrial customers	21/25 years for EGAT PPAs
EGCO/Mindanao small power projects	National Power Corporation, Philippines	PPAs	18 years

Growth Opportunities

CLP's regional development efforts are now carried out through OneEnergy and our in-country partnerships and vehicles.

During 2006, EGCO prepared for the next round of IPP solicitations in Thailand, which is scheduled to commence in 2007. EGCO continued development work on the 523MW Nam Theun 1 hydro project in Laos, in which it projects to hold a 40% interest. This project is targeted for financial close in 2007 and commercial operation in 2013.

The Taiwanese Government has launched its process for IPP solicitation to meet electricity demand requirements in 2011. The resulting projects will enjoy a 25-year PPA with Taipower. Taiwan Cement and CLP have a longstanding partnership in the Ho-Ping project and will be responding to the IPP solicitation with a bid to develop an expansion of the project. The bids are due to be submitted in December 2007. We are seeking the necessary environmental approvals for the project prior to that time. Expansion of the Ho-Ping facility meets the preference of Taipower for coal-fired capacity supplying Northern Taiwan.

OneEnergy, in consortium with Tanjong Public Limited Company of Malaysia, bid for a portfolio of generating assets in the Philippines made available for sale by Mirant. This bid was unsuccessful, but OneEnergy continues to monitor market and industry opportunities in the Philippines.

OneEnergy is also exploring greenfield opportunities in Indonesia and has submitted prequalification documents for a 2 x 600MW coal-fired project in Jawa Tengah. No date has yet been set for the submission of binding bids for this project. OneEnergy is in contact with relevant organisations in Vietnam to examine potential greenfield projects in this emerging market.

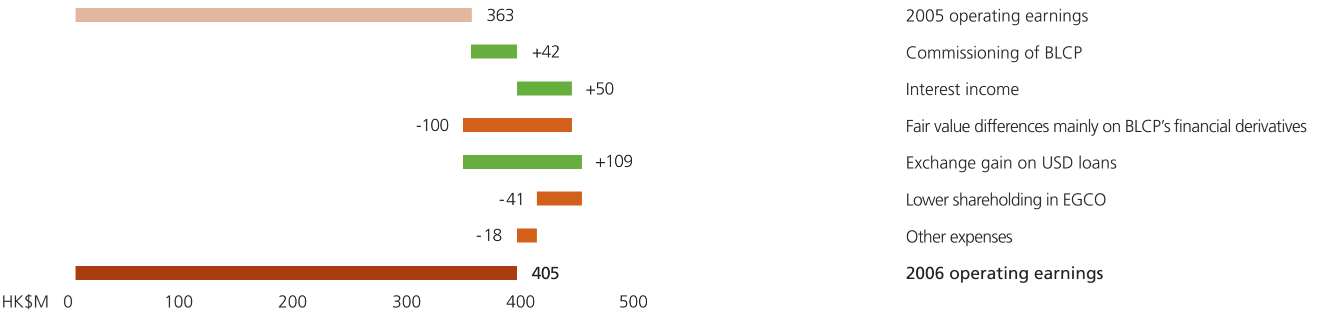
→ (Left) BLCP Power Station, Thailand
→ (Right) Opening Ceremony for OneEnergy Head Office in Hong Kong

Earnings

CLP's investments in Southeast Asia and Taiwan contributed HK$405 million to group earnings in 2006. The improved earnings of HK$42 million, compared to 2005, reflected an exchange gain on U.S. dollar loans and our share of the interest income from OneEnergy after the equity injection from Mitsubishi Corporation, partly offset by the fair value differences on derivative financial instruments.

The chart below depicts the major variations (plus or minus) in earnings between 2006 and 2005 from our investments in Southeast Asia and Taiwan:

Southeast Asia and Taiwan Operating Earnings



In addition to operating earnings, one-off gains were also recorded in this year. In March, HK$343 million was realised upon the formation of OneEnergy in which our interest in EGCO was injected. On the transfer of our 50% interest in BLCP to EGCO, another gain of HK$888 million was recognised towards the end of 2006.

Rebuilding a damaged coal dome at Ho-Ping Power Station, Taiwan

What are we going to deliver in 2007 and beyond?

Business Environment and Challenges

The economies in OneEnergy's target markets, namely, Thailand, Taiwan, Philippines, Indonesia, Vietnam and Singapore, continue to enjoy healthy economic growth averaging 5-6% per annum. The new generating capacity requirements for these markets over the next decade are forecast at around 75,000MW, of which 30,000MW may be available to the private sector, primarily through bilateral PPAs with the national utilities. Much of this new generation capacity will be awarded through competitive tendering, which will place a premium on competitive project execution capabilities and access to low cost financing.

Fuel is the single largest cost over the life of any fossil-fired power project and, potentially, the single largest risk if its availability is in doubt or if the fuel price is not adequately reflected in the electricity price. The coal market has been volatile over the past few years and locally available supplies of gas are reaching the point where they are fully committed to existing operations in some of the Asian countries where CLP is active. Imported LNG use is likely to increase in the medium term, but uncertainties remain as to its pricing and when it will be more widely available. Nevertheless, many Asian countries see an acute need for additional power generation capacity as economic growth continues and reserve margins reduce to critical levels. The choice of fuel type and source is therefore particularly important for the next stage of greenfield projects.

We expect that gas-fired generation will be used for part of the new generation capacity because of environmental considerations and carbon intensity. However, concerns over long term LNG availability and pricing, and over-reliance on import, will mean that coal will be a more realistic choice in many cases, at least in the short term.

CLP has long experience in construction and operation of coal fired power plant and is therefore well placed to develop new projects. However, and as the CEO discusses in his Review on pages 10 and 11, we are concerned about the climate change implications associated with an expanding use of coal. Those concerns are partly commercial, since there is a risk that carbon emissions may be penalised in some way, but increasingly become a matter of principle and ethics. This is one of the most difficult issues that the power industry has ever faced and involves dilemmas and choices that do not have easy answers. These issues affect CLP wherever we operate. They are particularly challenging in the Chinese mainland and the developing countries of Asia, whose people have an urgent need for access to affordable electricity to improve their lives, but who cannot yet meet the full economic cost of providing that electricity in an environmentally sustainable way.

In the short term CLP will seek to mitigate its fossil fuel impact by using advanced technology with the highest energy efficiency that can be achieved by proven plant and systems. However we will be examining the broader implications of climate change again to ensure that our policies respond to the business and ethical challenges we face.

In addition to opportunities to invest in new generating capacity, there may be openings to acquire assets and businesses from other power companies or through the privatisation of government-owned utilities. However, there is strong competition for both existing assets and new greenfield generating projects from other Asian players, some of whom may be willing to take lower equity returns and greater risk than those acceptable to CLP. Japanese trading houses are targeting the Asian power sector for growth, whilst funds and private equity vehicles are also active in the pursuit of acquisitions.

Year 2007

In 2007, CLP's objectives will be to:

- complete the injection of CLP and Mitsubishi's regional assets into OneEnergy;
- take forward our business in the region through OneEnergy as well as through existing and new partnerships at country and project levels;
- consider strategic acquisitions in the Philippines and Singapore, as the deregulated nature of those markets may require a critical mass to compete;
- pursue greenfield development opportunities in Thailand, Taiwan, Indonesia and Vietnam and, in particular, submit a competitive bid to the Taiwanese authorities for the expansion of Ho-Ping;
- continue relationship building in Vietnam with market participants and explore opportunities to participate in currently approved projects; and
- complete the rebuild of two of the three damaged Ho-Ping coal domes and replace the turbine blades on Unit 1, thereby restoring its full load capability.

Beyond 2007

Our objective beyond 2007 is to establish OneEnergy as a premier regional power company with a significant presence in its target markets. This will require a balanced portfolio with:

- investments in both stable and emerging markets in the region;
- a mix of operating and construction assets and development projects; and
- the development of self-financing capability within the next three to five years.

We also expect OneEnergy actively to support the development of renewable energy projects – reflecting the CLP Group's commitment to a significant renewable energy component in its overall generating portfolio.

In the next decade, do you foresee power trading happening aggressively between countries, the logic being it is cheaper to transport power than fuel for certain distances?

Mr. Pradip Roy
Executive Director,
Industrial Development
Bank of India Ltd.

A robust cross border electricity interconnecting network is the intermediate step before any pool market style trading could exist. Currently, cross border transmission lines exist in Asia, but mostly on a point to point basis for dedicated purposes. Because they are sized for the purpose of emergency supply or peak sharing, their capacity cannot handle the continuous baseload operation required in pool market trading. The Nam Theun 2 project (Thailand/Laos) would be the first major cross-border baseload-merit in Southeast Asia once it becomes commercial.

ADB, a pro-development Asian policy bank, has proposed the concept of a GMS Mekong Power Grid. Assuming member countries align their interests and reach consensus, it would take a decade to build up a regional transmission network. Considering the resource constraints facing many of the Greater Mekong Subregion (GMS) members, it is more likely such a project would take even longer. In addition, power and other similar infrastructures raise national security issues as countries are unlikely to become dependent on governments beyond their own control.

Mark Takahashi
Chief Executive Officer,
OneEnergy Limited