Strategy

Once we are clear about CLP's values and abilities we can develop a strategy which respects our values and exploits our abilities.

CEO's Review

Andrew Brandler, Chief Executive Officer

Historically, CLP's focus on our core Hong Kong electricity business has been consistent and effective. At present, with a new SoC in place since 2008, the regulatory risks to our business seem manageable, with a relatively low near-term competitive threat. With the discussions on the new SoC behind us, and ongoing excellence in the reliability, tariff levels and customer service which we offer, our public positioning is broadly favourable, even though as the sole supplier of an essential public service to 80% of Hong Kong's population, we will always remain the object of close, continuing and critical scrutiny. We can have no objection to that. In present circumstances, our Hong Kong electricity business provides a continuing platform for investment, albeit at a substantially reduced rate of return.

On the other hand, the model for our non-Hong Kong businesses has varied widely and, on occasions, has been unsettled by changing events and mixed experience. This experience has taught us a number of things. First, that geographic proximity may be an unproven business proposition – electricity markets are essentially local or national, rather than regional. Secondly, investment opportunities are usually "event driven" and "lumpy" (in the sense that we have not seen a smooth and predictable pipeline of realised investments, given our financial discipline). Thirdly, our previous strategic vision of building "meaningful" businesses in selected markets has not always been helpful – it assumed that we could always make the correct choices about the right markets to be in and that the Company and its shareholders should then allocate to these markets the potentially large-scale amounts of capital needed to build a "meaningful" business.

We cannot be sure that the SoC for our Hong Kong electricity business will necessarily be renewed in the same or similar form. Moreover, there are potentially paradigm-shifting environmental issues and concerns bearing on our industry – the potential impact of which has been illustrated by the significant risk to our balance sheet from threatened carbon pollution reductions legislation in Australia. We have, therefore, carefully reviewed our strategy with the Board. In doing so, we have recognised the differences between our Hong Kong electricity business and our activities in other markets.

Within the Hong Kong business, a priority is the ongoing management of the interface with our regulator, the HKSAR Government. This is both to defend shareholders' interests under the current SoC and to position the business for a post-2018 regulatory structure. This will include explanation and emphasis to Government of the importance of a stable, fair and long-term regulatory structure to enable the large-scale and long-term capital investment which is required to maintain the outstanding quality of Hong Kong's electricity supply. The continued quality of our operations will be critical to the relationship with Government, the shape of any revised regulatory structure and the willingness of Hong Kong people to extend our "social franchise" as the trusted provider of an essential public service. Quality in operations will include a strengthened focus on cost control and efficiency, as well as levels of customer service. Even though our environmental performance is first-rate, we know that we will be expected to lower our emissions even further, including carbon emissions. We should expect to make further investments in lower carbon emissions generation and, over time, to continue to move away from coal-fired generation – provided that Government and our customers understand the implications of doing so on tariff levels, reliability and energy security. We see environmental excellence, along with supply reliability, quality, tariff levels and customer service as major competitive advantages that we have, and can enhance, against potential entrants to the Hong Kong electricity market.

Outside Hong Kong, our strategy is to adopt a flexible, market-by-market approach with a focus on a balanced portfolio which reflects our trajectory towards a low-carbon business. This flexibility will manifest itself in different ways. We will no longer maintain a fixed intention to build "meaningful" businesses in pre-selected markets. We will be cautious when contemplating wide-scope corporate joint ventures. Although our partnerships in OneEnergy, Roaring 40s and elsewhere have served shareholders' interests, we are not satisfied that they proved to be the most effective manner to exploit our expertise, capital and management time and resources. CLP, traditionally, has not been a "seller" of projects and assets. Whilst we will not become a "trader" (this suits neither our philosophy nor reflects the long-term character of our business), we will be more flexible in the timing and manner of the maximisation of portfolio values.

In practice, this will involve harvesting legacy assets without obvious growth opportunities, and the exploitation of the growth potential of other assets and market positions, on a case by case basis, with a view to long-term expansion through a partial sale, merger, separate listing and the like. This is most likely to occur once overseas businesses have reached self-standing scale and maturity, the credibility of the Hong Kong business is no longer needed to support those activities and their capital needs exceed the prudent funding capability of CLP Holdings.

The performance and outlook for each of our major business streams outside Hong Kong is discussed later in this Annual Report. However, it is probably helpful if I summarise here the Board's strategic direction for each of these businesses, with which their activities will be aligned.

In Australia, TRUenergy is a platform either for organic growth or positioning within future industry consolidation. There are growth opportunities in the Australian energy sector, such as in gas-fired generation or New South Wales retail privatisation. Over time, TRUenergy will need external capital in some shape or form, if it is to fully participate in growing within the Australian market. In the meantime and in any event, TRUenergy needs to maintain its improving operating performance, as well as strengthening its position in upstream gas, renewables and clean energy. TRUenergy also has the challenging task of managing and mitigating the operational and financial impact of any carbon pollution reduction scheme on our brown coal-fired power station at Yallourn.

Within the Chinese mainland, we do not believe that we have a competitive advantage in conventional coal-fired generation. The electricity reforms of past years created five massive generating companies with significant state ownership. These serve in effect, as "national champions". This being so, our strategy will be to scale back investment in coal-fired generation, although our Fangchenggang Power Station is a valuable asset in itself, with potential for expansion at the site. Our growth opportunities are in renewable energy, hydro and, especially wind where we have increasing expertise and experience. The relationship with China Guangdong Nuclear Power Holding Company, Limited originally established through our work together at Daya Bay, offers an avenue for further participation in the expansion of China's nuclear power industry – principally in Southern China and, possibly, overseas in those markets where CLP already has an established business presence, reputation and relationships.

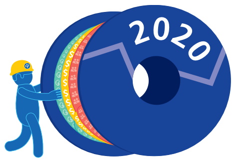
India presents significant long-term development opportunities. There may be occasionally troubled times and setbacks ahead, but the broad upward trajectory of social and economic development in India seems firmly established. This benefits the electricity sector. In recent years, and again this might change from time to time, India has been "open for business" in terms of accepting foreign investment in the power sector. This was demonstrated by our success in winning a competitive bidding process for the greenfield coal-fired power station project at Jhajjar. The opportunities we see, which will only be pursued in reforming states, exist across the industry, including gas-fired generation, renewable energy and transmission projects. It may be that the growth of this business will also make demands on CLP Holdings' capital on a scale beyond which we are prepared to fund ourselves. At that stage, we would need to look at alternative funding options, which could include a local listing.

In Southeast Asia, we will be critically reviewing the status of our investment in EGCO in Thailand. Ideally, we would like to increase our influence and input into the management and direction of EGCO, so that we can play a full part in developing EGCO as an investment platform for a Southeast Asia energy business. If that does not prove possible, then we will have to pursue other routes to exploit regional opportunities. These opportunities exist. Vietnam, for example, where we have been exploring, with our joint venture partners Mitsubishi Corporation, participation in two greenfield coal-fired power station projects, appears to be an interesting market with strong underlying demand for new generation. The challenge is to procure generating plant at a good price and international project finance on reasonable terms – our past experience at Ho-Ping, Fangchenggang, BLCP and Jhajjar suggests that this is an area in which CLP has relevant and valuable skills.

All of our market strategies, in Hong Kong and elsewhere, are consistent with CLP's Climate Vision 2050 – our commitment to make massive reductions over time in the carbon intensity of our generating portfolio. In doing so, we match environmental responsibility with economic motivation – capturing the rewards of lower carbon emissions generation, whilst mitigating the risks and penalties which will increasingly be associated with high carbon emissions. We will continue to invest in renewable energy, provided that government support, especially in the form of subsidies or similar incentives makes this form of electricity generation financially, as well as environmentally, sustainable. Where we have a customer base (presently in Hong Kong and Australia) we will look to pursue value-added products, such as energy saving solutions and green energy offerings.

Our investments in clean energy, whether in renewable energy or the abatement of emissions from more conventional generation, will centre upon proven technology. Our experience with our Solar Systems investment in Australia illustrated the dangers associated with investment in early stage technology. This is a field better left to venture capitalists and others with a greater risk appetite and more specialist expertise in the identification and commercialisation of new technology. At the same time, we believe it is important for us to monitor the latest trends with a view to introducing new technologies into our portfolio once these have been de-risked. Carbon Ventures, a group level business unit, will continue evaluating new technologies as well as identifying and introducing suitable and commercially sustainable new technologies to our projects and operations. One example of this may be solar photovoltaic technologies, whose cost curve is declining and efficiency gradually rising.

There would be no sense in having a strategy without the money to make it happen. We will continue to optimise our financial and capital structure and to keep this aligned with the business needs of the foreseeable future. However, we will remain prudent – as our long-serving Chairman, the late Lord Kadoorie used to say, it is not CLP's business to "work for the banks". Our financial position is robust, despite the economic downturn. Over the short to medium term, CLP has the firepower, without raising equity capital at CLP Holdings' level, but with selected non-strategic asset disposals, to pursue the strategy which we have explained above.

Our  Vision

The Board and I felt that our strategy should be tied to a longer term vision for the Company – the direction in which our strategy should lead us and the type of company we may be or become in the medium to longer term. We believe that our strategy points towards a vision of CLP in 2020 as a diversified electricity company which:

- maintains its base and core operating business in Hong Kong, subject to the opportunities and challenges offered by any changing electricity regulatory framework;
- holds a significant stake in a leading listed Australian energy supplier, following industry consolidation;
- is the controlling shareholder of a listed energy company in India and Southeast Asia;
- has a significant, but minority, stake in nuclear energy in Southern China and is looking to exploit this in other Asian markets;
- invests in and operates, if available, transmission and distribution assets in India and in the Chinese mainland;
- has largely exited conventional coal-fired generation in the Chinese mainland; and
- is one of Asia's largest investors in clean and renewable energy.

We hesitated about setting out this vision in our Annual Report. There were two reasons for this hesitation. The first was potential embarrassment about looking back in future years and comparing what has actually happened with that vision. The second, more substantial, reason is that experience has taught us to be realistic and modest about our capacity to predict the events and circumstances which will shape the future of our business. The implementation of CLP's strategy will be impacted by incoming disruptive change in our industry, including the speed of economic and social development in differing Asian countries, the effect of climate change and societies' responses to this threat, technological advances and regulatory changes. Unlike 20/20 vision in the true, optical, sense of the term, our vision is not perfect – our ability to foresee and influence these changes will vary. However, our experience in our industry and in the region equips us to detect trends and to proactively adapt to or exploit them.

Andrew Brandler

Andrew Brandler
Hong Kong, 25 February 2010