



Chairman's Statement

Dear Shareholders,

My remarks in the 2012 Interim Report noted that, although our business was well-balanced and operating well, the scale, nature and diversity of our portfolio could not safeguard CLP against all of the risks and challenges inherent in our business and the markets in which we operate. CLP's performance over the past year bears this out and illustrates the volatility of the Asia Pacific power sector due to the increasing velocity of economic, social, political, regulatory and technological change.

The Group's operating earnings were HK\$9,406 million, a decline of 8.8% compared with HK\$10,312 million in 2011. Group total earnings, which include non-recurring items, were HK\$8,312 million, 10.5% lower than that in the previous year.

This has been a difficult year for some of our overseas operations. For that reason, I have asked Andrew Brandler, our Chief Executive Officer, in his Strategic Review (which forms an important component of this Annual Report) to describe the various factors which lie behind the Group's earnings across our diversified portfolio. I suggested that Andrew might do this in similar terms to the briefing which the Board and I received in December during our review of CLP's performance and outlook, so that shareholders have a clear picture of their Company's strategy and the value that it creates as well as the prospects for further growth in the years ahead. In this Chairman's Statement I wish to focus on the performance and outlook of our Hong Kong electricity business, which remains at the core of the Group's operations

and provides the majority of our earnings. In doing so, I also wish to further develop some of the themes and issues which I canvassed in my remarks in last year's Annual Report and which I also addressed at our Annual General Meeting in May.

I believe it entirely appropriate for me once again to discuss the qualities of Hong Kong's electricity supply in this Chairman's Statement. Over the past 10 years, CLP's shareholders and lenders have invested almost HK\$72 billion in ensuring that Hong Kong has the electricity infrastructure it needs. Our capital providers are entitled to expect that this investment is made carefully and that CLP's assets are operated and maintained to the highest standards. Similarly, in the ongoing debate about our industry, our customers are entitled to expect outstanding levels of performance and service in return for the reasonable and carefully monitored tariffs they are asked to pay.

Energy for Life

In the past year, as in previous years, we have maintained excellence in the delivery of electricity to power the social and economic life of our community. CLP has continued to offer outstanding performance in all the respects by which the quality of the supply of electricity should be measured.

- Reliability – once again, the reliability of our electricity supply is amongst the best of any city in the world – more reliable than New York, London and Sydney and greatly superior to that delivered to customers in other major

cities of China, such as Beijing, Shanghai or Shenzhen. The strength of our network and the commitment of our staff was tested during the night of 23 July 2012 when typhoon signal No. 10 was hoisted as Severe Typhoon Vicente passed over Hong Kong. Supply to only 36,500 customers was affected. Despite hurricane-force winds and heavy rainfall, by around 10:00 a.m. the following morning supply had been restored to all except 4,000 customers, whose supply was restored during the day. The scale of outages was around one-tenth of that experienced the last time typhoon signal No. 10 had been hoisted, during the passage of Typhoon York in 1999. This demonstrated the reinforcement of our system strength and our increased organisational capability over the past decade. Whilst weather events and supply networks are never identical, I am aware that comparisons have been drawn between the almost inconsequential impact of Severe Typhoon Vicente on electricity supplies in Hong Kong and the major disruption experienced in New York during and after the passage of Hurricane Sandy in November 2012.

- **Efficiency** – the reliability of our generating assets, transmission network and retail services rests on effective cost management and carefully targeted investment. For example, our reserve margin (the extent to which the maximum potential output of all our available generating capacity exceeds the previous maximum demand for electricity – which reached a new level of 6,769MW on 28 August 2012) now stands at 31%, well within the reserve margin recommended by the International Energy Agency at 20% to 35%. By comparison, Singapore adopts a reserve margin of 50%.
- **Environmental performance** – due to the depleted gas reserves in the Yacheng field, which supplies gas for power generation at Black Point, less natural gas was available for use in 2012. Despite this, we were still able to keep emissions within regulated limits. Although experiencing a slight increase compared to 2011, total emissions are down by more than 80% compared to 1990, even though electricity demand actually increased by 81% over the same period.
- **Customer service** – while we always aim to do better, the benchmarking of our customer service against electricity utilities around the world demonstrates the quality of our service. We believe that our service compares favourably with that available to consumers anywhere in the world, including the most developed economies.

- **Tariff** – as explained elsewhere in this Annual Report (pages 42 and 43) CLP raised tariffs by an average of 5.9% with effect from 1 January 2013. We have done all we can to minimise the scale of this increase. However some increase is unavoidable, given the higher cost of fuel that we must pay to generate electricity to supply our customers. This is especially the case as the price and volume of natural gas we buy increases whilst we implement the Government's drive towards the lower use of coal and the greater use of gas, as part of Hong Kong's transition to cleaner generation. Even after the January tariff increase, CLP's tariffs, on average, remain amongst the most competitive in the world. To take a single example, residential electricity tariffs in Singapore (which has moved towards predominantly gas-fired generation and has competition between different generating companies) are 76% higher than the average tariffs paid by CLP's customers in Hong Kong.
- **Affordability** – since 1991, Hong Kong's GDP has grown by about 190% and average household incomes by over 100%. Electricity has become more, not less, affordable over the past 20 years. In fact, taking into account inflation, CLP's customers are paying almost 20% less in real terms today than they were in 1990.

Going Forwards

We will continue to build on the existing excellence of our Hong Kong electricity business for the benefit of our shareholders, our customers and the community at large.

Environmental Improvement

On environmental matters, the Government has announced plans to broadly achieve new air quality objectives (known as "AQOs") by 2020. I welcome the new Administration's commitment to pursue improvement in air quality on all fronts through better coordination of relevant policies on environmental protection, energy, transport and planning, as well as cooperation with Guangdong. I also welcome the remarks of the Chief Executive of the Hong Kong SAR in his recent Policy Address to the effect that Government and the community must make choices and take responsibility to make the right decisions, for the well-being of future generations. Such an approach by Government, with clear objectives and a roadmap to achieve cleaner air backed by the community as a whole, will support the efficient and timely long-term planning of CLP's generating capacity and key power supply infrastructure, which is essential to making sure that we can continue to do our part.

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The Government completed a public consultation process on Hong Kong's climate change strategy and action agenda at the end of 2010. Its consultation document proposed to change Hong Kong's fuel mix for electricity generation to 50% nuclear, 40% gas, 3 to 4% renewable energy, and no more than 10% coal, by 2020. In 2012, following consideration of the lessons from the Fukushima nuclear accident, Government reactivated the public engagement process. Such engagement is important as I do not yet see any clear community consensus around issues such as the increased import of nuclear energy, or the extent to which energy users are prepared to pay higher tariffs for low carbon generation. As with improvements to our air quality, clear objectives shared by Government and the community, and a timely roadmap, will allow CLP to make its contribution in the most efficient and effective way possible.

Reliability and Customer Service

I see no uncertainty about the overwhelming importance which the community, and those who speak for them, will always place on outstanding levels of reliability. We will maintain the world-class levels of supply reliability which our community demands and expects. This will involve ongoing investment in Hong Kong's electricity infrastructure, including that necessary to power the substantial new developments underway in our supply area, such as at Kai Tak and in West Kowloon. This investment will also support further improvements in customer services. I believe that our role will increasingly become one of helping our customers use their

energy wisely and efficiently, as opposed to merely being a supplier of power. The extensive work that we are already doing in researching and testing smart grid technologies is an example of the way in which, through innovation and investment, our relationship with our customers will evolve over the remainder of this decade.

Tariffs

As regards tariffs, our commitment to tight cost control and operational efficiency will remain. Our longstanding record in holding down tariffs speaks clearly to this commitment and our determination to continue to do so in the future. However, Government's decisions (whether those already taken or those in prospect) to move towards cleaner generation and place greater weight on improvements in environmental performance have direct consequences on the cost of power generation and, therefore, tariffs. Like all of us in Hong Kong, I would welcome a significant improvement in local air quality. I also recognise that further changes in local power generation form part of a much wider range of measures which Government needs to take towards this objective. In the power sector, as much as in any other part of our economy, measures to achieve environmental improvement must be paid for.

I have previously suggested that, as a result of gas supply agreements with Mainland suppliers required by the Memorandum of Understanding (MOU) signed between the SAR Government and the Central People's Government in 2008, fuel costs alone will increase by around 250% between



Visiting Black Point Power Station

2011 and 2015. This is because CLP will be required to use twice the current volume of natural gas, and the cost of this gas will be three times the price of the gas which was secured 20 years ago. This is the equivalent of a 40% increase in overall costs to consumers and will require regular and, at times, substantial tariff increases over several years.

The tariff increase with effect from 1 January 2013 is an example of this underlying trend. The actual trajectory of tariff increases over the next few years will be determined by factors such as the cost and availability of fuel in the energy markets, the speed, scale and direction of the implementation of Government's energy policies and the future level of energy demand. These factors cannot be predicted with certainty. I cannot, therefore, forecast the precise timing and levels of ongoing increases in electricity costs. I can foresee that these will be significant, in comparison to past trends (which, for example, saw CLP's tariffs frozen between 2000 and 2007). I can promise that CLP will make every effort to minimise the impact of these unavoidable pressures on future tariff levels.

Constructive Engagement and Transparency

I can also promise that CLP will work constructively with the SAR Government in managing and explaining these tariff pressures, as well as on the other important issues on which we must work together over the next five to six years. These include the Development Plan, which will set out the approved programme for CLP's investment in Hong Kong's electricity infrastructure between 2014 and 2018, and the Interim Review in 2013, where changes to the existing SoC Agreement can be mutually agreed by Government and CLP. In considering both issues, to ensure that Hong Kong can continue to enjoy an excellent electricity service into the future, Government must move forwards in a structured, balanced and fair manner, setting out its expectations for Hong Kong's electricity supply and how these expectations should best be met. Public attention is overwhelmingly paid to tariffs, which is understandable, whereas the other qualities of CLP's electricity service are taken for granted. In its consideration of the Development Plan it is

vital that Government takes into account not only the cost implications of investment, but also the manner in which this will contribute to safeguarding, and where appropriate enhancing, the other critical aspects of a balanced electricity service, including reliability, security of supply, environmental performance and customer service.

Looking further ahead, the current SoC Agreement is due to expire in 2018 if Government decides not to exercise the option to extend it for another five years. The duration of arrangements for gas and nuclear supply, as well as the operational life of new generation and transmission facilities, is 20 years or more. In other words, clarity on the post-2018 regulatory framework will be increasingly important if timely investment is to be made to ensure the continuation of Hong Kong's world-class electricity supply and the early and effective implementation of Government policies on environmental improvement.

I recognise that Government, legislators, the media and the community will expect CLP to be even more transparent in explaining the implications and costs of decisions about energy policy, the future direction of the power sector and the efficiency with which CLP conducts its business. We have nothing to fear from a frank and intelligent discussion about our business. On the contrary, an informed and open debate will contribute to informed and open decision-making about the future shape of Hong Kong's power sector.

I am confident that the outstanding quality of our Hong Kong electricity business, our capability to enhance that business in line with our customers' expectations and our willingness to engage in a constructive dialogue with our society about the future shape of this business mean that the supply by CLP of power to Hong Kong will remain central to the development and well-being of our community and to the delivery of value to our shareholders for many years to come.

Although CLP's operating earnings were down in 2012, the Board's confidence in our business and in its prospects for continued growth has been expressed in the decision to increase the dividends for the year by a fourth interim dividend of HK\$0.98 per share.



The Hon. Sir Michael Kadoorie

Hong Kong, 25 February 2013