Financial Review

Capital Expenditure, Liquidity and Financial Resources

Capital expenditure during the year amounted to HK$1,747 million, which was primarily funded by cash from operations. Total external borrowings outstanding at the year end were HK$13,495 million (2006 : HK$14,689 million), comprising unsecured bank loans and debt securities in issue. In addition, the Group had undrawn committed bank facilities of HK$7,145 million (2006 : HK$5,686 million) and available liquid funds of HK$12,180 million (2006 : HK$10,462 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 whilst managing the Group's currency, interest rate and counterparty credit risks.

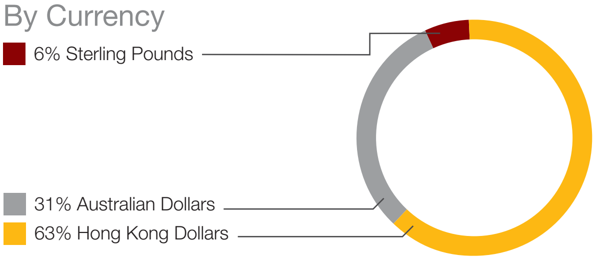
In January 2007, The Hongkong Electric Company, Limited ("Hongkong Electric"), through its subsidiary, Hongkong Electric Finance Limited, issued HK$500 million fixed rate notes due 2012 at a coupon rate of 4.32% p.a.. During the third quarter of 2007, Hongkong Electric refinanced HK$5 billion of its bank facilities at competitive rates and at the same time, extended the Group's debt maturity profile.

Following a review of the financing structure of its UK investment, the Company refinanced approximately 50% of its equity contribution with bank borrowings in November 2007.

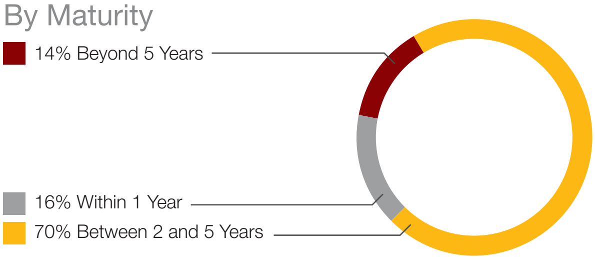
The Group's financial profile remained strong during the year. Standard and Poor's affirmed the A+ long term credit ratings of Hongkong Electric Holdings Limited and Hongkong Electric with a stable outlook in January 2008. As at 31st December 2007, net debt of the Group was HK$1,315 million (2006 : HK$4,227 million) with a net debt-to-equity ratio of 3% (2006 : 10%).

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

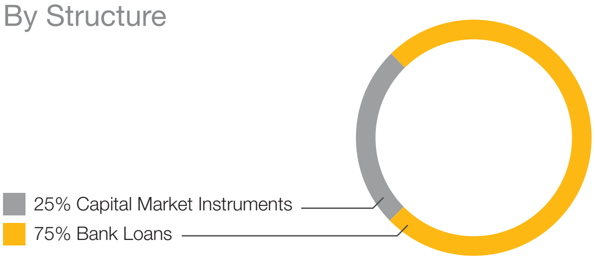
By Currency



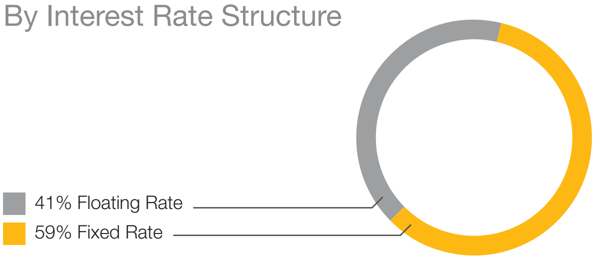
By Maturity



By Structure



By Interest Rate Structure



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 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 2007, 59% 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 2007, over 95% of the Group's transaction exposure was either denominated in US dollars or hedged into Hong Kong or US dollars. Where considered appropriate, foreign currency exposure arising from the Group's 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, with the resultant translation differences included in the Group's reserve account. Since such differences do not have any impact on cash flows until the investments are disposed of, currency translation exposure is not hedged.

The contractual notional amounts of derivative financial instruments outstanding at 31st December 2007 amounted to HK$9,576 million (2006 : HK$5,306 million).

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 2007 was HK$281 million (2006 : HK$75 million).

Contingent Liabilities

The Company had given guarantees in respect of banking facilities made available to an associate amounting to HK$2,482 million (2006 : HK$nil).

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$5,286 million (2006 : HK$5,563 million). Out of this amount, HK$5,156 million (2006 : HK$5,257 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, Hongkong Electric, has given guarantees to third parties in respect of the value of leased equipment of HK$210 million (2006 : 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 2007, excluding directors' emoluments, amounted to HK$843 million (2006 : HK$887 million). As at 31st December 2007, the Group employed 1,879 (2006 : 1,931) permanent staff. No share option scheme is in operation.

Apart from well-established training schemes for university graduates, trainee technicians and apprentices, the Group 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. Educational courses relevant to the job are also provided to develop and enhance the general skills and knowledge of employees.