Financial Review

Financial Performance

The Group's 2012 turnover reached HK$10,415 million (2011: HK$10,201 million). The 2% growth in turnover was due to a 1% increase in average basic tariff coupled with a 1% increase in unit sales of electricity in Hong Kong. Profit attributable to shareholders grew by 7% to HK$9,729 million (2011: HK$9,075 million), of which HK$5,108 million (2011: HK$4,563 million) came from operations outside Hong Kong and HK$4,621 million (2011: HK$4,512 million) was contributed by Hong Kong operations.

Our investments in the United Kingdom, providing an 18% higher earnings of HK$4,203 million (2011: HK$3,558 million), was the main driver of earnings growth. We immensely benefited from these electricity and gas distribution assets operating in a stable regulatory regime. Our Australian investments recorded slightly higher earnings of HK$848 million (2011: HK$843 million) despite unfavourable weather conditions and an adverse economic environment. Generation assets in mainland China faced soft electricity demand and notched less favourable results. Our operations in Canada, Thailand and New Zealand also delivered weaker performances compared with 2011 levels.

Profits from Hong Kong operations grew by 2%, mainly contributed by the stable earnings of the electricity business regulated by the Scheme of Control Agreement with the Hong Kong SAR Government.

Secure earnings and a strong financial position allowed us to continue with a stable dividend policy. 2012 full year dividends of HK$2.45 per share (2011: HK$2.32 per share) represented a 5.6% growth.

Financial Positions, Liquidity and Financial Resources

The Group's financial position remained strong. Fixed assets in Hong Kong grew to HK$49,298 million (2011: HK$48,799 million). Capital expenditure during the year amounted to HK$2,613 million (2011: HK$2,890 million), which was primarily funded by cash from operations. Interest in associates and jointly controlled entities rose by 16% to HK$41,511 million (2011: HK$35,697 million). In September 2012, we invested in a new joint venture called Transmission Operations Australia which will construct, own and operate a power transmission link to transport renewable energy to Victoria's power grid. In October 2012 we acquired a 30% stake in Wales and West Utilities Ltd, one of the United Kingdom's eight major gas distribution networks. Total external borrowings outstanding at the year end were HK$24,599 million (2011: HK$23,626 million), comprising unsecured bank loans and debt securities in issue. In addition, the Group had undrawn committed bank facilities of HK$8,033 million (2011: HK$6,500 million) and bank deposits and cash of HK$6,140 million (2011: HK$6,121 million).

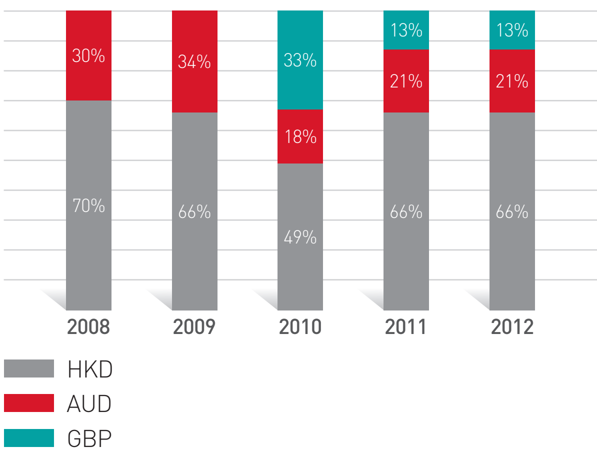
Treasury Policy, Financing Activities and Debt Structure

The Group manages its financial risks in accordance with guidelines laid down in its treasury policy, which is approved by the Board. The treasury policy is designed to manage the Group's currency, interest rate and counterparty risks. Surplus funds are generally placed on short term deposits denominated mostly in United States dollars or Hong Kong dollars. The Group aims to ensure that adequate financial resources are available for refinancing and business growth whilst maintaining a prudent capital structure.

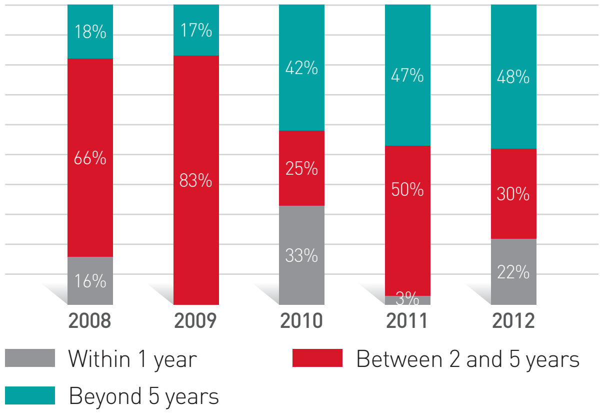
The Group's financial profile remained strong during the year. In December 2012, Standard and Poor's affirmed the "A+" long term credit ratings of Power Assets Holdings Limited and The Hongkong Electric Company, Limited with a stable outlook. As at 31st December 2012, the net debt of the Group was HK$18,459 million (2011: HK$17,505 million) with a net debt-to-equity ratio of 29% (2011: 30%).

The profile of the Group's external borrowings as at 31st December, after taking into account interest rate and cross currency swaps, is set out in the tables below:

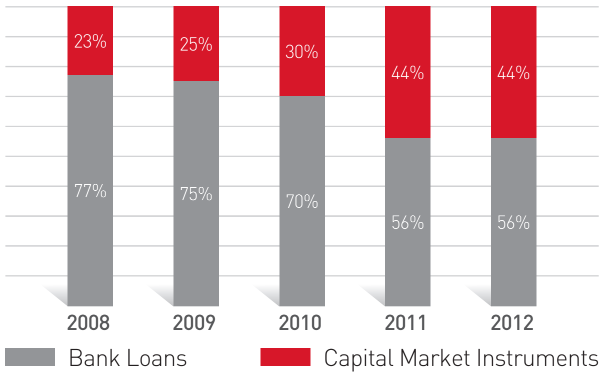
Debt Profile by Currency



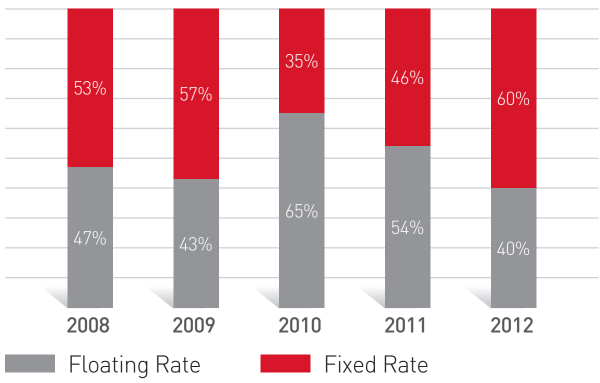
Debt Profile by Maturity



Debt Profile by Types of Borrowings



Debt Profile by Interest Rate Structure



The Group's policy is to maintain a portion of its debt at fixed interest rates. Interest rate risk is managed by either securing fixed rate borrowings or by using interest rate derivatives.

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 counterparty risk exposure.

The Group's principal foreign currency exposures arise from its investments outside Hong Kong and from the import of fuel and capital equipment. Foreign currency transaction exposure is managed mainly through forward contracts. As at 31st December 2012, over 90% of the Group's transaction exposure from the import of fuel and capital equipment was either denominated in United States dollars or hedged into Hong Kong or United States dollars. Currency exposure arising from investments outside Hong Kong is, where considered appropriate, mitigated by financing those investments in local currency borrowings and by entering into forward foreign exchange contracts. Foreign currency fluctuations will affect the translated value of the net assets of investments outside Hong Kong and the resultant translation difference is included in the Group's reserve account. Income received from the Group's investments outside Hong Kong which is not denominated in Hong Kong dollars is, unless otherwise determined, converted into Hong Kong dollars on receipt.

The contractual notional amounts of derivative financial instruments outstanding at 31st December 2012 amounted to HK$32,467 million (2011: HK$26,405 million).

Charges on Assets

At 31st December 2012, the Group's interest in an associate of HK$630 million (2011: two associates and a jointly controlled entity of HK$14,084 million) had been pledged as part of the security to secure financing facilities granted to the associate.

Contingent Liabilities

As at 31st December 2012, the Group had given guarantees and indemnities totalling HK$979 million (2011: HK$1,149 million).

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$8,889 million (2011: HK$8,161 million). Out of this amount, HK$8,889 million (2011: HK$8,156 million), while being a contingent liability of the Company, is reflected in the consolidated balance sheet of the Group.

Employees

The Group continues its policy of pay-for-performance and the pay levels are monitored to ensure competitiveness is maintained. The Group's total remuneration costs for the year ended 31st December 2012, excluding directors' emoluments, amounted to HK$910 million (2011: HK$858 million). As at 31st December 2012, the Group employed 1,832 (2011: 1,861) permanent employees. No share option scheme is in operation.