Financial Review

How can you approach our Financial Statements?

Financial Statements Decoded

The purpose of the Group's financial statements is to communicate the Group's financial information to its stakeholders. The financial statements comprise two essential components:

- Income statement – which is a representation of the Group's financial performance; and
- Balance sheet – which is a representation of the Group's financial position.

The income statement summarises the flows of economic resources to and from the Group (in the form of revenue and expenses) over a period of time, in this case the year 2006. It also represents how the Group moved from its financial position of last year to the current year (as illustrated under the heading "CLP Group's Financial Results and Position at a Glance" on pages 18 and 19). The income statement is further analysed on pages 20 and 21.

The balance sheet summarises the Group's economic resources (in the form of non-current assets and working capital), obligations and owners' equity (in the form of debts and other non-current liabilities, and equity respectively) at a particular point of time, in this case 31 December 2006. It also shows how the economic resources contributed by lenders and shareholders are deployed in the business. Further analysis of the balance sheet is set out on pages 22 to 27.

Non-current assets include interests in jointly controlled entities and associated companies. In accordance with accounting standards, the Group has elected to present each as a single-line item on the face of the balance sheet instead of on a line-by-line basis according to the Group's proportional share of their assets and liabilities. Further information on the Group's financial obligations in respect of these interests is presented on pages 30 and 31.

Financial Statements Illustrated

The diagram opposite illustrates the relationship between the income statement and the balance sheet, as well as their links with the Group's stakeholders.

On the one hand, the Group earns **revenue** from **customers** through the deployment of **non-current assets** and **working capital**; on the other hand, it pays **operating expenses** to **suppliers of goods and services** for their supplies. The net balance of revenue and operating expenses is the **profit** available for payment to **lenders** (in the form of **interest expense**) and for distribution to **shareholders** (in the form of **dividends**) in return for their contribution of funds to the Group (**debts** and **equity**).

A key component of financial statements not depicted opposite is the Group's cash flows, which comprise operating, investing and financing cash flows. While the operating profit underlies the operating cash flow, certain non-cash charges or credits, such as depreciation, amortisation and fair value changes on derivatives, create a distinction between the operating cash flow and the operating profit. Investing cash flows are the cash flows arising from the purchase or disposal of non-current assets. Financing cash flows represent the cash flows between the Group and the lenders and shareholders. These cash flows are summarised in the cash flow statement and are further explained on page 28.

Non-current Assets

Assets which are held long term, either for use in operations, or for investment (such as fixed assets and investments in jointly controlled entities). They are not expected to be consumed or sold within the normal operating cycle (usually 12 months).

Working Capital

Comprises current assets and current liabilities which are continuously circulating in the business operations (such as bank balances, trade receivables and payables).

Debts and Other Non-current Liabilities

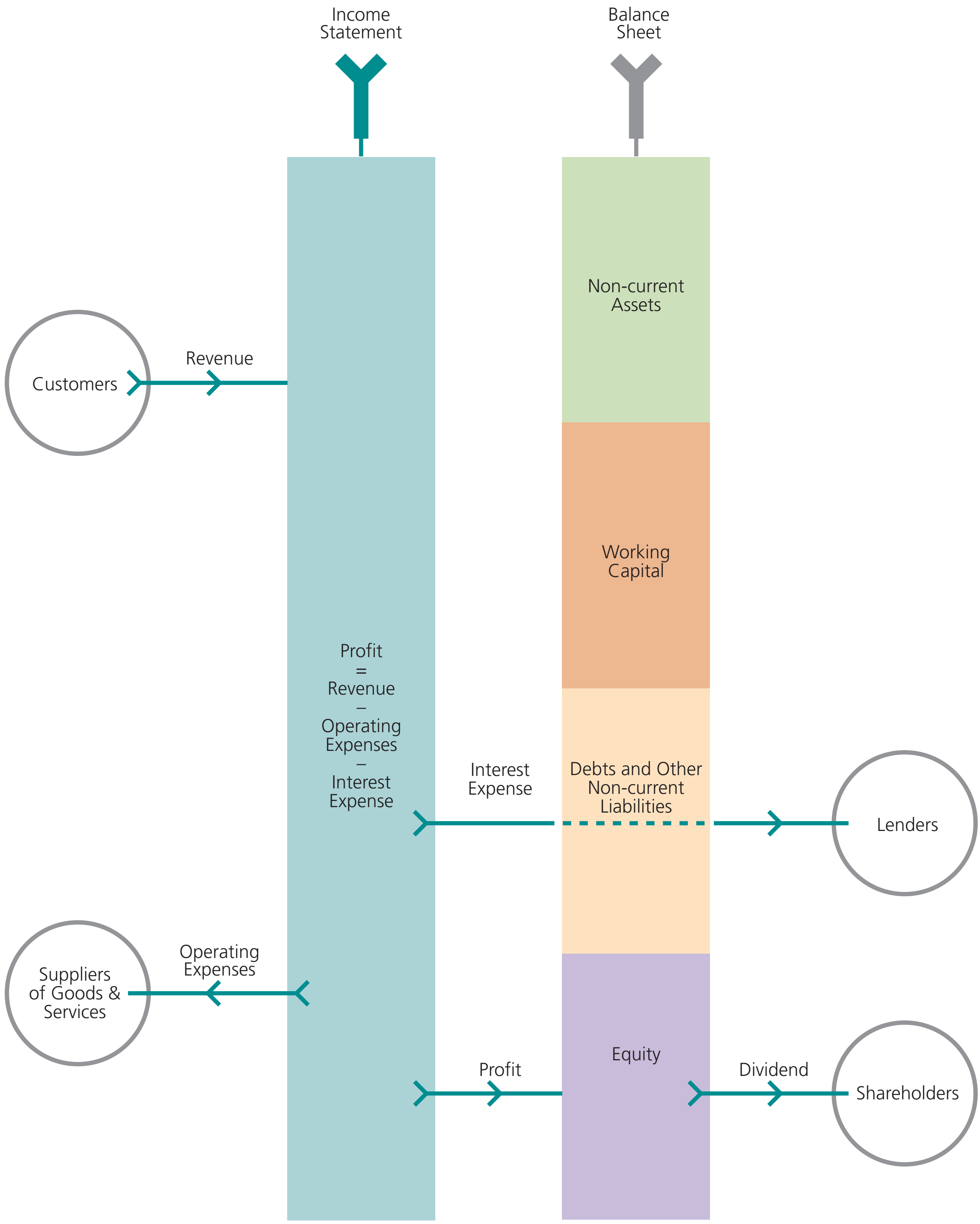
Funds borrowed from lenders which the Group has obligations to repay and other liabilities (such as deferred tax liabilities) which the Group is obliged to settle after the next 12 months.

Equity

Funds contributed by shareholders either as capital or profits retained in the Group. This is the residual interest in the Group's assets after all of the Group's liabilities have been paid off.

Note: The definitions and explanations of the financial statements in this section are for guidance purposes only. Readers should refer to the relevant accounting standards for comprehensive and authoritative definitions and explanations.

The Income Statement and the Balance Sheet – The Two Essential Components of Financial Statements



CLP Group's Financial Results and Position at a Glance

Last Year's Balance Sheet
(Consolidated Balance Sheet as at 31.12.2005)

	HK$M
Assets	
Fixed assets, leasehold land	
and land use rights	81,742
Goodwill and other intangible assets	6,930
Interests in jointly controlled entities	16,719
Interests in associated companies	1,798
Finance lease receivables	2,933
Deferred tax assets	2,537
Derivative financial instruments	1,562
Trade and other receivables	6,759
Cash & cash equivalents	2,041
Other assets	1,102
	124,123
Equity and Liabilities	
Share capital, premium & reserves	16,003
Retained profits	34,626
Shareholders' funds	50,629
Minority interest	111
Borrowings	29,391
Obligations under finance leases	21,497
SoC reserve accounts	4,174
Deferred tax liabilities	5,718
Derivative financial instruments	1,578
Customers' deposits	3,308
Trade and other payables	6,079
Other liabilities	1,638
	124,123

Cash Flow For The Year
(Consolidated Cash Flow Statement for the year ended 31.12.2006)

	Note	HK$M
Cash inflow from operating activities	1	11,472
Dividends paid less dividends received		(3,101)
Investments in/advances to jointly		
controlled entities		(846)
Capital expenditure	2	(5,826)
Net decrease in borrowings		(20)
Repayment of finance lease obligations		(1,958)
Other net outflow, including		
exchange effect		(149)
Net decrease in cash		(428)
Cash & cash equivalents at 31.12.2005		2,041
Cash & cash equivalents at 31.12.2006		1,613

Earnings For The Year
(Consolidated Income Statement for the year ended 31.12.2006)

	Note	HK$M
Revenue	3	45,702
Expenses	3	(33,590)
Other income, net	4	55
Share of results, net of income tax		
– jointly controlled entities		2,936
– associated companies		114
Profit before net finance costs		
and income tax		15,217
Net finance costs		(4,624)
Income tax expense		(683)
Profit after income tax		9,910
Profit attributable to		
minority interest		(10)
Earnings attributable to shareholders		9,900

1 Our Hong Kong electricity business remained our principal source of cash inflow while cash flow from our overseas business also grew considerably.

2 Capital expenditure was primarily on the transmission and distribution network in Hong Kong. There were also capital works on generation and other facilities in Australia.

3 This reflects the first full year of the MEB's operations in Australia since its acquisition by the Group in May 2005. The Hong Kong electricity business continued to account for most of the Group's revenue and expenses.

4 The Group formed a strategic joint venture, OneEnergy Limited (OneEnergy), with Mitsubishi Corporation of Japan in March 2006 and injected its 22.4% interest in Electricity Generating Public Company Limited (EGCO) in Thailand into OneEnergy, thereby realising a gain of HK$343 million. Subsequently, the Group also transferred its 50% interest in BLCP Power Limited of Thailand to EGCO and realised another gain of HK$888 million. However, an impairment loss of HK$1,176 million (HK$823 million after income tax) was provided for following an impairment assessment of Yallourn Power Station, Australia. Overall, these three items resulted in net one-off other income of HK$55 million (before tax).

Profits Retained For The Year
(Consolidated Retained Profits for the year ended 31.12.2006)

	HK$M
Earnings attributable to shareholders	9,900
Dividends paid for the year	
– 2005 finals	(2,264)
– 2006 interims	(3,612)
Revaluation reserves realised upon depreciation	3
Share of movements in reserves of jointly controlled entities	(17)
Net increase in retained profits	4,010
Retained profits at 31.12.2005	34,626
Retained profits at 31.12.2006	38,636

Today's Balance Sheet
(Consolidated Balance Sheet as at 31.12.2006)

	Note	HK$M
Assets		
Fixed assets, leasehold land and land use rights	5	85,653
Goodwill and other intangible assets		7,326
Interests in jointly controlled entities	6	19,173
Interests in associated companies		8
Finance lease receivables	5	2,866
Deferred tax assets		3,305
Derivative financial instruments		1,556
Trade and other receivables		8,799
Cash & cash equivalents		1,613
Other assets		792
		131,091
Equity and Liabilities		
Share capital, premium & reserves		17,202
Retained profits		38,636
Shareholders' funds		55,838
Minority interest		78
Borrowings	7	30,278
Obligations under finance leases	5	22,810
SoC reserve accounts		3,346
Deferred tax liabilities		6,054
Derivative financial instruments		2,020
Customers' deposits		3,417
Trade and other payables		5,893
Other liabilities		1,357
		131,091

5 Certain electricity supply and power purchase agreements of the Group have been classified as finance leases in accordance with the newly effected HKFRS–Interpretation 4 "Determining whether an Arrangement contains a Lease". CAPCO's operational generating plant and associated fixed assets have now become leased assets with a corresponding finance lease liability on the Group's balance sheet; while the power station of GPEC is replaced by a finance lease receivable.

6 CAPCO continued to be our largest investment in jointly controlled entities. During the year, a net advance of HK$328 million was made to CAPCO.

7 The Group issued HK$1 billion fixed-rate notes under the Medium Term Note Programme and raised a HK$500 million bank loan during the year. As at year end, the Group's gearing ratio decreased slightly from 36.7% to 35.1%.

Financial Analysis

Key Financial Events

Financial information cannot be understood in isolation. To provide a backdrop to this financial information, we highlight below those events in 2006 which have a significant impact on the Group's financial performance and position:

1. The Group adopted the newly effected Hong Kong Financial Reporting Standards – Interpretation 4 (HKFRS-Int 4) "Determining whether an Arrangement contains a Lease". As a result, certain of the Group's electricity supply and power purchase arrangements have been accounted for as finance leases rather than normal sales and purchases transactions. On the one hand, CLP Power Hong Kong, which was previously treated as a purchaser of electricity from CAPCO, has become a lessee of CAPCO's power generation facilities. These operational generating plant and associated fixed assets are now brought onto the Group's balance sheet as leased assets with a corresponding lease liability. On the other hand, GPEC, together with Ho-Ping and Electricity Generating Public Company Limited (EGCO) of Thailand, are accounted for as lessors instead of sellers of electricity. Lease receivables are recorded in place of the power generating fixed assets.

   The overall impact of HKFRS-Int 4 on our earnings is not significant. However, in effect, all the fixed assets employed for the electricity generating business are now better reflected in our balance sheet, changing the financial picture it presents.

2. In March 2006, a strategic jointly controlled entity, OneEnergy Limited (OneEnergy), was formed with Mitsubishi Corporation of Japan, to act as an investment vehicle in Southeast Asia and Taiwan. The Group injected its 22.4% interest in EGCO into OneEnergy. Upon the formation of OneEnergy, a one-off gain of HK$343 million was realised.

3. Towards the end of 2006, as part of the process to streamline the Group's interests in Southeast Asia, its 50% interest in BLCP in Thailand was transferred to EGCO, realising another one-off gain of HK$888 million.

4. An impairment review exercise has been carried out for all of the Group's fixed assets. The review for Yallourn Power Station, Australia identified an impairment of A$200 million, equivalent to HK$1,176 million (HK$823 million, net of income tax). The impairment has arisen as a result of significant decrease in forecast pool prices and reductions in performance of its ageing plant.

The year-on-year fluctuations of the key items of the income statement, balance sheet and cash flow are explained below. These fluctuations are driven by the Group's strategy, changes in the business environment and the key financial events described above.

Group's Financial Results

The 2006 results show the steady growth of our electricity business in Hong Kong and continuous expansion of our energy businesses elsewhere in the region. However, total earnings attributable to shareholders decreased by 13.3% to HK$9,900 million in 2006, compared to HK$11,420 million in 2005 which included a one-off tax consolidation benefit of HK$2,004 million. Excluding this one-off tax benefit and Hok Un redevelopment profit, the Group registered a 7.7% growth in its operating earnings to HK$9,856 million (2005: HK$9,149 million). Detailed analysis of the performance of individual business streams is provided on pages 32 to 62 of this Report.

	2006 HK$M	2005 HK$M	Changes HK$M
Revenue	**45,702**	38,491	7,211
Expenses	**33,590**	26,905	6,685
Other income, net	**55**	–	55
Finance costs	**4,762**	4,445	317
Share of results of jointly controlled entities, net of income tax	**2,936**	3,182	(246)
Income tax expense/(credit)	**683**	(845)	1,528
Total operating earnings (before Hok Un redevelopment profit & tax consolidation benefit from Australia)	**9,856**	9,149	707
Earnings attributable to shareholders	**9,900**	11,420	(1,520)

Revenue and Expenses

Our electricity business in Hong Kong is the largest component of the Group's revenue and expenses. The increase in revenue and expenses is mainly attributable to the full year effect of consolidating the financial results of the MEB in Australia since its acquisition in May 2005. Apart from this, our revenue and expenses have been stable as compared with 2005, reflecting our mode of operations. The Group's revenue and expenses in Hong Kong and elsewhere are as follows:

	2006			2005		
	Hong Kong HK$M	Outside Hong Kong HK$M	Total HK$M	Hong Kong HK$M	Outside Hong Kong HK$M	Total HK$M
Revenue	**29,559**	**16,143[1]**	**45,702**	28,518	9,973[1]	38,491
Expenses						
Electricity, gas and distribution services	**5,380**	**8,544**	**13,924**	5,381	4,499	9,880
Operating lease and lease service payments[2]	**7,176**	**–**	**7,176**	7,063	–	7,063
Staff expenses	**1,034**	**778**	**1,812**	994	511	1,505
Fuel and other operating costs	**1,548**	**4,162**	**5,710**	1,720	2,378	4,098
Depreciation and amortisation	**4,055**	**913**	**4,968**	3,686	673	4,359
	19,193	**14,397**	**33,590**	18,844	8,061	26,905

Notes:
1 About 37.9% (2005: 38.4%) of our revenue from the retail sales of electricity and gas in Australia is paid as network charges to third party network operators.
2 Represent certain payments from CLP Power to CAPCO under the electricity supply arrangement, such as those for services supplied with respect to the leased assets.

Other Income, net

This represents the one-off gain of HK$343 million from the formation of OneEnergy and of HK$888 million from the sale of CLP's interest in BLCP to EGCO, net of an impairment charge of HK$1,176 million (HK$823 million after income tax) of the fixed assets at Yallourn Power Station, Australia. The resulting one-off net gain from these transactions is HK$55 million (before income tax) or HK$408 million (after tax).

Finance Costs

Finance costs increased HK$317 million on higher borrowings to finance capital investments in Hong Kong and overseas power projects. In addition, finance costs of HK$3,020 million (2005: HK$2,832 million) on lease obligations were recorded following the adoption of HKFRS-Int 4.

Share of Results of Jointly Controlled Entities, net of Income Tax

The slight decrease in the share of jointly controlled entities' results is attributable to the reduced contribution from Hok Un redevelopment since most of the units were sold in previous years. The changes in results from other jointly controlled entities have been mixed and relatively small.

Income Tax Expense/(Credit)

The change is mainly related to a tax consolidation benefit from Australia of HK$2,004 million in 2005 together with the tax effect of the impairment loss on Yallourn Power Station. Last year's tax consolidation benefit arose from the formation of a tax consolidated group in Australia with the tax cost base of certain depreciable assets being reset.

Group's Financial Position

Our financial position remains robust as revealed by our healthy balance sheet. The adoption of HKFRS-Int 4 has brought new items onto the balance sheet. CAPCO's operational generating plant and associated fixed assets are now recognised as leased fixed assets, with the corresponding obligations under finance leases recorded on the liability side. Conversely, GPEC's power generation plants have been removed from the balance sheet and a finance lease receivable is recorded instead. Overall, this new accounting treatment has resulted in the increase of both the assets and liabilities in the Group's consolidated balance sheet.

On the balance sheet

	2006 HK$M	2005 HK$M	Changes HK$M
Total assets	**131,091**	124,123	6,968
Fixed assets	**83,418**	79,509	3,909
Leasehold land and land use rights	**2,235**	2,233	2
Goodwill and other intangible assets	**7,326**	6,930	396
Interests in jointly controlled entities	**19,173**	16,719	2,454
Interests in associated companies	**8**	1,798	(1,790)
Finance lease receivables (current & non-current)	**2,866**	2,933	(67)
Deferred tax assets	**3,305**	2,537	768

Deferred Tax Assets

The deferred tax assets refer mostly to the temporary difference arising from tax losses in our Australian business which could be utilised in the foreseeable future. Further deferred tax assets related to tax losses were recognised in the current year. The deferred tax assets, together with those recognised in previous years, have been and will be subject to impairment review in accordance with the Group's accounting policy.

Finance Lease Receivables

Following the adoption of HKFRS-Int 4, GPEC's power purchase agreement with its sole customer, GUVNL, has been accounted for as a finance lease. GPEC, being the lessor, has recorded finance lease receivables on the balance sheet. Part of the receipts from GUVNL under the agreement have been applied as repayment of the lease receivables during the year.

Interests in Associated Companies

The Group injected its interest in EGCO, an associated company, into OneEnergy upon its formation in March 2006, thereby effectively disposing of one-half of its interest in EGCO.

The remaining balance as at 31 December 2006 represented our 1/3 interest in Gascor Pty Limited owned through our Australian business.

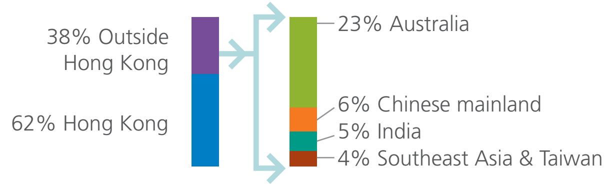
Interests in Jointly Controlled Entities

The significant increase is attributable to the formation of OneEnergy, into which the Group has injected its interest in EGCO and indirectly, BLCP. In addition, a further net advance of HK$328 million was made to CAPCO during the year.

Total Assets

The Group's total assets increased by HK$6,968 million, attributable to an increase in fixed assets and trade and other receivables. Most of our assets are non-current tangible assets and primarily include leased generating plants, owned transmission and distribution networks as well as investments in CAPCO and overseas projects.

Total Assets by Geographical Location



Fixed Assets, Leasehold Land and Land Use Rights

During the year, CLP Power Hong Kong invested HK$4,788 million (2005: HK$4,849 million) in transmission and distribution networks and other supporting facilities. Following the adoption of HKFRS-Int 4, the Group's leased assets now include the generation plant of CAPCO. The increase in the leased assets of HK$3,299 million in Hong Kong is primarily due to the commissioning of Unit 8 at Black Point Power Station. Elsewhere, in Australia we spent HK$1,086 million (2005: HK$749 million) mainly on generation facilities (including the Tallawarra project).

At 31 December 2006, the Group's capital commitments, contracted but not provided for in the financial statements, amounted to HK$4,407 million (2005: HK$2,689 million). Of these contracted amounts, HK$2,762 million (2005: HK$2,330 million) was for our electricity business in Hong Kong, primarily for enhancing our transmission and distribution systems, whilst HK$1,546 million (2005: HK$350 million) was related to our Australian business.

Fixed assets, leasehold land and land use rights as at 31 December 2006 and 2005 are summarised below:

	2006 HK$M	2005 HK$M
Hong Kong	**70,438**	66,819
Australia	**14,492**	14,196
Others	**723**	727
	85,653	81,742

Note: These are represented by property, plant and equipment, freehold and leasehold land as well as land use rights.

Goodwill and Other Intangible Assets

The increase is attributable to the appreciation of the Australian dollars in which most of the goodwill and other intangible assets are denominated.

A major portion of the goodwill arose from the acquisition of the MEB in 2005. The Group lodged a claim with the vendor, an affiliate of Singapore Power Limited in 2005. Settlement was subsequently reached in April 2006 with the purchase consideration reduced by HK$1,019 million. The goodwill was adjusted as if the revised consideration was effected at the time of the acquisition.

Management has reviewed the goodwill and other intangible assets and no impairment is identified.

Group's Financial Position

On the balance sheet

	2006 HK$M	2005 HK$M	Changes HK$M
Derivative financial instrument assets (current & non-current)	**1,556**	1,562	(6)
Derivative financial instrument liabilities (current & non-current)	**2,020**	1,578	442
Trade and other receivables	**8,799**	6,759	2,040
Bank balances, cash and other liquid funds	**1,613**	2,041	(428)
Customers' deposits	**3,417**	3,308	109
Trade and other payables	**5,893**	6,079	(186)

Trade and Other Payables

The balance comprises trade payables and other accruals, current accounts with jointly controlled entities (principally with CAPCO). There are no significant fluctuations in the balance for the year.

Customers' Deposits

Largely represents the deposits received from customers in Hong Kong as security on their electricity accounts. The balance has remained stable throughout the year.

Bank Balances, Cash and Other Liquid Funds

Major cash flows for the year are summarised on page 28.

At 31 December 2006, 91% (2005: 96%) of liquid funds was denominated in foreign currency and mainly held by overseas subsidiaries in India and Australia.

Trade and Other Receivables

The increase is mainly attributable to the consideration receivable from the disposal of BLCP to EGCO (HK$1,000 million) and the increase in trade receivables in Hong Kong and India.

Derivative Financial Instruments and Hedging

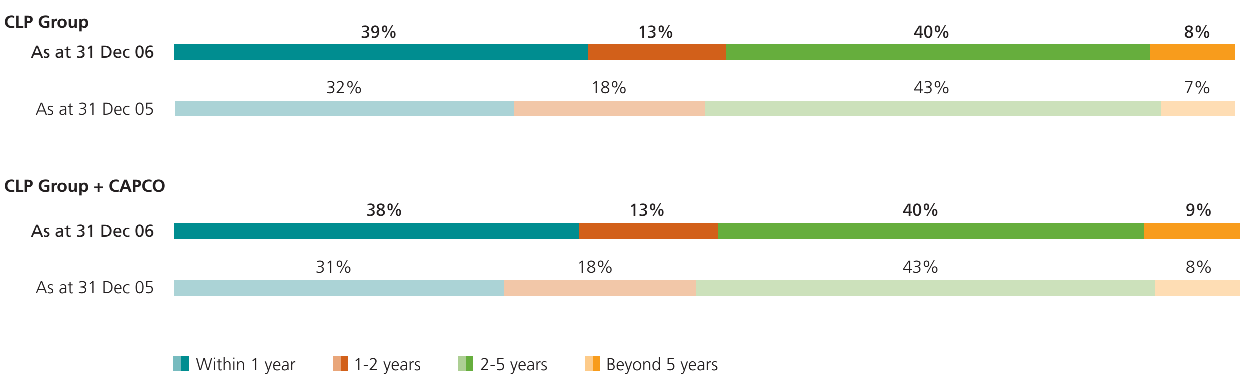
The Group uses different derivative financial instruments to manage its exposure to foreign currency and interest rate risks, as well as the price risks associated with sales and purchases of electricity in Australia, so as to minimise any potential adverse effects on the Group's earnings and tariff. Apart from certain electricity trading activities engaged by TRUenergy, it is the Group's policy to use derivative financial instruments solely for hedging purposes.

The derivatives were marked to market value at the balance sheet date and reported a net liability of HK$464 million (HK$481 million net liability for the Group and CAPCO combined). This represents the net amount we would pay if these contracts were closed out at 31 December 2006. However, changes in fair value of derivatives will have no impact on the Group's cash flow until settlement.

The breakdown by type and maturity profile of the derivative financial instruments is shown in the charts below:

	Notional Amount		Fair Value Gain/(Loss)	
	2006	2005	**2006**	2005
	HK$M	HK$M	**HK$M**	HK$M
CLP Group				
Forward foreign exchange contracts	**41,828**	42,828	**(483)**	(311)
Interest rate swaps	**12,401**	9,693	**140**	(48)
Cross currency & interest rate swaps	**2,340**	4,680	**26**	125
Renewable energy certificates/ NSW Greenhouse Gas Abatement Certificates	**314**	100	**22**	13
Energy hedging & trading caps & options	**547**	878	**71**	134
Energy hedging & trading swaps	**18,998**	11,469	**(240)**	71
	76,428	69,648	**(464)**	(16)
CAPCO				
Interest rate swaps	**3,562**	4,208	**(17)**	25
Total	**79,990**	73,856	**(481)**	9

Maturity Profile



Group's Financial Position

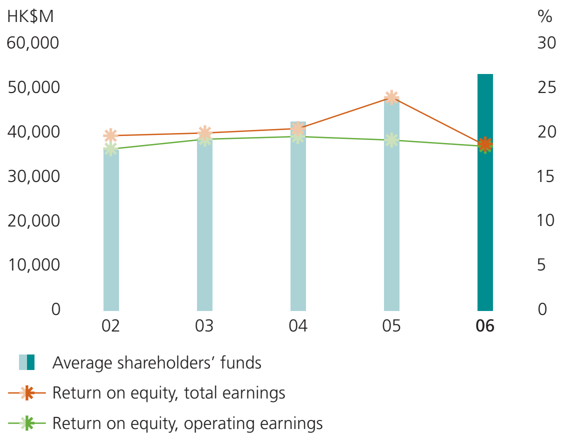
On the balance sheet

	2006 HK$M	2005 HK$M	Changes HK$M
Bank loans and other borrowings (current & non-current)	**30,278**	29,391	887
Obligations under finance leases (current & non-current)	**22,810**	21,497	1,313
Deferred tax liabilities	**6,054**	5,718	336
SoC reserve accounts	**3,346**	4,174	(828)
Shareholders' funds	**55,838**	50,629	5,209

Shareholders' Funds

Shareholders' funds increased 10.3% to HK$55,838 million as at 31 December 2006. This arose from the net increase in the retained profits of HK$4,010 million after dividend payments. At the end of 2006, the distributable reserves of CLP Holdings amounted to HK$19,913 million (2005: HK$19,631 million).

Return on Equity



SoC Reserve Accounts

The Development Fund and Rate Reduction Reserve are collectively referred to as SoC reserve accounts. The decrease was mainly due to the transfer from the Development Fund to the income statement during the year to maintain a freeze in tariff. Special rebates to customers also caused the Development Fund to decrease during the year.

Deferred Tax Liabilities

The deferred tax liabilities increased by HK$336 million, mainly owing to the temporary differences arising from the accelerated tax depreciation for capital works of CLP Power Hong Kong.

Bank Loans and Other Borrowings

During the year, the Group issued HK$1 billion of fixed-rate notes under the Medium Term Note Programme and also raised a HK$500 million bank loan. This is to support the expansion of our electricity business in Hong Kong. The gearing ratio has seen a slight decrease from 36.7% to 35.1% due to an increase in shareholders' funds.

Obligations under Finance Leases

With the adoption of HKFRS-Int 4, CLP Power Hong Kong's electricity supply contract with CAPCO has been accounted for as a finance lease. The recorded finance lease obligations correspond to the leased fixed assets recognised. The overall increase in the balance is mainly due to the new lease arising upon the commissioning of Unit 8 at Black Point Power Station, partially offset by repayments during the year.

Beyond the balance sheet

Apart from those items which appear on the balance sheet, the charges on assets, commitments and contingencies set out below are important to a full understanding of the Group's financial position.

Charges on Assets

Various assets of GPEC and Huaiji are pledged for their local borrowings of HK$888 million in aggregate. These pledged assets represented less than 3% of the total assets of the Group.

Operating Commitments

The outstanding non-cancellable operating lease commitments amounted to HK$12,591 million at 31 December 2006 (2005: HK$12,992 million). Of this, HK$9,559 million referred to the operating lease element of the Electricity Supply Contract between CLP Power Hong Kong and CAPCO, and HK$2,854 million was related to a 20-year Master Hedge Agreement between TRUenergy and Ecogen (which owns 966MW gas-fired generation facilities in Victoria). Under this Agreement, TRUenergy has the right to request the supply of electricity from the power stations.

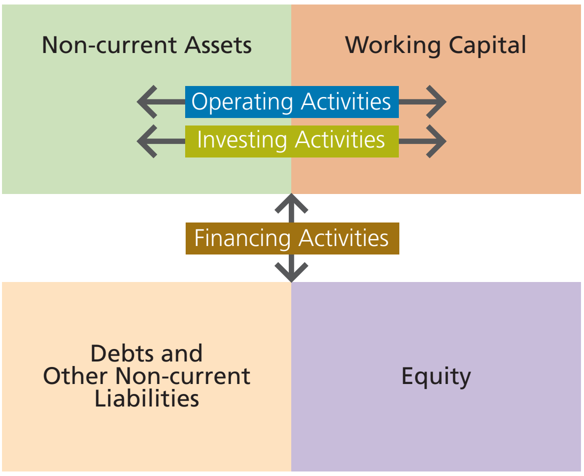
Contingent Liabilities

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% (revised subsequently to 70%). 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$1,275 million. Based on legal advice, no provision is considered necessary and the claim is disclosed as a contingent liability in our consolidated financial statements. Save for this, we have not identified any significant contingent liabilities.

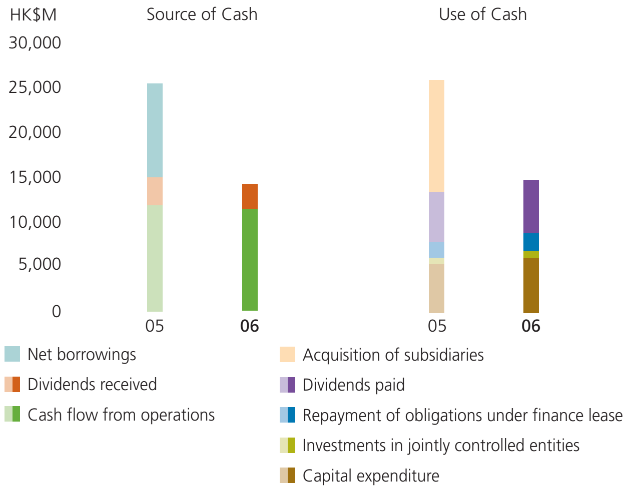
Cash Flow

We act prudently to ensure our cash inflows, from operations or from our lenders, are available in time to meet our various business needs for daily operations, capital expenditure, new investments and servicing our debts, as well as paying dividends to our shareholders. Our strong operating cash flows, especially those from our Hong Kong electricity business, have been our principal source of liquidity, providing us with substantial flexibility in meeting our funding requirements.

During 2006, excluding the effect of exchange rates, the Group's cash and cash equivalent decreased by HK$474 million, as analysed below in three kinds of cash flow activities.



Cash Utilisation



	2006 HK$M	2005 HK$M	Changes HK$M
Operating activities (such as receipts from customers, payment of operating expenses and interest)	**11,472**	11,753	(281)
Investing activities (such as purchase of fixed assets, dividends received from jointly controlled entities)	**(4,092)**	(15,241)	11,149
Financing activities (such as drawing and repayment of bank loans, payment of dividends to shareholders)	**(7,854)**	3,095	(10,949)
	(474)	(393)	(81)

Financing Activities

The Group has a net outflow from its financing activities, as opposed to a net inflow last year, as fewer loans were raised in the current year. With the adoption of HKFRS-Int 4, part of the electricity payments from CLP Power Hong Kong to CAPCO has been classified as settlements of finance lease obligations.

Investing Activities

In the absence of a major acquisition, this year's net cash used in investing activities reduced by HK$11,149 million. Most activities are capital expenditure related to our Hong Kong electricity business (HK$4,554 million), and contributions to new power projects through our jointly controlled entities (HK$846 million). These outflows were partially offset by dividends received from our jointly controlled entities.

Operating Activities

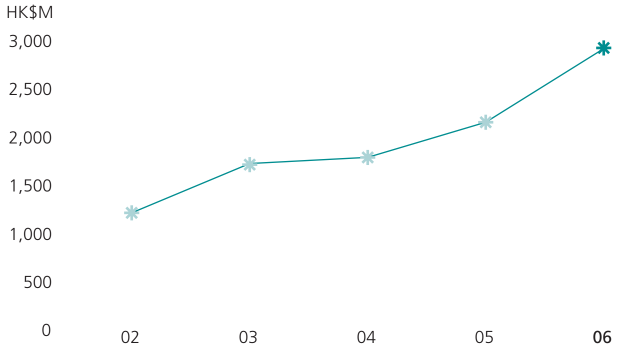
The well established electricity business in Hong Kong generates a steady and major source of inflow, whilst cash flows from our overseas operations have grown.

A Broader Perspective

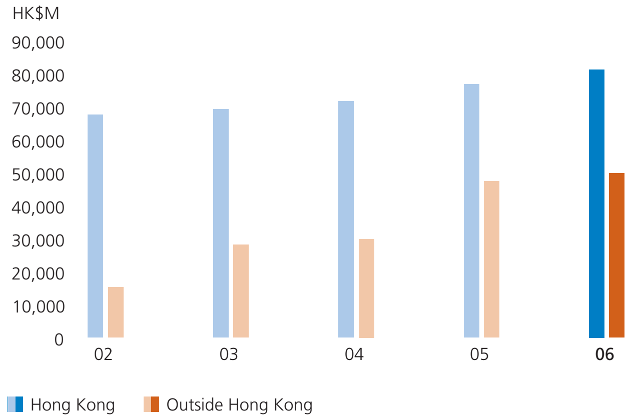
An Annual Report necessarily concentrates on one year's financial performance, with a comparison against the previous year. It might be helpful to offer a broader perspective on CLP's financial performance and its underlying trends. To do this, we have selected four financial indicators, which we believe best reflect past developments and may indicate future direction. These are overall earnings, growth of earnings from outside Hong Kong, total assets (in and outside Hong Kong) and gearing (total debt to total capital ratio). More detailed and comprehensive data can be found in the Ten-year Summary on our website.

Total and Operating Earnings

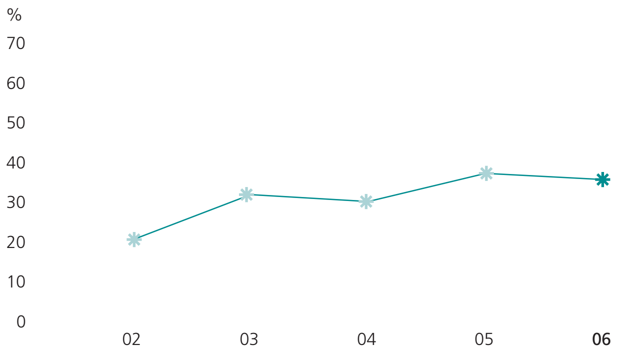
Operating Earnings from Outside Hong Kong



Total Assets – Hong Kong and Outside Hong Kong



Total Debt to Total Capital Ratio



Total debt to total capital = Debt / (shareholders' funds + debt + minority interest).
Total debt excludes obligations under finance lease.

These charts illustrate

- continuing growth in the Group's earnings over the past five years. Average annual growth in operating earnings over the period was 10.6% and for total earnings was 8.6%. Operating earnings and total earnings grew by 49.8% and 38.9% respectively from 2002 to 2006;
- the rising importance of earnings from outside of Hong Kong, from 16.7% of total earnings in 2002 to 29.2% in 2006. This is in line with our earlier decision to diversify our business beyond our Hong Kong base. We envisage this trend will continue towards a more balanced mix of Hong Kong and overseas earnings;
- the considerable growth in the Group's asset base, of which fixed assets comprise the major part. A large increase in 2005 occurred as a result of the acquisition of the MEB business in Australia;
- a material, yet healthy, increase in CLP's gearing, as is to be expected given the considerable investments made as we grow our business. Whilst we are using our balance sheet gearing more effectively, borrowings remained well within the prudent limits of 35.1% at the end of 2006; and
- the underlying strength of CLP's financial position – a quality we can exploit for competitive advantage and leverage for future earnings growth, but one that we must safeguard to ensure our long-term success.

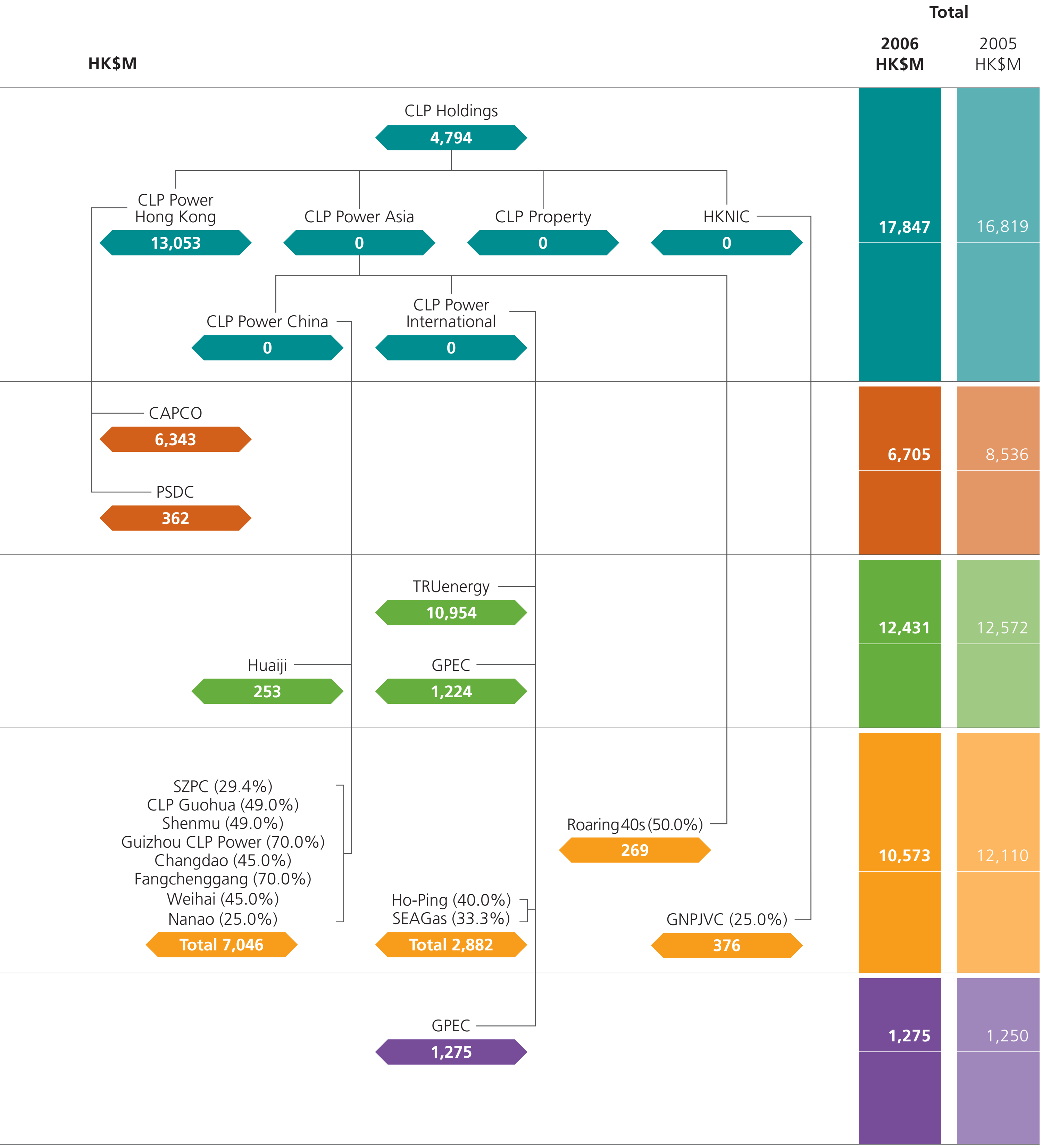
CLP Group's Financial Obligations at a Glance **as at 31 December 2006**

In recent years, market concerns have grown regarding the financial risks associated with borrowings and unconsolidated financial obligations of listed companies. It is our policy to adopt a prudent approach to such matters. The purpose of the following chart is to explain the total financial obligations of the CLP Group by classifying them into five categories according to their degree of recourse to CLP Holdings. Obligations under finance leases have not been included in the chart.

Category

1 Borrowings of CLP Holdings & Principal Direct Subsidiaries	Debts of CLP Holdings and its principal direct subsidiaries.
2 Borrowings of CAPCO & PSDC	100% of the debts of CAPCO and PSDC. Although the Group holds only a 40% interest in CAPCO and a 49% interest in PSDC, CLP Power Hong Kong has commitments to these companies through power purchase and service agreements, which are further explained in the Scheme of Control Statement on pages 194 and 195 and Note 36 to the financial statements.
3 Borrowings of TRUenergy, GPEC & Huaiji	These debts are non-recourse to CLP Holdings.
4 Share of Debts of Major Jointly Controlled Entities and Associated Companies*	These debts are non-recourse to CLP Holdings and its subsidiaries.
5 Contingent Liabilities	Contingent liabilities of CLP Holdings and its subsidiaries. Details of these are set out in Note 37 to the financial statements.

* In respect of Category 4, the share of debts is calculated by reference to the Group's shareholding in the relevant jointly controlled entities and associated companies.



Total
HK$M
2006 HK$M
2005 HK$M
CLP Holdings
4,794
CLP Power Hong Kong
13,053
CLP Power Asia
0
CLP Property
0
HKNIC
0
CLP Power China
0
CLP Power International
0
17,847
16,819
CAPCO
6,343
PSDC
362
6,705
8,536
TRUenergy
10,954
Huaiji
253
GPEC
1,224
12,431
12,572
SZPC (29.4%)
CLP Guohua (49.0%)
Shenmu (49.0%)
Guizhou CLP Power (70.0%)
Changdao (45.0%)
Fangchenggang (70.0%)
Weihai (45.0%)
Nanao (25.0%)
Total 7,046
Roaring 40s (50.0%)
269
Ho-Ping (40.0%)
SEAGas (33.3%)
Total 2,882
GNPJVC (25.0%)
376
10,573
12,110
GPEC
1,275
1,275
1,250