Chairman's Statement

The CLP Group's continuing good performance in 2005 provides a strong platform from which to tackle the important challenges of the year ahead.

The Hon. Sir Michael Kadoorie

Dear Shareholders,

On behalf of your Board, I am pleased to report that, during the year to 31 December 2005, CLP achieved a good financial and operating performance. There was continuing strong focus on creating and delivering value to our shareholders. We made determined efforts to promote a fair regulatory regime for our Hong Kong electricity business after 2008, to diversify our activities in the region and to further improve the management of the environmental aspects of our operations.

In this Chairman's Statement, I wish to say a little more about each of these four aspects of CLP's performance in 2005.

Year 2005 Financial Results

In 2005, the operating earnings of the Group increased by 10.4% to HK$9,097 million, reflecting an increased contribution from all of our main business streams.

Earnings from our Hong Kong electricity business increased by 3.8% to HK$7,047 million (2004: HK$6,788 million) as a result of ongoing investment in the transmission and distribution network, as well as investment in generation facilities by Castle Peak Power Company Limited (CAPCO), our jointly controlled entity.

Operating earnings from our Asia-Pacific energy/other businesses recorded an encouraging increase, from HK$1,671 million in 2004 to HK$2,339 million. The major contributions to this increase came from GPEC, India and our integrated electricity and gas business in Australia, following the acquisition of the merchant energy business (MEB) from Singapore Power in mid-2005. In addition to the contribution to the operating earnings, our Australian business also recognised a tax consolidation benefit amounting to HK$2,004 million. However, it should be noted that this is a one-off benefit and is a non-cash item until the tax benefit is utilised in the future.

Total earnings, inclusive of the above operating earnings, the tax consolidation benefit and a profit of HK$267 million from the sale of remaining units of Hok Un redevelopment were HK$11,368 million, an increase of 32.0% as compared to HK$8,614 million in 2004. Operating earnings per share and total earnings per share increased by 10.4% to HK$3.78 (2004: HK$3.42) per share and 32.0% to HK$4.72 (2004: HK$3.58) per share respectively, as compared with the previous year.

left Meeting with Mr. Li Xiaopeng,
President of China Huaneng Group, in Beijing
right "Safety Walk" at Shenzhen Depot, Guangdong

The Board has recommended a final dividend for 2005 of HK$0.83 per share and a special final dividend of HK$0.11 per share paid out of the profit from Hok Un redevelopment. These final dividends, together with three interim dividends, each of HK$0.48 per share, result in a total dividend of HK$2.38, as compared to HK$2.23 per share for 2004.

Hong Kong Electricity Business – Post-2008 Regulatory Regime

The earnings from our Hong Kong electricity business continue to represent by far the largest part of the CLP Group's total earnings. In 2005, the Hong Kong business contributed 75% of the Group's operating earnings before deduction of unallocated expenses. Hong Kong also remains the primary focus of our investments, with 53% of the Group's total assets being located within the Special Administrative Region.

Shareholders will recall that, since 1964, this business has been regulated by the Hong Kong Government under a Scheme of Control (SoC) which has remained largely unchanged over that period. Shareholders will also recall that the SoC expires in 2008 and that, in January 2005 Government launched a process of public consultation on the future regulation of Hong Kong's electricity industry. This consultation has been in two phases – the first, which ended in April 2005, solicited the public's views on options for the future development of Hong Kong's electricity market after 2008, whilst the second phase, initiated in December 2005, consults the public on the Government's proposals for the post-2008 regulatory framework.

The strength of Hong Kong's power system did not happen by chance. For example the major reduction of emissions by 40 – 70% since the 90s was largely the result of the introduction of natural gas and nuclear power into the power generation system – initiatives which required heavy investment and significant commitments. At the same time, working responsibly under the SoC, CLP delivers electricity to our customers at tariffs which are amongst the lowest of major metropolitan cities around the world, and our supply reliability – at over 99.99% – is world-class, well above many major cities whose utilities charge higher tariffs. This represents a good deal for our customers – world-class reliability and world-class environmental standards at moderate prices. These achievements were made possible by clear rules under the current regulatory regime, including a reasonable return that supports investment in new environmental facilities and technologies, and a tariff structure that is established on the basis of recovering the costs of providing the electricity supply system, a method which has served the highly urbanised and commercial environment of Hong Kong extremely well over the past 40 years.

The shape of the post-2008 electricity regulatory regime is therefore a matter of the greatest importance for CLP, its shareholders and for the Hong Kong community as a whole. We have been an engaged, informed and authoritative participant in the public discussions todate – as I have already reported to shareholders through my Chairman's Statement to last year's Annual Report, the Interim Report and my letters to shareholders of 1 February and 9 May 2005. CLP's response to Stage I of Government's consultation, "A Balanced Deal – A Bright Future" was submitted to Government in April. In this, we emphasised that the keys to the excellence of Hong Kong's electricity supply were found in a regulatory system which delivers practicality, service excellence, and a fair deal for investors, as well as clear accountability and responsibility.

Government's summary of the views received in response to Stage I of its consultation made it clear that the majority of those who had responded considered reliability and the safety of electricity supply to be the most important objectives of the future regulation of Hong Kong's electricity sector – in line with the views which CLP had already expressed. We were also encouraged that most respondents considered our electricity tariffs to be both reasonable and affordable, as is indeed the case.

I believe that there is clear consensus in the community around Government's policy objectives for its review of the regulatory regime – reliable, safe, efficient and environmentally responsible energy, supplied at reasonable prices. I believe there is also consensus that the future development of Hong Kong's electricity sector should be built around a forward-looking, stable and straightforward regulatory regime, in order to deliver these policy objectives.

Government's Stage II consultation paper has set out its views on the way ahead. CLP supports Government's policy objectives and many of the initiatives proposed in the paper. However, there are areas of the consultation paper where we have strong reservations and concerns. I consider that the paper overlooks the quality of Hong Kong's present electricity service, which is demonstrably world-class in terms of reliability, cost-effectiveness, affordability, customer service and environmental performance – and the role played by the SoC in promoting this achievement.

I wish to highlight three areas of major concern.

Appropriate incentives to encourage investment – no other private sector industry in Hong Kong matches the scale of the demands of the electricity sector for continuous, substantial and long-term investment. We have grave concerns about the return levels proposed in the consultation paper. These fail to recognise the fundamental nature of the industry and the level of risks undertaken by the power companies. If returns are not set at an appropriate level, the public will end up bearing the risks of insufficient investment – a costly social and economic consequence, which will take years to correct.

Duration of the regime – the electricity industry involves long investment cycles with asset lives running for over 30 years and long-term fuel purchase commitments extending well over 20 years. The minimum duration for the new electricity regime should be 15 years, as with the present SoC – properly reflecting the long lead-times, scale and lifespan of investments in the electricity industry, as well as the risks associated with the management of external factors such as fuel market volatility.

A clear energy policy with consistent environmental regulations – the proposals for the new regime need to have a clear energy policy to facilitate and support long-term fuel planning to meet both emissions and fuel security requirements in future. The consultation paper creates great uncertainty by envisaging lower returns for investments which reduce emissions levels, whilst at the same time seriously tightening emissions standards with added but unspecified penalties. Similarly, the Government's proposals indicate an intention to open up the electricity market in some fashion in the future; the vagueness of the proposals on competition policy for the electricity sector is another area that creates an uncertain climate for necessary future investment.

CLP has been serving our customers in Kowloon and the New Territories for over a century. The current SoC, which has enabled tight and effective Government and public scrutiny of our business for over 40 years, has provided the industry with a clear regulatory framework, under which we have consistently achieved excellence in the delivery of an essential public service and provided Hong Kong with the power to prosper as a world city in Asia. We welcome the Stage II consultation process and will continue to be an active, forthright and constructive participant in the debate on the future of our industry. It remains our intention to work with Government and the public to address our major concerns, with a view to promoting a fair, balanced and

left Greeting fellow Directors at the 2005 Annual General Meeting
right Visit to GPEC, India

durable regulatory regime which allows us to fulfill our mission of providing our community with an electricity supply of the quality which it expects, needs and deserves.

Australia

Shareholders will be aware that, in light of uncertainties about the future electricity regulatory regime in Hong Kong, together with the growing maturity of the Hong Kong electricity market, as evidenced by the slow-down in electricity demand growth, we have been taking steps to diversify the sources of the CLP Group's earnings. The acquisition in May 2005 of the MEB in Australia was a major step forward in this regard.

Coupled with CLP's existing Yallourn Power Station, CLP is now on the way towards building a diversified and integrated energy business in Australia, focusing on electricity and gas retail, with a portfolio of physical assets in support of that retail business.

This Annual Report explains the considerable progress that has been achieved in integrating the MEB with our existing business at Yallourn and in introducing to that business the standards of operational excellence, financial control and corporate values of the CLP Group as a whole.

This business, which has been rebranded as "TRUenergy" combines a diversified and balanced electricity generation capacity with a retail business which constitutes one of the largest energy retailers in Australia. TRUenergy has already started to contribute to the Group's operating earnings – the Board and I will be paying close attention to the ongoing and effective management of our activities in Australia, so that these can make a sustained and meaningful contribution to our earnings in the years ahead.

Environment

We are well aware of the importance of the effective management of the environmental impact of our activities. This is our duty as a socially responsible company. Moreover, the long-term viability and success of CLP, and its ability to continue to create value for shareholders and the communities we serve, depend upon us conducting our activities in a manner which is environmentally sustainable.

2005 saw significant progress made by the CLP Group in environmental matters. Further details of these are set out in our Social and Environmental Report. I will therefore only briefly mention here a few of the highlights of our environmental performance in 2005 and plans for future years. SER

- Our programme to improve the emissions performance of our coal-fired power generation plant in Hong Kong is well underway. As each unit is progressively installed with emissions control facilities from 2009 onwards, emissions of SO_2 and NO_X will be reduced by about 90% and 80% respectively, while emissions of particulates (of which more than 99% are already captured) will also be further reduced. In line with my earlier comments, it is essential that this improved environmental performance is properly recognised in both the post-2008 regulatory regime and the future emissions regulation of our business.

- Our work to develop the infrastructure needed to bring liquefied natural gas to Hong Kong for electricity generation is moving ahead. With timely support from Government and the community, Hong Kong will have the capability to continue to use this clean fuel source by early next decade.
- We have adopted a climate strategy framework – reflecting the importance to a responsible electricity generator, such as CLP, of contributing to addressing issues of greenhouse gas emissions and resulting implications in terms of global climate change.
- We have made significant progress towards our target of developing generating capacity from renewable energy sources, such that by 2010 this will represent approximately 5% of the Group's total generating capacity. In 2005, we added an additional 114 equity MW of small renewable energy generation to our portfolio – meaning that this now represents 1.4% of our generating capacity. The partnership established in 2005 with Hydro Tasmania in our Roaring 40s joint venture will provide an excellent platform for further development of renewable energy opportunities in the region.

We will continue to manage responsibly our operations and their impact on air quality and global climate. We will make good on the commitments that we made to our shareholders and other stakeholders in our "Manifesto on Air Quality and Climate Change" which we issued in December 2004 and which continues to guide our actions in this area.

The Board and I believe that 2006 is an extremely important and challenging year for the Company – whether in terms of the shaping of the future electricity regulatory regime in Hong Kong, the effective management of our assets elsewhere, notably the continuing integration and enhancement of our TRUenergy business in Australia, or in meeting the expectations of society for the responsible management of the environmental aspects of our business. I am confident that the skill and dedication of our staff, the strong support of our shareholders, and the goodwill that we have earned in the communities we serve, provide a solid base from which we can tackle these challenges effectively, and secure the continuing long-term success of your Company.

The Hon. Sir Michael Kadoorie
Hong Kong, 28 February 2006

Chairing the
2005 Annual General
Meeting