

# chairman's statement

The results of the Group for 2005 were mixed. In Hong Kong, the earnings from our Hong Kong operations were HK\$5,508 million compared with HK\$5,521 million in 2004. On the other hand, our strategy of investing internationally so as to decrease our reliance on Hong Kong earnings produced excellent results in 2005, with earnings of HK\$3,054 million compared to HK\$735 million in 2004.

This was the third year in succession that the electric utility in Hong Kong has not earned its permitted return under the scheme of control under which it operates. For 2005, the shortfall in permitted return together with the special subsidy paid to customers amounted to approximately HK\$1 billion, bringing to more than HK\$2 billion the total amount of its permitted return that the Company has foregone in the past 3 years in order to benefit customers by charging lower electricity tariffs than it is entitled to do. In addition, for the last several years the Company has not imposed additional tariffs to establish a development fund as would have been permitted under the scheme of control. In spite of all this, we have always maintained the highest standards of reliability and quality of electricity supply. In 2005, our customers once again enjoyed over 99.999% reliability in electricity supply. Considering the vital importance to Hong Kong of its role as an international financial and commercial centre and the fact that more than 50% of our customers live or work above the fifteenth floor, we believe that maintaining this high standard must continue to be our highest priority, and that it should not in any circumstance be put at risk.

Our operations outside Hong Kong reported an increase of over 90% in operating earnings before proceeds of disposition and non-cash tax adjustments, from HK\$445 million in 2004 to HK\$846 million in 2005. In addition, the Company also recorded a non-recurring gain of HK\$1,560 million on the disposal of part of our interest in our Australian operations in December 2005 (2004: Nil) and non-cash tax adjustments of HK\$648 million (2004: HK\$290 million).

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## Results, Final Dividend and Special Dividend

The Group's audited consolidated net profit after tax for the year ended 31st December 2005 was HK\$8,562 million (2004 as restated : HK\$6,256 million), an increase of 37%. The Directors will recommend a final dividend of HK\$1.01 per share and a special dividend of HK\$0.73 per share. Together with the interim dividend of HK\$0.58 per share, this will give a total dividend of HK\$2.32 per share for the year (2004 : HK\$1.77).

## Hong Kong Operations

Unit sales growth in electricity for 2005 was 1.5%. Of the 10,755 million kWh of electricity sold, commercial sales made up 73.2%, domestic sales 22.7% and industrial sales 4.1%. Maximum demand in 2005 was 2,565 MW compared with 2,588 MW in 2004.

Our continuing programme to lower emissions from the Lamma Power Station by reducing our reliance on coal-fired generation progressed well in 2005 as construction of our Lamma Power Station Extension for Unit 9, which will be our first gas fired unit, moved towards completion. We expect Unit 9 will be completed and ready to receive gas by mid-2006. During the year, we also added our first renewable energy source for Hong Kong with the construction of Hong Kong's first wind turbine on Lamma Island. The 800 kW turbine started to generate electricity in September 2005 and we are currently evaluating the commercial viability of building additional wind turbine units in the future.

The price of coal remained well above historic levels in 2005 providing challenges for us. We were able in part to mitigate higher coal costs by adjusting the varieties of coal we consume. We expect coal prices will remain volatile in 2006. In 2005, we continued with our improvement and refurbishment of our transmission and distribution system to ensure supply meets demand. The installation of the 275 kV cable circuit from Lamma

Island to the Marsh Road switching station made good progress with the laying of the submarine cables across the east Lamma channel commencing in November and construction of the switching station commencing in December.

In 2005, we maintained our record of achieving a supply reliability rating of 99.999%, a mark continuously achieved since 1997. Our customers demonstrated their satisfaction with our service by making a record number of commendations in 2005.

We continued to participate in community and environmental activities in 2005. The Hongkong Electric Volunteers team, which now numbers over 700, undertook various community service activities in 2005. We also continued with our "Smart Power" campaign which aims to promote energy conservation and efficiency among students. During the year, close to 4,000 students from 23 primary schools took part in various activities under this programme. In November 2005, we launched a new round of activities with the theme of renewable energy.

## International Operations

Our Australian operations continued to perform well in 2005. Solid financial performance was achieved through a combination of increased electricity consumption, customer growth and a focus on operational efficiency. In December 2005, we sold a partial interest in our Australian businesses. This enabled us to realize a substantial part of the increase in value of our investment in the businesses while at the same time maintaining an operating interest in the businesses going forward. Non-recurring gain from this disposition was HK\$1,560 million.

In June 2005, we completed the acquisition of a 19.9% stake in Northern Gas distribution networks. Northern Gas is one of eight gas distribution networks in the U.K. The business has already made a strong start in achieving both its operational and financial targets.

In Thailand, financing arrangements for the construction of a 1,400 MW gas fired power station in Ratchaburi province have been concluded and construction work is currently scheduled to commence in 2006. The Group has a 25% interest in the project.

### **Future Development of the Electricity Market in Hong Kong**

Hong Kong depends on a reliable and uninterrupted electricity supply to maintain its position as a leading financial and commercial centre and assure the safety and comfort for our dense urban population. For over 100 years since 1890, we have met Hong Kong's needs with an exceptional track record of success. Any proposals to change the existing arrangements for the electricity market in Hong Kong should only be made after very careful and extensive consideration and consultation, and with the agreement of the industry. We will be making a submission to the Government in respect of the stage II consultation paper outlining the Company's concerns regarding the arrangements proposed in that paper particularly as they relate to the permitted rate of return, the duration of the regulatory framework and changes to emission penalties. We will be stating in that submission as we have already publicly stated that certain of the arrangements as currently proposed in the consultation paper are entirely unacceptable to the Company. As we progress through this consultation process, we will continue to work with the Government on the many issues that need to be addressed in the hopes of achieving a reasonable commercial outcome that safeguards the vital interests of our consumers in continued security of supply.

The current high standard of reliability and security of electricity supply in Hong Kong is a fact that is often taken for granted. This should not be the case. In effect, the reliability and security of supply enjoyed by Hong Kong consumers reflects the success of the current scheme of control both in assuring the timely availability

of long term investment capital necessary to sustain it, as well as in encouraging a prudent operating and cost structure to deliver it. Any change proposed to be made to the existing electricity supply arrangements must be such that Hong Kong can be absolutely certain that what has been achieved so well in terms of reliability and stability of electricity supply to date will not be placed in jeopardy in future.

### **Outlook**

We expect Hong Kong's economy will remain robust in 2006. However, we also expect continued high coal and natural gas prices to provide challenges for our generating businesses going forward. In Hong Kong, we expect low growth in electricity sales in 2006, continuing the trend we have seen in 2005. Internationally, we will continue to look for suitable investment opportunities to further reduce our earnings reliance on Hong Kong.

On 1st November 2005, Mr. George Magnus retired as Chairman and as an executive director of the Company. Mr. Magnus was appointed an executive director of the Company in 1985 and as Chairman in 1993. I would like, on behalf of the Board, to express our deep appreciation for his valuable advice and contribution over the years. Going forward, I am glad that the Company will continue to benefit from his experience in his capacity as a non-executive director.

The Company's achievements in 2005 could not have been made without the contribution and skill of our employees and the guidance of the Board of Directors and I would like to express my gratitude to them for their efforts in 2005.

### **Canning Fok Kin-ning**

Chairman

Hong Kong, 9th March 2006