Financial Results Review

Appreciable earnings growth in 2005.

The financial statements for the year ended 31 December 2005 incorporate the following two significant changes from the corresponding period in 2004:

1. the adoption of a number of new and revised Hong Kong Financial Reporting Standards (HKFRSs) and Hong Kong Accounting Standards (HKASs) (collectively referred to as new HKFRSs) issued by the Hong Kong Institute of Certified Public Accountants which become effective for accounting periods beginning on or after 1 January 2005; and
2. the consolidation of (a) the MEB in Australia following the completion of the acquisition of a 100% interest in the energy retail and generation business in May 2005 and a 33⅓% interest in SEAGas partnership in August 2005 and (b) the Huaiji hydro power project in the Chinese mainland after a shareholding restructuring in November 2005.

The adoption of the new HKFRSs does not have a material impact on our earnings, but requires changes to the presentation of the profit and loss account as well as changes in accounting policies relating to leasehold land, financial instruments and business combinations. Details are discussed in Note 2(A) to the Accounts.

We acquired the MEB from Singapore Power for a cash consideration of HK$13,013 million. The acquisition was funded from internal resources as well as new financing facilities which are discussed further in the "Funding/ Financing" section. We also increased our shareholding in the Huaiji hydro power project from 41.5% to 75.0% by first acquiring the interest held by Sun Hung Kai China Development Fund Limited for HK$53 million and then undertaking a shareholding restructuring scheme. These entities were consolidated into our Group accounts effective from the date we acquired control. The consolidation gave rise to a significant increase in a number of profit and loss and balance sheet items, which are described in more detail under the "Consolidated Financial Results" and "Group's Financial Position" below.

Consolidated Financial Results

The financial results for 2005 reflected steady growth of our electricity business in Hong Kong and continuous expansion of our energy businesses elsewhere. The Group achieved appreciable earnings growth in 2005 with total earnings increasing by 32.0% to HK$11,368 million (2004: HK$8,614 million) and operating earnings (i.e. earnings excluding Hok Un redevelopment profit and a one-time tax consolidation benefit from Australia) increasing by 10.4% to HK$9,097 million, compared to HK$8,241 million in 2004.

Revenue and Expenses

The analysis of the Group revenue and expenses is as follows:

	2005			2004		
	TRUenergy, GPEC and Huaiji HK$M	Hong Kong Operations and Others HK$M	Total HK$M	Yallourn and GPEC HK$M	Hong Kong Operations and Others HK$M	Total HK$M
Revenue	10,031	28,553	38,584	3,813	26,928	30,741
Expenses						
Purchases of electricity, gas and distribution services	4,499	17,017	21,516	–	16,055	16,055
Staff expenses	511	994	1,505	216	1,068	1,284
Fuel and other operating costs	2,790	1,182	3,972	1,742	1,328	3,070
Depreciation and amortisation	870	2,026	2,896	603	1,882	2,485
	8,670	21,219	29,889	2,561	20,333	22,894

Our Hong Kong electricity business continues to represent the largest part of the Group revenue and earnings. The increase in Group revenue and expenses as compared to 2004 was mainly attributable to the consolidation of the seven-month financial results of our Australian energy business after the acquisition in May 2005.

Taxation

The Group recognised a tax charge of HK$1,082 million (2004: HK$1,296 million) and a tax consolidation benefit from Australia of HK$2,004 million during the year. The effective tax rate (excluding the share of taxation of jointly controlled entities and associated companies and the one-time tax consolidation benefit from Australia) was 15.0% compared to 19.0% in 2004. The decrease in the effective tax rate was principally due to higher tax credits from tax losses in Australia which has a higher statutory tax rate, over provision for tax from our Australian business and release of the dividend distribution tax provision from GPEC.

Our wholly-owned subsidiary, CLP Australia Holdings Pty Ltd (CLP Australia Holdings), elected to form a tax consolidated group during the year. Pursuant to Australian tax consolidation rules, CLP Australia Holdings reset the tax cost base of certain depreciable assets of its group, resulting in the adjustment of deferred tax balances and recognition of a one-time tax benefit of HK$2,004 million in 2005. The reset will result in additional tax depreciation available over the lives of the assets. This will also have the effect of deferring the utilisation of the deferred tax asset of HK$3,815 million arising from tax losses in Australia recognised by the Group. In accordance with the Group's accounting policy, the deferred tax asset will be subject to impairment review. Current financial projections indicate it is probable that future taxable profits will be available against which the unused tax losses can be utilised. However, any significant adverse change to the business environment in the future may affect the financial projections, resulting in reduced future taxable profits. Should such circumstances arise, it may be necessary for some or all of this deferred tax asset to be impaired with the impairment being charged to the profit and loss account.

Earnings Growth

Earnings per share increased by 32.0% to HK$4.72 per share when compared to 2004. Excluding Hok Un redevelopment profit of HK$267 million and the tax consolidation benefit from Australia of HK$2,004 million, earnings per share increased by 10.4% to HK$3.78 per share.

Detailed analysis of the performance of individual business streams is provided on pages 14 to 35 of this Report.

Group's Financial Position

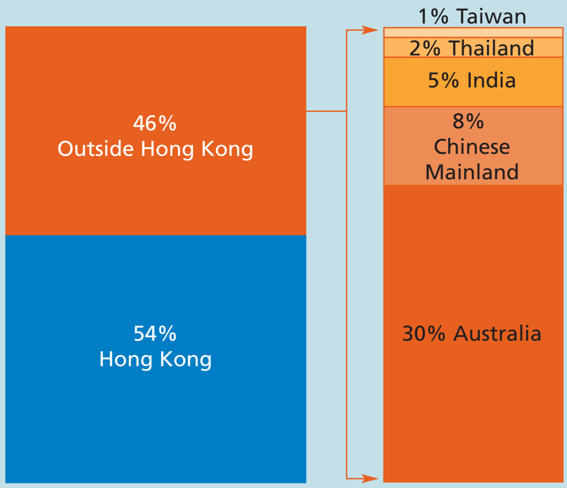
The Group's balance sheet remains strong, with major changes of individual items when compared to 2004 mainly attributable to:

(a) acquisition of the MEB, which resulted in an increase in total assets (in particular fixed assets, goodwill and other intangible assets, and trade and other receivables) and borrowings; and

(b) changes in accounting standards; the most significant impact is to recognise derivative instruments in the balance sheet starting in 2005.

The Group's total assets increased by HK$21,106 million to HK$101,905 million. Most of our assets are long-term assets and include primarily generating plants and transmission and distribution networks as well as investments in CAPCO and overseas power projects. The distribution of the Group's assets by geographical location is as follows:

Total Assets by Geographical Locations



Fixed Assets and Capital Expenditure

Fixed assets, leasehold land and land use rights as at 31 December 2005 and 2004, as well as the related capital expenditure of the Group for the year then ended, are summarised below:

	Fixed Assets[1] as at 31 December		Capital Expenditure year ended 31 December	
	2005 HK$M	2004 HK$M	**2005 HK$M**	2004 HK$M
SoC business	**45,099**	42,415	**4,849**	5,278
Asia-Pacific energy businesses	**17,840**	15,147	**786**	523
Other business activities	**110**	186	**5**	22
	63,049	57,748	**5,640**	5,823

1 This represents the total amount of property, plant and equipment, freehold and leasehold land as well as land use rights.

During the year, CLP Power Hong Kong and its jointly controlled entity CAPCO, together invested HK$6,005 million (2004: HK$6,961 million) primarily in the transmission and distribution networks as well as in customer services and other supporting facilities. In June 2005, the Hong Kong Government approved the Financial Plan for the period from January 2005 to September 2008, submitted pursuant to the SoC Agreement. The Financial Plan provides for an estimated capital expenditure of HK$23.8 billion, the majority of which will be used to enhance the transmission and distribution systems.

Of the capital expenditure incurred by overseas subsidiaries, HK$749 million (2004: HK$510 million) was for our Australian business, with major projects including the power station control system upgrade, mine development and other investments in generating facilities at Yallourn.

Capital expenditure contracted but not provided for in the accounts as at 31 December 2005 amounted to HK$2,689 million (2004: HK$2,207 million). Other than HK$358 million (2004: HK$240 million) related to overseas subsidiaries, these contracted amounts were primarily for enhancing our transmission and distribution systems in Hong Kong.

Goodwill and other Intangible Assets

We recognised goodwill of HK$6,717 million at 31 December 2005, as compared to net negative goodwill of HK$1,022 million at 31 December 2004. Except for the goodwill of HK$23 million which related to the acquisition of GPEC in 2002, the remainder arose from the acquisition of the MEB and was primarily attributable to the non-contracted customer base of the retail business and significant synergies expected through post-acquisition integration with our existing Yallourn operation.

Pursuant to HKFRS 3 "Business Combinations", the unamortised negative goodwill of HK$1,046 million as at 31 December 2004 was derecognised with adjustment to the balance of retained profits on 1 January 2005. Goodwill will no longer be amortised, but be subject to impairment review.

Other intangible assets amounted to HK$1,232 million (2004: nil), representing the contracted customers and lease arrangement under a long-term hedge agreement with Ecogen Energy Pty Ltd (Ecogen) which also arose from the acquisition of the MEB in May 2005.

Interests in Jointly Controlled Entities and Associated Companies

The Group's interests in each geographical region are summarised below:

	2005 HK$M	2004 HK$M
Energy business		
Hong Kong	6,693	6,296
Australia	1,098	–
Chinese mainland	6,888	6,643
Asia	3,036	3,101
	17,715	16,040
Electricity-related business (Hong Kong)	445	598
	18,160	16,638

In 2005, we made equity contributions totalling HK$721 million to a number of power projects, including HK$439 million and HK$236 million in cash consideration to Fangchenggang and Roaring 40s joint ventures respectively. Pursuant to the joint venture agreements entered into to develop the BLCP power project in Thailand as well as the Fangchenggang power project and Weihai and Nanao II wind projects in the Chinese mainland, we are required to make equity contributions totalling HK$1,695 million during the period 2006 to 2008.

As at 31 December 2005, our aggregate loan and advances to jointly controlled entities amounted to HK$6,865 million (2004: HK$6,681 million), including HK$6,505 million to CAPCO. CLP Power Hong Kong provides funds to CAPCO mainly in the form of shareholders' advances, which are unsecured, interest-free and have no fixed repayment terms. The increase in CLP Power Hong Kong's investment in CAPCO from HK$6,296 million to HK$6,693 million was mainly caused by the increase in advances for funding capital investments.

Deferred Tax Assets and Liabilities

The deferred tax assets of HK$2,537 million (2004: HK$1,043 million) primarily related to the temporary difference arising from tax losses in our Australian business which could be utilised in the future. As mentioned earlier, the deferred tax assets will be subject to impairment review in accordance with the Group's accounting policy.

The deferred tax liabilities increased from HK$5,084 million to HK$5,472 million during the year, mainly due to the temporary difference caused by accelerated tax depreciation for capital works of CLP Power Hong Kong.

Derivative Instruments

The Group uses different derivative instruments to manage its exposure to foreign currency, interest rate risks and price risks associated with the sales and purchases of electricity in Australia, with an objective to minimise the impact of exchange rate, interest rate and electricity price fluctuations on earnings, reserves and tariff charges to customers and shareholders. Other than certain electricity trading activities engaged by subsidiaries of CLP Australia Holdings, all derivative instruments are employed solely for hedging purposes.

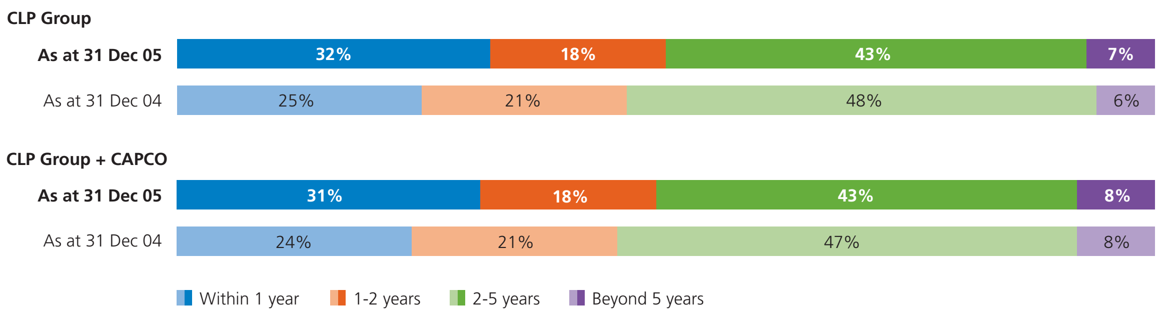
As at 31 December 2005, we had gross outstanding derivative instruments amounting to HK$69.6 billion (HK$73.9 billion for the Group and CAPCO combined). The fair value of the Group's outstanding derivative instruments as at 31 December 2005 was a deficit of HK$16 million (HK$9 million surplus for the Group and CAPCO combined), which represents the net amount we would pay if these contracts were closed out at 31 December 2005. The significant change in fair value from a net deficit of HK$1,199 million as at 31 December 2004 was primarily attributed to the strengthening of the U.S. dollar in the forward currency markets in 2005.

With the adoption of HKAS 39 "Financial Instruments: Recognition and Measurement" in 2005, all derivatives are required to be recognised in the balance sheet at their fair value. The fair value of derivatives as at 31 December 2004 has been recognised as assets or liabilities on 1 January 2005. Subsequent changes in fair value of the derivatives will have no impact on the Group's cash flow until settlement, as these are non-cash items. The breakdown by types and maturity profile of the Group's derivative instruments is shown in the charts below:

	Notional Amount		Fair Value Gain/(Loss)[1]	
	2005 HK$M	2004 HK$M	2005 HK$M	2004 HK$M
CLP Group				
Forward Foreign Exchange	42,828	44,961	(311)	(1,192)
Interest Rate Swaps	9,693	16,295	(48)	(358)
Currency Swaps	4,680	4,680	125	255
Renewable Energy Certificates	100	–	13	–
Energy Hedging & Trading Caps & Options	878	48	134	–
Energy Hedging & Trading Swaps	11,469	2,330	71	96
	69,648	68,314	(16)	(1,199)
CAPCO				
Interest Rate Swaps	4,208	4,378	25	(253)
Total	73,856	72,692	9	(1,452)

1 The 2004 comparative figures are provided here for reference only and they are not incorporated in the consolidated accounts as HKAS 39 "Financial Instruments: Recognition and Measurement" prescribes the recognition of derivatives at fair value in the balance sheet to take effect prospectively from 1 January 2005.

Maturity Profile



Current Assets and Liabilities

As at 31 December 2005, we had liquid funds of HK$2,041 million (2004: HK$2,520 million), of which 96% were denominated in foreign currency mainly held by GPEC and TRUenergy and deposited with highly-rated international or local banks. The remainder was in Hong Kong dollars.

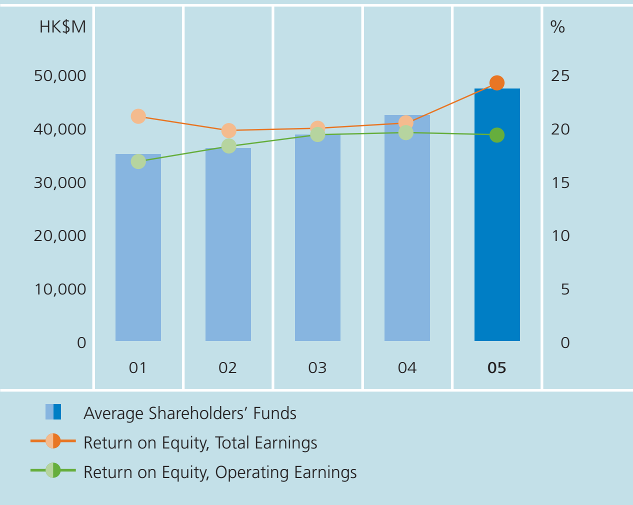
Trade and other receivables amounted to HK$5,505 million (2004: HK$3,564 million), of which HK$3,257 million (2004: HK$1,610 million) was attributed to overseas subsidiaries. The increase of HK$1,647 million was mainly due to the incorporation of receivables from the energy retail business in Australia. GPEC has obtained payment of some of its receivables from GUVNL through bill discounting with recourse and the transactions have been accounted for as collateralised borrowings.

Total current liabilities as at 31 December 2005 amounted to HK$14,405 million (2004: HK$8,916 million). The significant increase was mainly attributable to (a) reclassification of U.S. dollar Yankee notes of HK$2,340 million which will be due in April 2006, (b) recognition of derivative instruments of HK$1,134 million and (c) increase in trade and other payables of HK$1,863 million arising principally from the consolidation of the MEB. With the projected cash flow from operations and credit facilities arranged, we expect to have sufficient funds to meet these liabilities.

Shareholders' Funds

Shareholders' funds as at 31 December 2005 increased 13.5% to HK$50,159 million (2004: HK$44,199 million). The increase was mainly attributable to the retained profits of HK$5,781 million after dividend payments and an adjustment to the opening balance of retained profits of HK$1,046 million upon adoption of HKFRS 3 "Business Combinations" to derecognise negative goodwill, partly offset by the net exchange loss of HK$1,041 million relating to the translation of investments in subsidiaries and affiliated companies. We achieved a return on equity of 24.1%, or 19.3% when excluding the one-time tax consolidation benefit from Australia and Hok Un redevelopment profit.

Return on Equity



As at 31 December 2005, the distributable reserves of CLP Holdings amounted to HK$19,631 million (2004: HK$17,616 million).

A minority interest of HK$111 million represented the interest held by Huaiji County Huilian Hydro-electric (Group) Co. Ltd. in the net assets of the Huaiji hydro power project.

Borrowings

Total borrowings increased from HK$18,774 million to HK$29,391 million, with the proceeds being utilised by the Group to acquire the MEB and by CLP Power Hong Kong for investment in the supply network for enhancement of services to customers. The gearing ratio correspondingly increased from 29.8% to 36.9%. Details of the Group's borrowings are provided in the "Funding/Financing" section.

Development Fund

The Development Fund balance as at 31 December 2005 was HK$3,685 million, an increase of HK$514 million mainly resulting from the transfer from profit and loss account during the year. Its balance represented 5.2% (2004: 4.6%) of the SoC average net fixed assets of CLP Power Hong Kong and CAPCO. The Development Fund is considered as a liability of the Group and does not accrue to the benefit of shareholders.

Charges on Assets

The debts of overseas subsidiaries, which totalled HK$12,572 million as at 31 December 2005, are without recourse to CLP Holdings. Of these borrowings, HK$803 million was secured liabilities relating to the bank loans and collateralised borrowings of GPEC and/or Huaiji.

Operating Commitments

We had a number of non-cancellable operating leases with future minimum lease payments aggregated to HK$3,020 million at 31 December 2005 (2004: HK$30 million). Of this, HK$2,827 million related to a twenty-year Master Hedge Agreement between TRUenergy and Ecogen (which owns 966MW gas-fired generation facilities in Victoria). Under the Agreement, TRUenergy has the right to call upon electricity from the power stations in consideration of fixed premiums over the life of the Agreement. Other non-cancellable operating leases are for leases of various offices and equipment.

Contingent Liabilities

Under the original power purchase agreement between GPEC and its off-taker GUVNL, GUVNL was required to make a "deemed generation incentive" payment to GPEC when the plant availability was above 68.5% (70% as revised subsequently). GUVNL has been making such payments since December 1997. In September 2005, GUVNL filed a petition before the Gujarat Electricity Regulatory Commission claiming that the "deemed generation incentive" payment should not be paid for the period when the plant was using naphtha as fuel instead of gas. GUVNL's contention is based on a 1995 Government of India notification which disallowed "deemed generation incentive" for naphtha based power plants. The total amount of the claim plus interest amounts to about HK$1,250 million. On the basis of legal advice that has been sought, this claim is disclosed as a contingent liability in our consolidated accounts.