Electricity Business in the Asia-Pacific Region

Business Environment and Challenges (Regional)

The opportunities in coming years for CLP to increase its presence in the power industry in the Asia-Pacific region will be heightened by:

- the continued withdrawal of international competitors;
- the strong economic growth in the region that is creating opportunities for greenfield projects; and
- renewed interest by some governments in privatising their electricity sectors, wholly or in part.

but tempered by:

- the need for a cautious attitude to investment risk, given the long-term, capital-intensive nature of the power business; and
- the slow pace of privatisation and market reform, since this is subject to political events and may often face strong opposition from entrenched state-managed power utilities.

CLP's overall objectives for this business stream will include:

- completing the consolidation into the CLP Group of its existing investments, particularly those in India and Australia which are now wholly-owned;
- reviewing opportunities to expand our generation presence into retail operations, where the relevant regulatory framework permits, thereby providing our businesses with direct access to customers;
- exploring new greenfield project opportunities that would supply power at affordable off-take prices, in areas where there is adequate demand and where CLP would be able to apply the maximum scope of its power industry experience;
- exploring possible acquisitions when, in particular, remaining international competitors leave the region;
- rationalising total operating cost, with a progressive increase in localised management; and
- strengthening our network of partnerships. In addition to local partners at project level, we will consider strategic partnering at a regional or business unit level.

The goal for our activities in the Asia-Pacific region remains to build self-sustaining local businesses in our target markets. To do this, we aim to have the ability to access local capital markets to sustain growth, thereby capping CLP's commitments and exposure, while maintaining control of our assets.

The electricity markets across the region have very differing and individual characteristics. In the following sections we consider each of those markets in which we are currently engaged.

Business Environment and Challenges (By Country)

Thailand

In our Annual Report 2003, we reported that the Thai electricity sector was going through a period of change. The state-owned EGAT was preparing for an IPO and the Thai government had approved a regulatory regime which would establish an independent electricity sector regulator who would be responsible for tariff setting as well as the awards of new projects. However, the privatisation of EGAT and, in turn, the broader market reform, did not take place. Although, following the elections in February 2005, the Thai Government has reaffirmed its intention to proceed with this, the timing remains uncertain.

This uncertainty surrounding the future direction of the Thai electricity sector has made it difficult for CLP to define a strategy for its existing investments in Thailand (our shareholding in EGCO and interest in the BLCP greenfield project) and the manner in which we might want to build on these investments. Nevertheless, the high demand growth which is underway in Thailand and the future greenfield opportunities that will be required, continue to make this an interesting market for CLP.

There are indications from EGAT and the Ministry of Energy that a further solicitation for independent power producers (IPPs) will be conducted in 2005. EGCO would be well-placed to compete in this tender given the low cost expansion potential at its main Rayong and Khanom sites.

We regard our partnership with Banpu as positive and productive, as demonstrated by the excellent progress on the BLCP project. The underlying economics of BLCP are strong and we expect that it will prove to be a valuable investment in the Asia-Pacific region.

Australia

Foreign investors have withdrawn and continue to withdraw from the Australian power sector, mostly due to business and financial challenges in their home markets. This has been the case with a number of leading players in the international power industry, such as TXU, CMS, Duke, Edison Mission and Intergen. There has been considerable merger activity and consolidation of the deregulated generation and retail electricity markets under fewer, larger operators. There has been a trend towards further vertical integration with major retail operators taking positions in base load generation, and horizontal integration as existing generators purchase additional generating capacity. However, there is some regulatory concern about such integration on the part of the Australian Competition and Consumer Commission (ACCC).

In the meantime, wholesale prices in the National Electricity Market remain below a level that most operators believe to be sustainable in the long term. Rational market behaviour would suggest there should be limited new investment by all generators until the balance between supply and demand is restored and market prices rise to new entrant levels. However, the Australian market is not perfect, with a mixture of private and government ownership, and limited interconnection between market nodes.

2005

In 2005, our objectives in Thailand will be to:

- manage the construction of the BLCP project effectively, within budget and towards the planned commercial operation dates in 2006 and 2007;
- build an organisation able to take over operation of the BLCP plant and apply our industry knowledge to achieve best practice standards;
- continue to participate actively on the EGCO Board and its subcommittees to exercise a positive role in the direction of EGCO affairs and, in doing so, to create value for CLP as a major shareholder;
- support EGCO in taking the longstanding development of the Nam Theun 2 hydro project to financial close and start of construction; and
- enhance our relationship with EGAT, which irrespective of whether and when any privatisation occurs, is likely to remain the major generator in Thailand.

Beyond 2005

We will continue to monitor moves by the Thai government to privatise EGAT. CLP's position as a major international investor in the Thai power sector, together with the extent of our operations and relationships through EGCO and BLCP, position us well for any changes in the underlying structure of the industry.

If CLP's investments and relationships do develop favourably, and the business environment is positive, we will be keen to take advantage of opportunities to participate in the future expansion of generating capacity in Thailand and possibly in the wider Mekong delta region.

Although the performance of our existing asset, Yallourn Energy, was generally satisfactory in 2004, we aim to improve its operating and economic performance further. In 2005 we aim to:

- complete the acquisition of Singapore Power's merchant energy business and start integrating this with Yallourn Energy;
- refinance Yallourn Energy, so it is placed on a long-term sustainable financial footing;
- reduce operating costs and review capital expenditure for long-term operating integrity; and
- manage effectively the remaining work on the upgrade of the station's instrumentation and control systems.

Combining Singapore Power's merchant energy business with Yallourn Energy will create a diversified energy business, with substantial generation and retail activities. This will be a strong platform for growth, in particular in the retail sector, as well as offering possibilities in gas-fired and renewables generation.

The integrated business will mitigate the risk of market volatility and offer opportunities for increased and more stable earnings, thereby creating a self-financing portfolio with stand-alone financial strength and the longer-term potential to create shareholder value through an IPO on the Australian market.

Business Environment and Challenges (By Country)

Taiwan

Growth in electricity demand in Taiwan is expected to remain modest. At present, the Taiwan government has shown no signs of initiating a further round of IPP solicitation. However, a requirement for new generating capacity may emerge by 2010 or earlier, whereupon there may be opportunities for new investment in the Taiwanese generating sector. Market reform and the privatisation of state-owned Taipower remain on hold and acquisition opportunities for private sector investors such as CLP are therefore limited. On the other hand, there is a stable environment for existing investors under the PPA terms established with Taipower as the off-taker.

The surge in international coal prices affected earnings from CLP's investment in Ho-Ping in 2004. These adverse effects are expected to extend into 2005, before the lagged adjustment mechanism in the power purchase agreement with Taipower begins to operate to allow partial recovery of increased fuel costs.

India

In our Annual Report 2003, we explained that CLP's continued presence in India would 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 viability of external investment in the Indian power industry; and
- development of suitable local partnerships for future investment opportunities.

The outlook for the first two of these criteria appears more positive in the light of developments during 2004. The third, relating to local partnerships, still requires progress.

There have been positive trends in the development of the Indian power sector with strong underlying economic growth as well as moves by the Federal government to create a clear regulatory framework for private power development. The Electricity Act 2003 has opened up the opportunity for power plant developers to sell electricity to a range of potential purchasers across the country, thereby removing the historical risk of selling to a single power purchaser whose credit position was variable and subject to manipulation by political pressure. In addition, we are seeing the start of a movement by some states to privatise distribution circles.

Reforms have also been taking place in some states to improve the weak financial position of the state electricity boards. Overall, there has been a gradual improvement in the ability of those boards to meet their off-take obligations, even though fully sustainable measures to resolve receivables collections are not yet complete.

These broader regulatory and business trends have been reflected at GPEC itself, with an improvement in the receivables position and, in consequence, in the overall performance of that investment.

2005

In 2005, we intend to:

- continue to overcome the residual technical issues with the Ho-Ping equipment and thereby reduce the incidence of unit trips;
- resolve the commercial consequences of the coal dome failure and start the rebuild; and
- continue feasibility studies, so that we are ready for any opportunities for a future expansion at the Ho-Ping site.

Beyond 2005

Our strong relationship with Taiwan Cement, our joint venture partner at Ho-Ping, and the experience we have gained in constructing, commissioning and operating power generation facilities in Taiwan, mean that CLP is well placed to explore opportunities for acquisitions or greenfield projects.

In particular, as and when the Taiwan government does offer the private sector the opportunity to provide new generating capacity, Ho-Ping will be a strong competitor given its geographic location, expansion capability and position as one of the few base load coal generation sites in Taiwan.

In 2005, CLP will be looking to:

- continue the effective management of the receivables situation at GPEC;
- consider a possible selldown of part of our stake in GPEC with the funds being re-invested in GPEC II (a potential 1,050MW of additional gas-fired capacity) or other new projects. Our focus will be on any such projects being located in pro-reform states with stronger electricity boards and the possibility of direct access to creditworthy retailers; and
- continue to look for suitable local partners with regard to new opportunities in selected states.

Growth in electricity demand is expected to remain strong in India with continuing shortages in supply. India has an installed generating capacity which is only one-third of that in the Chinese mainland, to serve a population which is only marginally lower.

The need to satisfy the population's demand for electricity, and the massive capital investment which this would require, should promote political support for private sector participation in the electricity generating industry and the creation of a legal and market framework which encourages such investments.

Whilst it is still too early to judge, the move towards deregulation and reform, coupled with strong economic growth trends in India, suggests an encouraging future for our business in India, where we remain the single largest international investor in the power sector.