Management Discussion and Analysis – Business Review

This business review sets out the major activities of the various business streams within the CLP Group during the first half of 2001, and the outlook for those businesses.

Hong Kong Electricity Business

The Group's core Hong Kong electricity operations, carried out by CLP Power, supply electricity to almost two million customers, representing a population of approximately 5.4 million in Kowloon, the New Territories, Lantau and a number of outlying islands. In the first half of 2001, local unit sales of electricity increased by 2.9% over the same period last year. Total unit sales, including sales to the Chinese mainland, rose 5.2%. This reflected increased supply to Guangdong Electric Power Holding Company, attributable to higher demand in Guangdong province.

To meet future demand growth and to maintain supply reliability, significant on-going investments are being made in CLP Power's electricity generation, transmission and distribution systems. For the six months to 30 June 2001, CLP Power's total capital expenditure was on track against budget. Capital expenditure in the transmission and distribution networks, which constitutes the lion's share of the total budget, amounted to HK$1,520 million. During the period under review, the major transmission and distribution projects in progress included the construction of Centenary Substation, Cha Kwo Ling Road Substation, Hin Wo Lane Substation, Tin Shui Wai 'B' Substation and Tseung Kwan O MTRC Infeed Substation. In addition, CLP Power also invested HK$282 million in other supporting facilities.

CLP Power's high standards of environmental awareness were recognised by awards from the Environmental Protection Department under its Wastewi$e Scheme, which benchmarks and assesses participating companies in their commitment towards environmental protection through waste reduction.

CLP's excellent safety record was marred by a tragic accident at a 132/11kV substation in Kowloon in January 2001, which led to the loss of life of two CLP Power employees. Everything possible is being done to ensure that this never happens again. In line with our absolute commitment to excellence and continuous improvements in safety performance, a full-time task force reporting directly to senior management is undertaking an overall review of all CLP's safety policies and procedures.

In general, overhead line repair and maintenance work requires the power to be shut off, causing disruption to the electricity supply. With a view to minimising such interruptions, a team of highly skilled staff is carrying out live line maintenance work which is a technology introduced in CLP Power in 1999.

CLP Power continues to identify areas for strengthening its operational performance. During the past six months, several benchmarking exercises against international power utilities in power supply were completed. The results indicate that CLP Power's performance is well above average in distribution, supply reliability, transmission system operations and power quality.

CLP Power is pressing on with the achievement of its major business objectives set for 2001 and the coming years. These include:

- Reinforcing the quality of service to customers and enhancing customer loyalty;
- Continuous advances in internal business management and performance against world best practices;
- Stringent management of capital expenditure and operating cost;
- Cultivating a culture of innovation and personal development amongst staff;
- Investment in information technology infrastructure; and
- Responsible corporate citizenship, partnering with the Hong Kong Government and the community.

Efforts made to improve business performance have already resulted in significant gains in productivity enhancement and cost competitiveness. Productivity in terms of local unit sales per employee increased by 8.2%, compared with the corresponding period in 2000. CLP Power's success in cost management directly benefits its customers, and has allowed tariffs to be frozen for three consecutive years since 1998.

We are confident that CLP's continuous pursuit of these business objectives will ensure that CLP Power remains a world-class electricity utility and that we are well-positioned to meet our customers needs, whether in terms of increased electricity demand, improved service quality or cost competitiveness.

Mainland and Asia-Pacific Electricity Businesses

CLP has been actively expanding its asset portfolio in the Chinese mainland and elsewhere in the Asia-Pacific region through its subsidiaries, CLP Power China and CLP Power International respectively. In doing so, we have reinforced the Group's position as a leading player in the regional power sector.

Chinese Mainland

The joint stock company with Beijing Guohua Electric Power Corporation, CLP Guohua Power Company Limited, was established in January 2001. Owned 49% by CLP Power China and 51% by Beijing Guohua, it holds interests in three coal-fired power stations, namely Beijing Yire Power Station in Beijing, Panshan Power Station in Tianjin, and Sanhe Power Station in Hebei. These have a combined installed capacity of 2,100 MW, of which the joint stock company owns 1,285 equity MW. The Beijing Yire plant (2x200 MW), commissioned in 2000, is equipped with flue-gas desulphurisation facilities and supplies electricity as well as heat to Beijing. The co-generation plant replaced some 350 small boilers in the city and has helped to reduce air pollution in Beijing.

In addition to owning and operating these assets, the joint stock company plans to develop greenfield projects and acquire power assets in various parts of the Chinese mainland. In March 2001, CLP Power China signed an agreement to acquire a 49% interest in a newly commissioned 200MW coal-fired power station in Shenmu county, Shaanxi Province for injection into the joint stock company.

Beijing Yire Power Station

Operation of the Guangdong Daya Bay Nuclear Power Station owned by Guangdong Nuclear Power Joint Venture Company, Limited, in which CLP has a 25% interest, was satisfactory and high levels of safety and production were achieved. For the second year in succession, Daya Bay won the Nuclear Safety Award in the annual Electricité de France Nuclear Safety, Radiation Protection and Industrial Safety Competition in France. The 3,000MW joint venture in Shandong Province, in which CLP Power China holds a 29.4% interest through Shandong Zhonghua Power Company, continued to perform well. Shiheng I and Shiheng II Power Stations maintained the status of First Class Power Stations by the State Power Corporation of China. The construction of Heze II and Liaocheng Power Stations is proceeding according to schedule, budget and quality requirements.

The financial results achieved by the Guangdong Nuclear Power Joint Venture Company, Limited and Shandong Zhonghua Power Company, including shareholder earnings, have been on target.

Asia-Pacific Region

CLP Power International entered into a joint venture with Powergen UK plc (Powergen) in December 2000 whereby, subject to a number of conditions, CLP Power International would acquire an equity interest of 80% in the Asia-Pacific portfolio of electricity generating assets previously owned by Powergen. This portfolio includes a 1,450MW coal-fired plant and captive coal mine in Australia owned by Yallourn Energy Pty Limited (Yallourn Energy) and a combined cycle 655MW power station in India owned by Gujarat Powergen Energy Corporation Limited (GPEC).

After the completion in February 2001 of the acquisitions by the joint venture of shares in Yallourn Energy previously held by Powergen and other third parties, CLP Power International now has an equity interest of 73.6% in Yallourn Energy. The refinancing of Yallourn Energy was also completed in February 2001. Yallourn Energy now has a more robust capital structure. This will enable Yallourn Energy to take market opportunities as they arise and more effectively manage market risks. Although it incurred a loss during the four months after acquisition, the financial performance was still in line with budget. The CLP Group is confident of the future prospects of Yallourn Energy.

In respect of the acquisition of GPEC, efforts continue on obtaining the consents from relevant lenders and regulatory authorities. CLP Power International is also working to complete the acquisition by the joint venture with Powergen of other Powergen assets and development projects in Thailand, India and Indonesia, the last being subject to a number of specific conditions including renegotiation of power purchase agreements and refinancing.

Construction of the Ho-Ping Power Station in Taiwan, in which CLP Power International now holds a 40% equity stake, is making good progress. The transmission line linking the power station to the Taiwan grid has been completed and energised, and the majority of the equipment for the power station has been manufactured and delivered to site. We expect the two 660MW units to start commercial operation in 2002.

The CLP Group's portfolio of electricity assets in the Mainland and Asia-Pacific region continues to grow. We are reinforcing our position in target markets. As CLP gains competitive market skills and develops its partnerships in those markets, we will examine further opportunities for growth through acquisitions and greenfield development projects.

Non-electricity Activities in Hong Kong and Southern China

The first six months of 2001 saw progress in CLP's telecommunications business, carried on through CLP TeleCom.

In April 2001, CLP TeleCom launched a new retail brand "Oxygen" and its first consumer product: Narrowband Internet Access. Supported by a defining tag-line *"it's easy with Oxygen"* the brand places special emphasis on user-friendliness. During the reporting period, CLP TeleCom announced that it had reached an agreement with Yes Television plc to launch Oxygen TV, an interactive TV venture for the Hong Kong market.

CLP TeleCom was awarded an External Fixed Telecommunications Network Services Licence by the Hong Kong Government in June, and through its "ChinaLink" service, now offers highly secure network solutions between Hong Kong and the Mainland. We intend to make this an attractive product in an increasingly competitive business environment. ChinaLink offers a number of features including:

- Security through its deployment on the overhead power network;
- A fully protected ring on both sides of the Hong Kong-China border; and
- Scalability to match traffic growth on the Hong Kong-China route.

CLP TeleCom's efforts are now focusing on the marketing of its Broadband Internet Access, launched in July 2001, conclusion of the joint venture with Yes Television and introduction of Oxygen TV in Hong Kong, and the ramp up of sales on ChinaLink.

In February 2001, CLP Enterprises was informed by the relevant Mainland authorities that its bid for a stake in a major liquefied natural gas terminal project in Shenzhen had not been successful. In May 2001, CLP Enterprises formed a consortium with ExxonMobil China Gas Pipeline Limited to submit a joint bid response to PetroChina Company Limited for the West-East Gas Pipeline Project. This is a world-scale undertaking to link the upstream gas resources in western China with downstream end-users to the east, where power generation is expected to utilise about 50% of the gas volume. The ExxonMobil/CLP Enterprises consortium is one of the four which have been selected by PetroChina to sign a Memorandum of Understanding with a view to further negotiation towards a joint venture agreement. CLP Enterprises is also developing new business opportunities that can draw from CLP's assets and businesses, including information technology and customer relationships.

The core business of CLP Engineering during the period under review was lighting works with provision of contracting services to Hong Kong Government, Airport Authority and other private sectors clients. As the current public lighting contract with the Hong Kong Government will expire in October 2001, the future revenue from lighting business will depend on whether CLP Engineering is successful in bidding for the new public lighting contract.

Against this background, a review of CLP Engineering's activities was completed during the first half of 2001. The review concluded that CLP Engineering should seek to expand and grow its business in power engineering, energy services and facility management, in addition to its active involvement in lighting business and Mass Transit Railway and Kowloon-Canton Railway infrastructure projects.

Property Redevelopment in Hong Kong

CLP also undertakes the redevelopment of its property sites in Hong Kong which are no longer required for electricity purposes. Its major current project is the residential and commercial redevelopment of the former power station at Hok Un. This joint venture project, Laguna Verde, led by CLP Property and Cheung Kong, will comprise 4,735 flats, 1,692 carparks and 270,000 sq. ft. commercial space upon completion. During the period under review, presales of Phase 4 of Laguna Verde continued. As at 30 June 2001, more than 70% of the 1,377 flats in Phase 4 had been sold. Presales of flats in Phase 5 were launched in June. More than 80% of all the flats in the redevelopment have now been sold. Construction work at Laguna Verde is continuing.

Our People

On 30 June 2001, the Group employed 3,966 staff, of whom 3,596 were employed by CLP Power. Total remuneration for the six months ended 30 June 2001 was HK$1,070 million, including contributions to retirement benefit schemes of HK$80 million.

The Group's remuneration policies are to attract, retain and motivate high performing staff.

The Hon. Michael D. Kadoorie, Chairman of CLP Holdings and staff sharing a joyful moment before the Centenary Lighting Ceremony.

CLP continues to exploit the full potential of information technology to raise the efficiency and effectiveness of our employees. For example, a new SAP based Human Resources Information System was successfully implemented by CLP Power, allowing the Group to manage its human capital more efficiently.

CLP is committed to nurturing a learning culture throughout the organisation. We provide assistance and guidance to our employees in their quest for broader knowledge. A structured process is in place to proactively identify, manage and develop high potentials to ensure a continuum of competent leadership over time for all key positions.

Substantial investments have been made in building the Group's management and leadership capabilities. These include the establishment of Development Centres to identify the development needs of high-potential employees, and drawing up new Leadership and Management Development Programmes in conjunction with leading international business schools.

Management Discussion and Analysis – Financial Review

Consolidated Financial Result

During the six-month period to 30 June 2001, local electricity unit sales in Hong Kong increased by 2.9%. Total unit sales, which include sales from Hong Kong to the Chinese mainland, increased by 5.2%. There was no increase in electricity tariffs in 2001. Turnover registered a 2.2% increase.

Total earnings were HK$2,788 million, being HK$139 million lower than the corresponding period last year. Scheme of Control (SOC) earnings increased by 4.1% to HK$2,638 million while other non-SOC operating earnings reduced by HK$132 million. This reduction was due to increased development expenditure on diversifying the Group's activities, through power projects outside Hong Kong, telecommunications and other businesses.

Earnings Attributable to Shareholders

Earnings per share reduced by 4.7%. Excluding the Hok Un redevelopment profit and impairment losses on investments, earnings per share reduced by 1.7%.

The contribution of each major activity to the Group earnings is analysed as follows:

6 months ended 30 June	2001		2000		Increase/ (decrease)
	HK$M	HK$M	HK$M	HK$M	%
Scheme of Control earnings		**2,638**		2,535	4.1
Interest income		**17**		36	
Non-Scheme of Control operating earnings					
Electricity businesses outside Hong Kong	**215**		307		
Public lighting, property and export sales	**73**		23		
Development of telecom and other businesses	**(93)**		(23)		
Corporate finance costs	**(12)**		–		
Unallocated Group expenses	**(50)**	**133**	(42)	265	
		2,788		2,836	(1.7)
Hok Un redevelopment profit		**–**		1,121	
Impairment losses on EGCO and YTL Power		**–**		(1,030)	
Group earnings attributable to shareholders		**2,788**		2,927	(4.7)
Earnings per share [(1)], HK$		**1.11**		1.17	(4.7)
Earnings per share [(1)] excluding Hok Un and impairment losses on investments, HK$		**1.11**		1.13	(1.7)

(1) Earnings per share for 2000 is adjusted to reflect the bonus issue made on 23 April 2001 of one share for every five shares held.

Significant Investments

Fixed assets of the Group, mainly consisting of investment in the transmission and distribution network for the core Hong Kong electricity business, amounted to HK$31,726 million as at 30 June 2001. During the six months, the Group invested HK$1,845 million (2000: HK$1,106 million), of which HK$1,802 million (2000: HK$1,105 million) was made by CLP Power, in fixed assets. Capital expenditure by associated Hong Kong generating companies for the six months was HK$202 million (2000: HK$140 million).

Investment in the electricity business in the Chinese mainland and Asia-Pacific Region increased significantly mainly due to the acquisition of the interests in Yallourn Energy in Australia and the investment in the CLP Guohua Power Company Limited.

The Group's investments in jointly controlled entities, associated company and investment securities in each geographical segment is shown below:

	30 June 2001		31 December 2000	
	HK$M	**%**	**HK$M**	**%**
Electricity Business				
Chinese mainland	**5,516**	**38**	4,773	41
Asia-Pacific Region	**4,729**	**32**	2,744	23
Hong Kong	**4,332**	**30**	4,213	36
	14,577	**100**	11,730	100
Property and other Businesses				
Hong Kong	**1,814**		2,241	
	16,391		13,971	

Liquidity and Capital Resources

As at 31 December 2000, the Group had liquid funds of HK$2,172 million which have largely been deployed for investments in the past six months. At 30 June 2001, the Group had liquid funds of HK$217 million, comprising HK$134 million cash and deposits and HK$83 million floating-rate notes and fixed rate certificate of deposit. About 64% of these liquid funds were denominated in Hong Kong dollars and the remainder in foreign currency.

Financing facilities totalling HK$14.7 billion (HK$34.5 billion for the CLP Group and Castle Peak Power Company Limited (CAPCO) combined) were available, of which HK$4.5 billion (HK$19.1 billion for the CLP Group and CAPCO combined) had been drawn down.

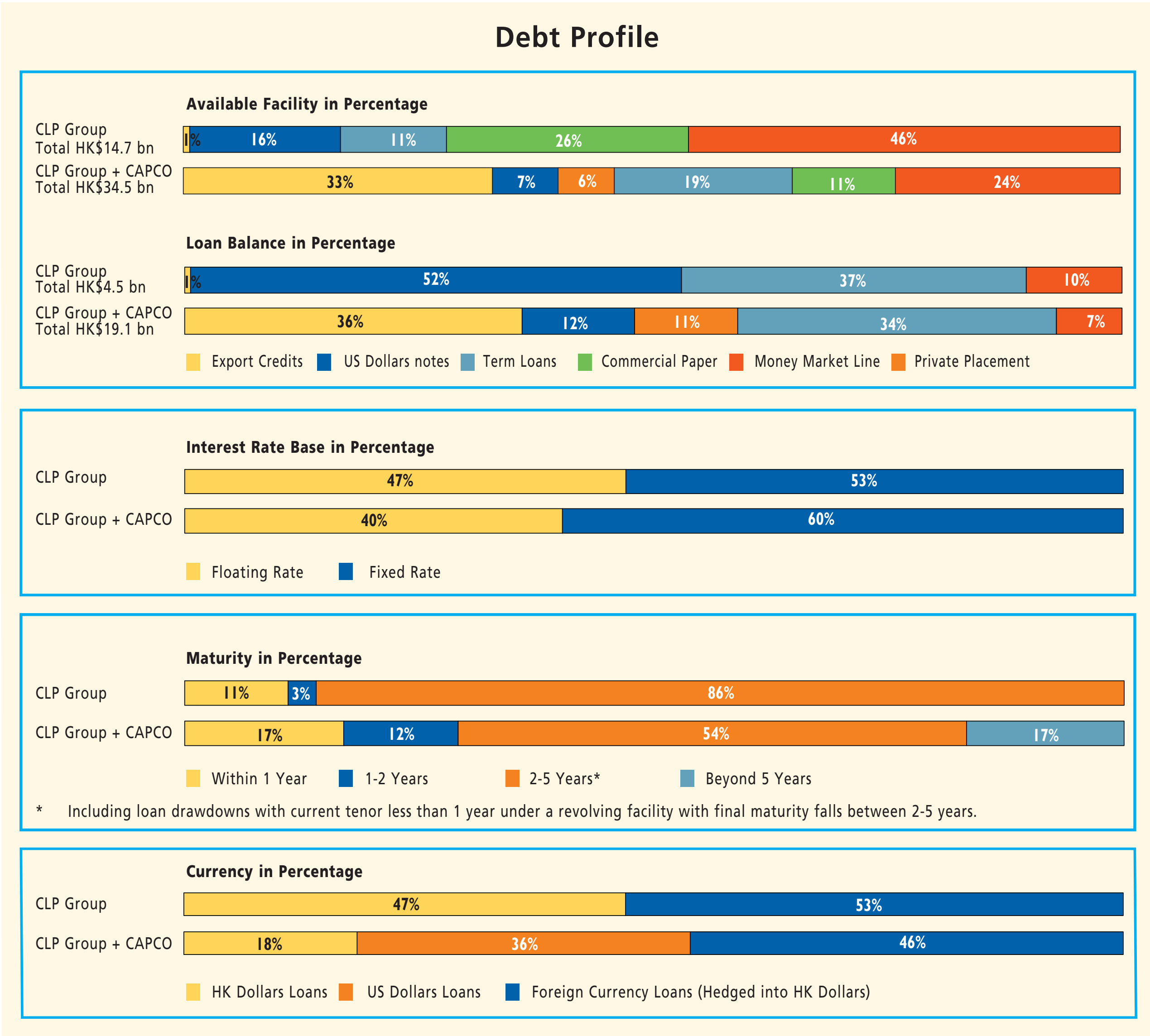
As at 30 June 2001, the Group's total debt to total capital was 11.8% and interest cover was 29 times. On a most conservative basis, i.e. including 100% of CAPCO's debt, total debt to total capital increased to 32.4% and the interest cover was still maintained at a healthy ratio of eight times.

Financing

The capital expenditure programmes of CLP Power and its associated Hong Kong generating companies are funded by bank loans, issuance of debt securities and cash flow from operations.

The Group adopts a prudent approach on financial arrangements while at the same time aiming to achieve cost efficient funding. During the first quarter of 2001, the Group has taken advantage of favourable interest rate market conditions to swap HK$1,170 million floating rate obligations, representing 50% of the USD Notes due 2006, into fixed rate. In addition, to capitalise on the low interest rate environment, the Group has taken the opportunity to arrange new financings of HK$6.5 billion equivalent for CAPCO to prepay some of its existing loans which had higher interest rates.

The charts below show the type, interest rate, maturity and currency profiles of borrowings as at 30 June 2001:



Credit Rating

In February 2001, Standard & Poor's (S&P) upgraded the long-term foreign currency rating of both CLP Holdings and CLP Power from 'A' to 'A+' after raising the long-term foreign currency sovereign rating of Hong Kong to 'A+'. At the same time, Moody's revised the outlook of the A3 long term foreign currency ratings of CLP Holdings and CLP Power from stable to positive following the change of the outlook for Hong Kong's A3 foreign currency sovereign rating to positive. The upgrading of CLP Holdings' and CLP Power's rating concurrently with Hong Kong's rating is an indication of our strong financial strength.

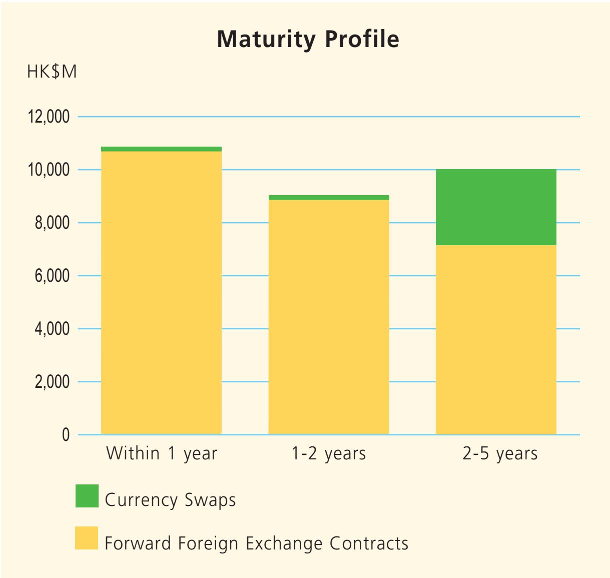
Our premier credit ratings can facilitate and enhance our position in various local and overseas business activities, including fund raising, investment and new business opportunities of the Group.

	CLP Holdings		CLP Power	
	S&P	**Moody's**	**S&P**	**Moody's**
Long-term Rating				
Foreign currency	A+	A3	A+	A3
Local currency	A+	Aa2	A+	Aa1
Outlook	Stable	Positive	Stable	Positive
Short-term Rating				
Foreign currency	A-1	P-1	A-1	P-1
Local currency	A-1	–	A-1	–

Off-Balance Sheet Financial Instruments

The Group uses forward foreign exchange contracts and currency swaps to manage its foreign currency exposure with an objective to minimise the impact of exchange rate fluctuation on earnings and tariff charges to customers. Foreign currency exposures are mainly obligations related to loan repayments and purchases of goods and services. The Group's policy is to hedge only existing quantifiable transactions, and speculation is strictly prohibited. All hedging transactions are with counterparties with acceptable credit ratings. A limit is assigned to each counterparty for monitoring the credit exposure.

The Group has taken opportunities to purchase forward US dollars to hedge the Group's US dollar exposure on other loan interest/repayments, fuel-related payments and other projected expenditures. As at 30 June 2001, the Group had outstanding forward foreign exchange contracts and currency swaps amounting to HK$29.9 billion (at 31 December 2000: HK$30.3 billion). US dollar forward foreign exchange contracts and currency swaps accounted for about 99% of them. Fair values for these off-balance sheet financial instruments, which represent the amount we would receive to close out the transactions at 30 June 2001, were HK$86 million. The maturity profile of the outstanding forward foreign exchange contracts and currency swaps is shown in the chart below:



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