CEO's Strategic Review

"Turning our **2020 Vision** into reality"

Andrew Brandler, Chief Executive Officer

CLP's business model is a simple one. We are an investor and operator in the energy sector of the Asia-Pacific region. We do not wish to conduct any other activity, nor extend our business beyond that region. Our basic business model may be simple, but realising our vision as the leading responsible energy provider in the Asia-Pacific region, from one generation to the next, is an extremely challenging task. Our business requires us to make large-scale capital investments in assets whose economic life may span many decades, in widely differing markets, volatile economic conditions, with evolving expectations of government and society and potentially disruptive changes in technology. In the circumstances, it is essential that there is strategic clarity as between CLP management, our Board and our Shareholders. This CEO's Review provides me with an ideal platform to reinforce that clarity and sense of common purpose. In doing so, I want to return to the remarks I made in my Review to our 2009 Annual Report. Although only two years have passed since then, the increasing velocity of the events which shape our industry and the intervening developments within CLP itself, mean it is timely to review the progress we have made in realising our strategy and on our journey towards our 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.

Hong Kong

As regards our strategy for the Hong Kong business, we have always recognised the priority to be given to the ongoing management of the interface with our regulator, the HKSAR Government, both to protect shareholders' interests under the current SoC and to position the business for a post-2018 regulatory structure. We have identified the continued quality of our operations as 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. We understand that quality operations must include a strengthened focus on cost control and efficiency, as well as levels of customer service. Although our environmental performance has been first-rate, we expect to lower our emissions even further, including carbon emissions. This will involve further investments in lower carbon emission generation and, over time, a continued 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.

This Annual Report, and the accompanying online Sustainability Report, demonstrate that we have continued to deliver on our commitment to provide our Hong Kong customers with an electricity supply which is characterised by supply reliability, power quality, environmental performance, excellence in customer service and reasonable tariff levels. As regards the quality of the relationship with our regulators within the HKSAR Government, and as Sir Michael Kadoorie has remarked in his Chairman's Statement, we would have welcomed Government being more forthcoming in the public domain about the consequences of its energy policy, the choices which it has made and the impact of its decisions on tariff levels. In 2012 and beyond we will re-double our efforts in explaining to Government and to the wider community the importance of a stable, fair and a 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.

We will also seek to explain, in an honest, informed and transparent manner, that the major transformation in Hong Kong's electricity infrastructure which Government has set in place as we move away from heavy reliance on coal-fired generation towards cleaner energy sources, notably gas and nuclear energy, requires substantial investment and the entering into contracts and commitments which will last 20 years or more. We will explain that the environmental benefits of this cannot be attained and maintained without increased cost, through higher tariffs, to the community for whom those benefits are intended. We welcome an intelligent and informed debate about Hong Kong's electricity supply – the motor of the SAR's social and economic development. We welcome rational and balanced choices about the future shape of that industry.

Outside Hong Kong

Our strategy outside Hong Kong is to adopt a flexible, market-by-market approach, with a focus on a balanced portfolio which reflects our long-term move towards a low-carbon business. We have moved away from our earlier intention of building "meaningful" businesses in pre-selected markets. We have become more cautious when contemplating wide-scope corporate joint ventures. Traditionally, CLP has always been a long-term holder of its assets and investments. Whilst CLP has not become a "trader", which reflects neither our business nor our philosophy, we have become more flexible in the timing and manner of the maximisation of portfolio values. This involves 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 retention and organic growth, or through a partial sale, merger, or separate listing of various businesses.

In the following paragraphs, I discuss each of our four business streams outside Hong Kong from the perspective of our strategic approach and our progress towards our 2020 vision.

A couple of years ago, I described TRUenergy in Australia as a platform either for organic growth or positioning within future industry consolidation. The acquisition in March 2011 of the EnergyAustralia retail business in NSW and substantial additional generating capacity was a transforming transaction for TRUenergy. It positions TRUenergy firmly as one of the three leading energy generators and retailers in Australia's national energy market and as the second largest in terms of electricity alone.

The size and quality of this business is such that it may be regarded as capable of being listed on the Australian Securities Exchange if and when such a step would be beneficial to CLP's shareholders and to TRUenergy's long-term future. Such a listing may have a number of potential benefits: it allows a return of capital to CLP, provides TRUenergy with its own capability to raise capital to fund future investment and strengthens the Australian identity of the business. In addition, it would allow TRUenergy's board and management to focus single-mindedly on its own business, rather than competing for resources and capital within the CLP Group as a whole. To that end, we have engaged financial advisors, on a preliminary basis, to review the prospects for a future possible listing. Even so, the quality of the business, and our growing experience in the Australian energy market are such that TRUenergy is a major asset to CLP, as it stands. As such, whilst a listing is an option for serious consideration, we have not yet taken any decision as to the principle, terms or timing of any such step.

Within the Chinese mainland we are repositioning our investment in coal-fired generation, as demonstrated in 2010 by the sale of our 70% interest in the Anshun II power station in Guizhou. We are also looking critically at those coal-fired assets with limited scope for expansion where we have a minority interest. On the other hand, our majority-owned coal-fired power station at Fangchenggang has proved to be a valuable asset and, within the next year, we hope to obtain the necessary approvals for two further 660MW units at the site. Other than Fangchenggang, our growth opportunities are predominantly in renewable energy and in nuclear power. We have started to build on the longstanding relationship with China Guangdong Nuclear Power Holding Company (CGNPC), which originated through our work together at Daya Bay. CLP's agreement to take a 17% interest in CGNPC's Yangjiang Nuclear Power Station in Guangdong is an example of how that relationship offers an avenue for further participation in the expansion of China's nuclear power industry, principally in Southern China and, possibly, in the longer term in overseas markets where CLP already has established a business presence, reputation and relationships. The Fukushima accident has, understandably, caused a pause in the planned expansion of China's nuclear energy capacity. Nonetheless, I firmly believe that China's nuclear expansion will resume its projected path, once the lessons of Fukushima have been carefully analysed and absorbed and any necessary design and operating changes and improvements have been fully assessed and implemented.

India continues to present significant long-term development opportunities aligned with the overall upward trajectory of social and economic development. There are indications, such as the volatility of the Indian rupee, the Union Government's budget deficit and disruptions in coal supplies, that the power sector in India may be going through a period of turbulence. However, CLP has gained considerable experience in the Indian market over the past decade, whilst other foreign energy players have withdrawn or stayed away. Our existing gas-fired power station in Gujarat, the progress of our greenfield coal-fired power station project in Jhajjar and the growth of our wind energy portfolio mean that CLP has a broad presence in the Indian power sector and the capabilities to catch opportunities as they arise. It is possible that, as with TRUenergy, our Indian business may at some stage make demands on CLP Holdings' capital on a scale beyond that we are prepared to fund ourselves. Our response might involve recourse to joint ventures at project level, in order to ease our capital commitments. In due course we would consider a local listing, although the time scale for such a step is well beyond that which I might envisage for TRUenergy.

In our 2020 vision, I suggested that the future might see CLP, amongst other outcomes, as a controlling shareholder of a listed energy company in Southeast Asia. For the moment, this is the aspect of our 2020 vision in which I have lowest degree of optimism. Markets such as Indonesia, the Philippines, Vietnam and Thailand, have a significant need for additional generating capacity and transmission infrastructure to support ongoing economic growth. However, in practice, the opportunities for outside private sector participants such as CLP to invest in these markets on terms which meet our required investment criteria and quality seem limited. The outcome of our development efforts on the two coal-fired projects which we are jointly developing in Vietnam, and on which we have already expended considerable time and effort, will be a major indicator of the medium to longer term prospects for this aspect of the Group's activities.

Climate change

Shareholders will recall that CLP's Climate Vision 2050, which we announced in December 2007, set targets for the progressive reduction of the emissions intensity of our generation portfolio. These targets were based on our best forecast at the time of the speed of change in our business and the scale of policy and regulatory support. Our target was to reduce the CO_2 emissions intensity of our generating portfolio from 0.84kg CO_2/kWh progressively to 0.2kg CO_2/kWh by 2050. We also planned to increase the non carbon-emitting generating capacity in our portfolio to 20% by 2020 and to ensure that 5% of our generating capacity came from renewable energy by 2010.

By December 2010 we had made substantial progress towards our targets, in some cases significantly beyond our own expectations. For example, our renewable energy generating capacity had already grown from approximately 1% in 2005 to 15% by 2010. In those circumstances, we set new and more stringent targets for 2020. These are set out on our website and explained in our publication "Our Journey to A Low-Carbon Energy Future". They include a commitment to reduce our CO_2 emissions intensity to 0.6 kg CO_2/kWh by 2020, increase our renewable energy to approximately 20% of our generating portfolio and to ensure that 30% of our generating capacity will be non-carbon emitting. We remain on track to meet these more ambitious targets. For example, our renewable energy capacity now stands at over 18% of our total generating portfolio and about 22% of our generating capacity is non-carbon-emitting.

The series of UN-sponsored meetings on a multinational framework for tackling climate change have, as yet, produced disappointing results. Even so, I believe that international efforts to reduce carbon emissions, including those from the power sector, will continue, even if those efforts may sometimes be slowed by adverse economic conditions. In the medium-term the impetus for clean energy will likely stem less from a new global accord and more from policies and regulations at a national level. CLP has seen examples of this in all of the markets in which we are present – each of which offers support, in one form or other, for renewable energy. I am, therefore, confident that CLP is on the right path in moving towards large-scale reductions in the carbon emissions from our activities. In doing so, we do the right thing for our planet, we are aligned with the direction of national policy in our markets and we mitigate the risks associated with future carbon liabilities – and we have seen an example of the scale and potential of such risks with the impairment we have made to our brown coal-fired power station at Yallourn, following the passage of the Australian Government's "Clean Energy" Legislative package.

Sustainability

CLP has been around for over 100 years. In that sense, we have already proved ourselves to be a sustainable business. We aim to be here a century from now. To achieve this, our mission is to produce and supply energy with minimal environmental impact to create value for shareholders, employees and the wider community. The Sustainability Committee Report, which is at page 116 of this Annual Report, explains the sustainability framework which we established in 2011 and the steps we are taking to embed sustainability goals in business planning and operations throughout the CLP Group. We do not see sustainability as purely an environmental concept, nor do we see it as something which is separate from the main stream of our business activities. In addition to establishing our sustainability framework, and setting specific and measurable sustainability goals for each of our business streams, we aim to improve our reporting to stakeholders, such as in this Annual Report and our accompanying online Sustainability Report, so that you have a wider and more informed view of CLP's performance in all aspects of its operations.

Funding

Our strategy and vision cannot be realised, nor would CLP be a sustainable business, without the necessary financial strength to achieve our objectives. CLP Holdings' liquidity and financial position remains strong. We have used this strength to implement several major financing efforts on favourable terms. For example, in the first half of 2011, CLP Holdings and TRUenergy arranged significant corporate loan facilities to support capital investment commitments, as well as to provide a reasonable liquidity cushion. CLP Power in Hong Kong continues to utilise non-bank finance through the public capital markets, as well as private placement with Hong Kong and other Asian investors. This strategy of lengthening maturities and diversifying funding sources has positioned CLP well to meet its short to medium-term financing requirements. Nonetheless, the uncertainties of financial markets and the scale of demands on CLP's capital mean that we must exercise discipline and caution in the pursuit of the opportunities available to us, in order to avoid over-extending ourselves. Substantial new investment opportunities will be carefully scrutinised for their potential to generate strong returns or deliver significant strategic benefits.

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CLP's price earnings ratio is comparable to those Australian power companies such as AGL. In any restructuring of its Australian business (including a possible listing of TRUenergy), how will CLP maximise value for CLP shareholders and avoid any discount to its current valuation?

Mr. Pierre Lau
Managing Director, Head of Regional Utilities,
Deputy Head of China,
Asia Pacific Equity Research,
Citigroup Global Markets Asia Limited

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We have not taken any decision to proceed with a possible listing of TRUenergy. In any case, we would only do this if we were satisfied that this would create value for CLP's shareholders. This would require a valuation which properly reflected the quality of the business, including by reference to relevant benchmarks such as AGL and Origin. In that regard, TRUenergy's valuation is not necessarily that which would be derived by applying the price / earnings ratio of the CLP Group as a whole to the TRUenergy business in isolation. The attractiveness of any potential IPO would be enhanced by good timing – choosing a moment when the full potential of TRUenergy's business, including following last year's NSW acquisition, was apparent to investors and when market conditions as a whole were welcoming for new issues.

A New Home

As many of our shareholders are residents in Hong Kong, they may have seen recent press coverage regarding the possible redevelopment of CLP's head office at Argyle Street in Kowloon. This has been CLP's home since 1940. Over the past 70 years the building has served CLP extremely well. However, after many decades we have reached a point where it is no longer suitable for modern business needs – as to which, it might be noted that most of the building was originally designed years ago as residential accommodation. Moreover, changes to fire safety and building regulations require substantial and expensive renovation works. These would involve major disruption to our operations over an extended period.

As a result, during 2012 we will move to occupy two floors of a converted commercial centre at Hok Un. This will provide additional office space, allow us to once again bring under one roof most of the major group functions and provide an improved working environment for our staff. The costs of the move are being carefully monitored and the location, layout and facilities at the new head office will correspond to CLP's typically modest and low-key approach to such matters.

The departure from Argyle Street does allow the possibility of residential redevelopment at the site. We do have approved plans for such redevelopment, but the decision, timing and details of any such redevelopment are not yet determined. We are aware of the heritage value of the Argyle Street building, in particular the Clock Tower which will be a familiar sight to many of our fellow citizens. We are working towards an outcome which would see a proper balance being struck between the legitimate interest of CLP's shareholders in the realisation of value from the redevelopment of the site and the community's desire, supported by Government, to see the preservation of an important and distinctive element of Hong Kong's built heritage.

Although the office from which I write to you next year may have changed, I look forward to the opportunity to report on continued progress in turning our 2020 vision into reality.

Andrew Brandler
Hong Kong, 27 February 2012

How can Management strike a balance between making the maximum profit for the shareholders on one hand and not to overburden the electricity consumers on the other?

Mr. Silvanus Lo
Shareholder

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In the case of our Hong Kong electricity business, we cannot simply maximise profit for shareholders since this is capped by the SoC – and our permitted returns were substantially reduced under the new SoC which took effect towards the end of 2008. As regards the burdens on electricity consumers, it is important to note that shareholder profit represents only one element of the overall tariff paid by those customers. The majority of the tariff is attributable to the cost of generating, transmitting and distributing electricity – most notably the purchase of fuel to generate electricity (on which CLP makes no profit whatsoever). CLP has an outstanding and demonstrable track record in controlling tariff levels. The facts speak for themselves – tariffs have fallen in real terms by about 30% since 1986, whilst at the same time, being accompanied by world-class levels of reliability, customer service and environmental performance.