



ENERGISING Hong Kong for a brighter future

MAINTAINING reliable power night and day

AIMING for even higher service standards

ENCOURAGING our talented people to excel

FULFILLING our responsibilities to the community

BROADENING our view of the world

Chairman's Message

2003 was an extremely challenging year for our business in Hong Kong. The Severe Acute Respiratory Syndrome (SARS) epidemic had a major negative impact on Hong Kong's economy, our local business, and the livelihood of our customers and this resulted in much lower than expected unit sales growth. In addition, earnings were also adversely affected by an increase in tax charges due to an increase in tax rates and a substantial one-off provision for deferred tax. These adverse factors, neither of which was foreseen when it was decided to freeze tariffs for 2003, were partially offset by our continued success in controlling costs, and improving productivity; combined with strong growth in our Australian operations where increased sales and significant improvements in productivity resulted in earnings above expectations. For the eighth consecutive year we delivered on our core commitment to provide an efficient electricity supply which at 99.999% reliability is among the most reliable in the world.

Results

The Group's audited consolidated net profit after tax for the year ended 31st December 2003 was HK\$6,057 million (2002:HK\$6,624 million), including profits from the Group's overseas activities of HK\$437 million (2002:HK\$335 million).

Final Dividend

The Directors will recommend a final dividend of HK\$1.13 per share. This, together with the interim dividend of 58 cents per share, will give a total dividend of HK\$1.71 per share for the year (2002: HK\$1.71).

Hong Kong Operations

The outbreak of SARS in March seriously affected many of our customers, particularly those in the retail, restaurant, hotel and business services sectors.

As economic activity stalled, consumption of electricity was naturally affected and normal levels of consumption were not resumed until July/August. As a result, maximum demand remained almost the same at 2,440 MW (2002: 2,436 MW), and unit sales of electricity for 2003 were only 0.4% above that of 2002, but below our forecast. Consequently, profits earned were below the permitted level specified in the Scheme of Control Agreement.

The other significant factor affecting earnings in 2003 was an increase in tax charges and provisions resulting from the introduction of the new Statement of Standard Accounting Practice on Income Taxes and an increase in tax rates. This resulted in HK\$94 million more current tax and a one-off provision for deferred tax of HK\$431 million.

At the onset of the SARS epidemic, the Company took immediate precautions to protect the health and safety of our staff and contractors. A SARS Contingency Committee was set up and key employee groups were segregated into two teams to minimise the risk and impact of infection. We also introduced a Remote System Control Centre as a backup to ensure that electricity would continue to be despatched to customers in the most reliable and efficient manner.

Following a series of blackouts around the world causing major disruption and huge financial loss, the Company went to considerable lengths to understand their causes and to review our reliability practices in light of the findings. Against this backdrop, the Company remains fully committed to the provision of a world-class, reliable and cost-effective power supply to support the growth and vitality of Hong Kong.

Supply reliability of 99.999% in 2003 was achieved for the eighth consecutive year. Customers responded to this achievement and to our fulfillment of our 18 demanding service pledges by issuing a record number of unsolicited commendations.

As part of the Company's ongoing development of the transmission and distribution network, the first 22 kV distribution substation was commissioned at Cyberport in January and 63 new distribution substations were added, bringing the total number in service to 3,531.

Site formation work and piling for the first 300 MW power unit was substantially completed at the Lamma Power Station extension. However, the commissioning of this first unit will be deferred by one year to 2006 due to the lower than expected maximum demand growth. As natural gas will be the fuel for the future power units, a long term gas supply contract was signed in Beijing in March 2003 for the supply of natural gas from the Guangdong LNG terminal.

The Company's safety performance in 2003 surpassed all previous records. At the end of the year, annual safety audits were conducted on the safety management system of both the Generation Division and Transmission and Distribution Division and both were found to be highly effective.

During the year, the Company carried forward its ongoing commitment to environmental responsibility. We increased our use of wastewater and rainwater to reduce our consumption of mains water. We have agreed with Government to build a 600 kW wind turbine on Lamma Island, the first commercial scale wind turbine in Hong Kong. The project aims to explore the wider application of wind energy in Hong Kong. We launched a high-profile campaign to promote energy efficiency, targeting secondary school students.

The 2003 Interim Review of the Scheme of Control Agreement was conducted during the year with Government. While some minor changes were agreed, these will not have any material effect on the Company.

Overseas Business

Our operations in Australia continue to grow strongly. The contribution to the Group from ETSA Utilities, Powercor, and CitiPower (acquired in August 2002), all owned in equal partnership with Cheung Kong Infrastructure Holdings Limited, has increased by 30% over last year. We added to our customer base of over 1.6 million, which makes us the largest distributor of electricity in Australia in terms of customers.

Shareholders in Ratchaburi Power Company Limited (formerly Union Power Development Company), which has entered into a Power Purchase Agreement with the Thai Government to construct and operate a 1,400 MW power station, have endorsed the change of fuel from coal to gas. Formal approval to proceed was granted at

Chairman's Message

the end of February 2004. Under the Power Purchase Agreement, the Electricity Generating Authority of Thailand is obligated to purchase the entire output of the power station for 25 years under a cost-matching tariff structure indexed to the U.S. dollar which offers a secure return. Following a reorganization of shareholdings, the Group will have a 25% interest in this project.

Associated Technical Services Limited, a wholly-owned subsidiary of Hongkong Electric Holdings Limited, secured two new consultancy projects in Vietnam and Thailand to complement ongoing projects in Australia, Philippines and Turkey.

Outlook

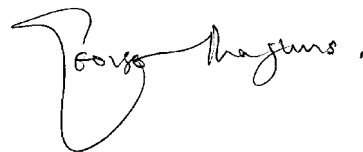
The difficult, depressing and unexpected circumstances of SARS in 2003 resulted in the Group reporting lower profits.

However, the current prospects for a more buoyant 2004 should help Hong Kong regain its footing on the path of sustained economic growth. The Group has shown its commitment to assisting in this recovery process by continuing to freeze basic tariff for 2004, and the Board considers this short term sacrifice to be in the long term interest of its shareholders. Increasing demand growth resulting from Hong Kong's economic recovery, combined with the restoration of the tariff adjustments allowed under the legally binding Scheme of Control Agreement should enable the Group to return to the path of solid profit growth in the years ahead. In addition, the recent substantial increase in coal prices and freight charges, where market prices have more than doubled, will have to be reflected in the tariff through the agreed fuel cost adjustment mechanism.

In Hong Kong, the Company continues to improve productivity and to re-assess all aspects of its operations in order that our customers will benefit from all possible cost savings. The Company also has sufficient flexibility within its capital expenditure programmes to ensure that its asset base expands only as necessary to match economic and market circumstances. This is in line with our obligation to provide reliable electricity to satisfy current and future demand at the lowest cost to the consumer compatible with the terms of the Scheme of Control Agreement with Government.

Profit diversification continues to be an important Group strategy, and the Group's strong financial position supports the ongoing worldwide search for suitable investment opportunities offering an acceptable return relative to the risks involved.

I wish to thank our Directors and employees for their dedication, cooperation and hard work. It is this ardent commitment that helps maintain the loyalty and confidence of both our customers and investors.



George C. Magnus

Chairman

Hong Kong, 4th March 2004