

HONGKONG ELECTRIC HOLDINGS LIMITED

OPERATIONS REVIEW

Sales of electricity grew by 3.5% over 1999 to 9,992 million KWh. Maximum demand rose by 3.2% to 2,417 MW, another record high and in line with our long term forecasts. The performance is a significant rebound that reflects Hong Kong's improving economy and the growth of our user base. All market segments recorded increases, led by a 3.9% rise in commercial sales, which accounted for 71.5% of the total. The number of customers rose to 525,563.

We encountered no Y2K related incidents and reliability of supply was maintained at 99.999%.

Generation

The Generation division continued to exceed targets for reliability, availability, efficiency and safety while increasing productivity through reductions in headcount and operational expenditure.

As a continued effort to enhance the efficiency and reliability of Lamma Power Station, three older units have been retrofitted in stages with digital control systems. The submerged scraper conveyor system retrofitted to three units for handling bottom ash from boiler furnace came into operation. This has significantly reduced discharge to the sea and facilitated the industrial use of bottom ash, a proactive step in the drive towards sustainable development. Work on remaining units will be completed by 2002.

In line with the worldwide drive towards higher efficiency in power generation, two of the existing gas turbines are being converted to a combined cycle unit by installing a steam-cycle bottoming system. By recovering the waste heat energy from the gas turbine exhaust, the conversion will produce an extra output of 115 MW without consuming additional fuel. The combined cycle unit will be in operation in mid 2002.

Low-sulphur coal remains our main fuel supply and consumption in 2000 rose to nearly four million tonnes. The new integrated coal handling system has increased average loading rates and saved costs. We continue to find ways to reduce the cost of coal, one of the Group's main expense categories, through competitive sourcing.

To meet the future demand for electricity, design and planning for the construction of the first gas-fired combined cycle unit as an extension to the Lamma Power Station is well underway. The unit is scheduled for commercial operation in 2004.

Transmission and Distribution (T & D)

A range of improvement works carried out during the year contributed to this performance, including commissioning 82 new distribution substations and laying 225 km of 11kV cables.

To meet customers' future needs, reinforcement work on the transmission network continues to be carried out, including the construction of new primary substations and transmission cables in Eastern/Central areas.

In 2000, we introduced a new group billing service for larger customers and a new Wireless Application Protocol (WAP) service. We have also introduced the Computer-Telephone-Integration (CTI) System at our call centre to increase its operational efficiency and to provide more personalised service.

The record reliability achieved during the year was mirrored by increasing levels of customer satisfaction and all 18 existing pledged service standards covering our dealings with customers were exceeded.

International

Hongkong Electric International Limited (HEI)

HEI's first major investment of A\$3,250 million to acquire the power distribution assets of the State of South Australia, ETSA Utilities, was concluded in late 1999. The first year of ETSA's operation under the joint ownership of HEI and Cheung Kong Infrastructure Holdings Limited (CKI) has proceeded smoothly. ETSA successfully refinanced its short-term debt, secured an A-/A3 long-term credit rating and completed the transition from public to private ownership. During the period ended 31st December 2000, the company increased sales of electricity by 10.7% while reducing costs by 7.6%. This produced revenues of A\$584 million yielding a profit, before interest and tax, of A\$262 million.

In September 2000, HEI completed another investment in Powercor Australia Limited in the neighboring State of Victoria, again in an equal partnership with CKI. Powercor is Victoria's largest electricity distribution and retail business, annually distributing over 8,000 GWh of electric power to 566,000 consumers. The A\$2,315 million purchase of Powercor is an attractive investment in its own right, whose value we will maximise through increasing operational efficiency. It also offers potential synergies with our ETSA operations, through economies of scale that can be derived from shared services, combined purchasing and reduced operating costs.

Extracts from the financial statements of both these businesses are shown on pages 48 to 49.

Associated Technical Services Limited (ATS)

ATS again made a positive contribution to the Group's results, as its increasing reputation translated into a steady flow of overseas consultancy contracts, despite a competitive environment. New contracts have been secured in China, Hong Kong and overseas for the provision of management training, marketing of switchgears and engineering services.

People

Training

Technical excellence and superior levels of customer service are indispensable to the Group's success and we take great care to attract, retain and develop the right people, while optimising the size of our workforce.

During 2000, 1,496 staff participated in various training courses organized by the Group. These courses included computer applications, system engineering, occupational safety and health, environmental engineering and overseas training. The Generation division conducted over 20,000 man-hours of training, focusing on enabling people to acquire multiple skills. The new simulator we commissioned during the year will be used to augment our training in 2001.

Health and Safety

The company's active 'safety first' culture continues to pay dividends. In 2000, HEC's Generation and T & D divisions achieved a Disabling Injury Frequency Rate of 0.36% and zero respectively, which is classified as "excellent" by international standards. The two divisions also outperformed teams from other companies to win safety quizzes organized by the Hong Kong's Occupational Health and Safety Council, for the fourth year running.

New legislation was introduced during the year requiring increased training in general safety and certification for workers in confined spaces. Our outstanding record enabled us to secure approval from the Labour Department for our in-house training courses, which can now certify Group employees and those of contractors.

Personnel Review

The Group's total remuneration costs for the year, excluding directors' emoluments, amounted to HK\$1,096 million. As at 31st December 2000, the Group employed 2,366 permanent staff, a reduction of 79 from the previous year. No share options scheme is in place. The salary freeze imposed in 1999 was extended into 2000 due to the difficult economic conditions.

Corporate Citizenship

The Group is dedicated to making a positive contribution to the wider community and the environment.

Environmental Care

Care for the environment is fully integrated into all of the Group's planning and operations. We invest substantially to counter air, water and noise pollution. 2000 again saw no major environmental complaints and full compliance with relevant legislation.

We have devoted much effort during the year to the development of our Environmental Management System, which after its introduction in 2001 will raise our environmental monitoring to the highest international standards. We neared our target of zero ash disposals, with two more units converted to a closed loop system that allows ash to be recycled for cement making. Our rainwater collection schemes have further reduced our use of supplied water.

Throughout 2000, we continued our research into renewable energy. A feasibility study into wind energy is under way and data from wind monitoring stations is being collected and evaluated. We are sponsoring a study by the University of Hong Kong into photovoltaics, which convert sunlight into electricity. In July, we installed a solar hot water supply system at the Lamma Power Station that uses sunlight to heat water directly for use in the facility's washrooms.

Our deep concern for the environment is well demonstrated by plans for the Lamma extension, which has passed all required regulatory approvals. The use of natural gas as the fuel for base load will minimize emissions, cutting those of sulphur dioxide by 60%. We will also ensure that associated works, including the undersea gas pipeline, are to the highest environmental standards.

Community Outreach

During the year, we increased our concessionary tariff scheme that helps many elderly and disabled people to enjoy the benefits of electricity. We developed a special home page on our website to assist the visually impaired, the first utility in Hong Kong to do so. We continued to support local charities and activities in promotion of a cleaner environment. We also built a new helicopter-landing pad at our Lamma facility to help evacuate local people in need of urgent medical treatment. The Lamma Power Station also saw the opening of a new visitor centre to cater to the growing number of visitors.

Treasury

Our well respected treasury department uses the balance sheet and access to the international capital markets to optimise the use of capital in continuing operations and new investments. Excluding overseas investments, the Group achieved an average cost of borrowing which is amongst the lowest for public companies in Hong Kong.

During the year, the Group took on additional external borrowings of HK\$6,200 million to fund our new investments overseas. Innovative financings for the ETSA and Powercor acquisitions, involving combinations of bridge financing, interest-rate hedging, syndicated loans and Australian dollar denominated bond issues, ensured a low cost of capital.

The average maturity of our debt is between two and five years and 61% is fixed rate. The treasury's focus on risk management and control means that financing transactions relate directly to our underlying business. The Group typically secures funds in Hong Kong or US dollars and uses a variety of instruments to hedge currency and interest rate risk. Approximately 99% of the Group's borrowings in relation to operations in Hong Kong were denominated in or swapped into Hong Kong dollars. Those arising from overseas investments are similarly hedged.

Corporate Governance

HEH is committed to ensuring high standards of corporate governance. We believe this approach is increasingly important to our shareholders. Guided by the regulations of The Stock Exchange of Hong Kong and practices in international markets such as the United States, we have developed codes of conduct for employees and directors that cover ethical, safety, environmental, provident fund and shareholder issues.