

Chairman's Statement



Canning Fok Kin-ning
Chairman

The year 2007 saw the Group progress its businesses both in Hong Kong and internationally culminating in early January 2008 with the signing of a new Scheme of Control Agreement (SCA) for our Hong Kong electricity business.

The new SCA signed by The Hongkong Electric Co., Ltd. (HEC) and the Hong Kong Government is for ten years commencing 1st January 2009 with a Government option to extend the SCA for a further term of 5 years. The agreement provides for a 9.99% permitted rate of return on average net fixed assets other than for renewable energy fixed assets for which the permitted return is 11%. The new SCA also contains provisions which encourage emission reduction, energy efficiency, operational performance, service quality and the use of renewable energy. I believe that in the current regulatory environment, the new SCA effectively balances the interests of our customers in reliable and secure electricity supply at reasonable prices while providing our shareholders with the benefit of the certainty and stability of a long term regulatory framework.

Outside of Hong Kong, the Group's international operations performed well with results for 2007 ahead of those for 2006. In December 2007, as part of our strategy of investing outside Hong Kong, we acquired an interest in six power plants in Canada with a total generating capacity of 1,352 MW.

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Results

The Group's audited consolidated net profit after tax for the year ended 31st December 2007 was HK\$7,448 million (2006 : HK\$6,842 million), an increase of 8.9%. Earnings from the Group's Hong Kong operations were HK\$6,727 million (2006 : HK\$6,173 million). Higher HEC unit sales of electricity and the impact of no special rebate in 2007 and higher interest income contributed to the higher earnings from Hong Kong operations. Earnings from the Group's international operations were HK\$721 million (2006 : HK\$669 million). The higher international operations earnings in 2007 were primarily due to higher earnings from the Australian electricity businesses.

Final Dividend

The Directors will recommend a final dividend of HK\$1.43 per share, payable on 16th May 2008 to those persons registered as shareholders on 15th May 2008. This, together with the interim dividend of HK\$0.58 per share, will give a total dividend of HK\$2.01 per share for the year (2006 : HK\$1.85 per share).

Hong Kong Operations

Unit sales of electricity grew by 1.1% in 2007 compared with 0.2% in 2006. The number of domestic and commercial customers increased slightly during the year while the number of industrial sector customers continued their declining trend. Maximum Demand in 2007 was 2,552 MW compared with 2,597 MW in 2006.

During 2007, Unit 9, HEC's first gas-fired combined cycle unit which was commissioned in October 2006, generated 17% of the electricity sent out from the Lamma Power Station helping to reduce emissions levels at the power station. Gas for Unit 9 is supplied to the power station through a 92 kilometre submarine pipeline from the Guangdong Dapeng Liquefied Natural Gas Terminal in Shenzhen. The Lamma Power Station coal-fired generating units which generate the majority of electricity at the power station operated satisfactorily during 2007.

Lamma Winds, the 800 kW wind turbine on Lamma Island with its associated exhibition centre on renewable energy continued to attract considerable interest in 2007.

High coal and gas prices continued to put pressure on fuel costs in 2007 with the higher costs continuing to be felt into 2008. In order to mitigate in part the impact of higher coal costs we continued to source and use a variety of coal during the year.

Our emission reduction programme at the Lamma Power Station progressed well during 2007. Civil construction work commenced for the flue gas desulphurisation (FGD) plant and low nitrogen oxide system retrofit works for the coal-fired Units 4 and 5. The environmental permit for the coal-fired Unit 2 FGD retrofit work has been issued and the contract for the supply of the FGD plant awarded. Conversion of GT57 from an oil-fired combined cycle unit to a gas-fired unit was substantially completed. By the end of 2010, it is expected that over 95% of the electricity generated at the Lamma Power Station will be generated by gas and by coal-fired units fitted with FGDs and low nitrogen oxide burners resulting in lower emission levels as we work toward achieving the Hong Kong Government's emission targets.

As we enter into the new regulatory framework for the electricity industry in Hong Kong, we plan to undertake a review of the mix of our generating capacity at the Lamma Power Station which comprises coal-fired units, some of which will be nearing the end of their useful lives over the next ten years, gas-fired generating plant, oil-fired gas turbine generating plant, and renewable energy plant with a view to continuing to reduce the emission levels at the Lamma Power Station. Part of this review will include the evaluation of the potential for a 100 MW offshore wind farm. As part of this evaluation, we have commissioned a marine traffic impact assessment and an environmental impact assessment study which are expected to be completed in early 2009.

Supply reliability was maintained at over 99.999% in 2007 surpassing our pledged service standards. This world class supply reliability has been consistently maintained at above 99.999% since 1997.

During the year, a network reliability and operations review was conducted on the reliability and safety of our transmission and distribution assets as part of our ongoing standard improvement efforts.

During 2007, we continued with our participation in environmental and community activities. The Smart Power 2006/2007 campaign which focused on reliable power concluded successfully with a record number of people taking part, the 2007/2008 campaign focusing on sustainability and energy conservation was launched in November 2007. The Hongkong Electric Clean Energy Fund continued its efforts in 2007 in promoting renewable energy. The Hongkong Electric Volunteers which celebrated its third anniversary in July 2007 now has a membership of over 750 employees. Volunteer activities in 2007 focused on care for the elderly and those in the community in need as well as on improving the environment. The Hongkong Electric Centenary Trust continued to provide scholarships for secondary students and funding for self learning centres for senior citizens.

International Operations

In Australia, ETSA Utilities in South Australia and Powercor and CitiPower in Victoria, our electricity distribution businesses, performed well in 2007 recording higher revenue and meeting their operational targets. Reliability levels contributed to improved customer service during the year.

In the U.K., Northern Gas Networks (NGN) which operates a gas distribution network in the north of England recorded results ahead of those for 2006. In a recent independent benchmarking performed by the U.K.'s gas and electricity regulator, NGN was benchmarked as the most efficient network in the U.K.'s gas industry setting the efficiency frontier for the industry. NGN recently concluded a regulatory price reset review for the regulatory period 2008-2013. The outcome was considered acceptable and should permit NGN to record a satisfactory return over the new regulatory period.

In Thailand, construction of the 1,400 MW gas-fired Ratchaburi Power Station is nearing completion with

the first 700 MW unit scheduled to commence commercial operation in March 2008 followed by the second unit in June 2008.

In Canada, the acquisition of a 50% interest in Stanley Power Inc. was completed at the end of 2007. Stanley Power holds a 49.99% interest in TransAlta Cogeneration L.P. TransAlta Cogeneration has interests in six power plants located in three Canadian provinces Alberta, Saskatchewan and Ontario with a total attributable generating capacity of 810 MW. Five of the power plants are gas-fired and one coal-fired.

Outlook

The current and past schemes of control have ensured that the necessary investment in Hong Kong's electricity infrastructure has been made over the years as Hong Kong transitioned from a developing economy with an industrial base to a developed economy with a service base and an international financial centre. With the signing of the new SCA, much of the recent uncertainty surrounding the electricity industry in Hong Kong has been removed and we can now focus on planning for the future so as to continue contributing to the economic development of Hong Kong.

Internationally, we will continue to look for investment opportunities so as to increase the proportion of Group earnings derived from activities outside Hong Kong.

On behalf of the Board, I would like to record our thanks and appreciation to Mr. Ewan Yee who resigned as a director at the beginning of 2008 for his contributions over 40 years of service to the Company.

I would also like to express my appreciation to the directors for their valuable counsel during the year and to the management and staff for their loyalty and hard work in 2007.

Canning Fok Kin-ning

Chairman

Hong Kong, 6th March 2008