Financial Review

Capital Expenditure, Liquidity and Financial Resources

Capital expenditure during the year amounted to HK$2,305 million, which was primarily funded by cash from operations. Total external borrowings outstanding at the year end were HK$14,689 million (2005 : HK$10,645 million), comprising unsecured bank loans and debt securities in issue. In addition, the Group had undrawn committed bank facilities of HK$5,686 million (2005 : HK$3,465 million) and available liquid funds of HK$10,462 million (2005 : HK$4,561 million).

Treasury Policies, Financing Activities and Capital Structure

The Company manages its financial risks in accordance with guidelines laid down in its treasury policy, which is approved by the Board. The Company aims to ensure that adequate financial resources are available for refinancing and business growth. The Company's treasury policy is designed to manage the Group's currency, interest rate and counterparty risks.

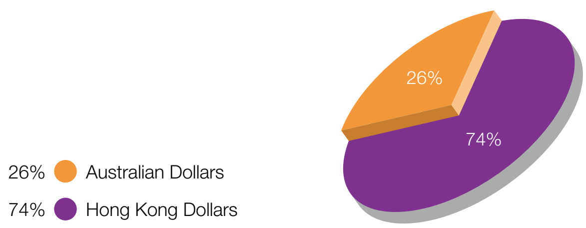
During the year, advantage was taken of the liquidity in the bank loan and debt capital markets to secure new funding to refinance at a lower rate a portion of the Group's existing borrowings and to extend the maturity of the Group's debt profile.

In January 2006, Hong Kong Electric International Finance (Australia) Pty Limited, a wholly-owned Australian subsidiary, refinanced A$617 million bank borrowings extending the maturity of those borrowings to January 2011 on improved financial terms. In September, The Hongkong Electric Company, Limited ("Hongkong Electric") secured a seven-year HK$5 billion syndicated bank loan facility at an attractive rate for its corporate funding requirements. During the last quarter of 2006, Hongkong Electric, through its subsidiary, Hongkong Electric Finance Limited, issued a total of HK$900 million Hong Kong dollar bonds, comprising two tranches of 10-year notes of HK$500 million and HK$400 million at an annual interest rate of 4.55% and 4.32% respectively.

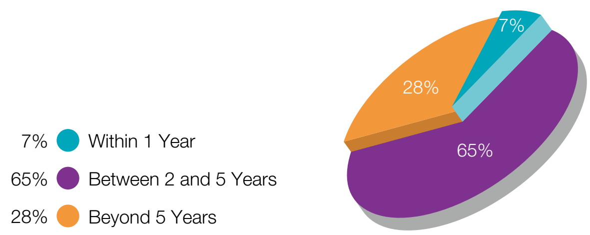
The Group's financial profile remained strong during the year. Standard and Poor's affirmed the A+ long term credit ratings of Hongkong Electric Holdings Limited ("HEH") and Hongkong Electric with a stable outlook in June 2006. As at 31st December 2006, the net debt of the Group was HK$4,227 million (2005 : HK$6,084 million) with a net debt-to-equity ratio of 10% (2005 : 15%).

The profile of the Group's external borrowings, after taking into account of currency and interest rate swaps, was as follows:

By Currency

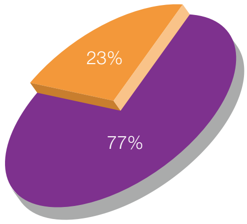


By Maturity



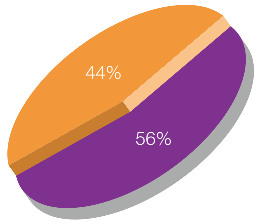
By Structure

23% Capital Market Instruments
77% Bank Loans



By Interest Rate Structure

44% Fixed Rate
56% Floating Rate



Currency and interest rate risks are actively managed in accordance with the Group's treasury policy. Derivative financial instruments are used primarily for managing interest rate and foreign currency risks and not for speculative purposes. Treasury transactions are only executed with counterparties with acceptable credit ratings so as to control credit risk exposure.

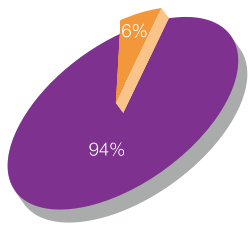
The Group's policy is to maintain a portion of its debt in fixed or capped interest rates. Interest rate risk is managed by either securing fixed or floating rate borrowings or by using interest rate swaps and caps. As at 31st December 2006, 44% of the Group's total borrowings were fixed rate.

The Group's principal foreign currency exposures arise from its overseas investments and from the import of fuel and capital equipment for Hongkong Electric. Foreign currency transaction exposure is managed, utilising forward contracts and currency swaps. As at 31st December 2006, over 99% of the Group's transaction exposure was either denominated in US dollars or hedged into Hong Kong or US dollars. Where considered appropriate currency exposure arising from overseas investments is mitigated by financing those investments in local currency borrowings. Foreign currency fluctuations will affect the translated value of the net assets of overseas investments and the resultant translation difference is included in the Group's reserve account.

The contractual notional amounts of derivative financial instruments outstanding at 31st December 2006 amounted to HK$5,306 million (2005 : HK$10,210 million).

Derivative Financial Instruments

6% Foreign Exchange Forward Contracts
94% Interest Rate Swaps



Charges on Group Assets

The shares of an associate were pledged as part of the security arrangements for project financing facilities for that associate. The carrying value of the associate as at 31st December 2006 was HK$75 million (2005 : HK$222 million).

Contingent Liabilities

The Company had given guarantees and indemnities in respect of bank and other borrowing facilities made available to and financial commitments of subsidiaries totalling HK$5,563 million (2005 : HK$5,002 million). Out of this amount, HK$5,257 million (2005 : HK$4,781 million), while being a contingent liability of the Company, is reflected in the Consolidated Balance Sheet of the Group.

A wholly-owned subsidiary of the Company, The Hongkong Electric Company, Limited, has given guarantees to third parties in respect of the value of leased equipment of HK$210 million (2005 : HK$210 million) at expiry of the lease.

Employees

The Group continues its policy of pay by performance and market pay levels are monitored to ensure competitiveness is maintained. The Group's total remuneration costs for the year ended 31st December 2006, excluding directors' emoluments, amounted to HK$887 million (2005 : HK$889 million). As at 31st December 2006, the Group employed 1,931 (2005 : 1,987) permanent staff. No share option scheme is in operation.

Apart from well-established training schemes for university graduates, trainee technicians and apprentices, the Group also provides training for employees in management and functional skills, language skills, computer knowledge and technology relevant to the Group's industry by both classroom training and e-learning platforms. Job-related courses to develop and enhance the general skills and knowledge of employees are also provided.