CEO'S STRATEGIC REVIEW

" If I were asked to describe our current strategy in a word, I would choose *focus*."

In this, my first, Strategic Review I would like to start by underlining my commitment to repay the trust the Chairman and Board of Directors of CLP have placed in me by appointing me Chief Executive Officer. Second, I wish to acknowledge the solid foundation left to me by my predecessor, Andrew Brandler, who spent 13 successful years in this post. The task ahead of me is to build on this foundation, so that the Company continues to grow and prosper for the benefit of our shareholders and, on a larger scale, benefit Hong Kong and all the communities we serve.

In tackling my new responsibilities, I would stress that there will be no fundamental change to the Group's "2020 Vision". We plan to continue the strategic direction that was set out by the Board in 2009 and has guided us over the past five years. It is as well to remind ourselves from time to time of the keystones of that vision.

It is generally recognised that the operating environment in the energy markets in which we operate, has become more challenging in recent years. The regulatory issues we faced in Hong Kong in 2013 relating to the Interim Review of our SoC, the 2014-2018 Development Plan, and the 2014 Tariff Review are but one example. With the performances of some of our overseas operations continuing to be mixed, our near-term focus will be on strengthening those businesses.

We are prepared to roll up our sleeves to get those operations that are facing ongoing challenges running profitably and generating the return we would expect. Over the next few years, we plan to continue to grow the business at a measured pace.

In the following paragraphs, I shall outline the most pertinent issues in each of our major business streams and summarise our strategic direction for the businesses. I shall focus on the performance of Hong Kong and Australia as these two markets account for 95% of our revenue. More details will be discussed later in this Annual Report in the specific country sections.

Staying Focused

CLP has run very successful and reliable businesses for over a hundred years, particularly our core operation in Hong Kong. If I were asked to describe our current strategy in a word, the word I would choose is "focus".

In Hong Kong, we have a vertically integrated, regulated business which is the core of our operations. We generate, distribute and provide a world-class electricity supply to 2.4 million customers with a reliability rate of 99.999% – that takes focus and an unswerving commitment to doing things right for the benefit of our customers. Over the past decade, we have expanded our business outside of Hong Kong based on our view that a diversified portfolio would provide growth opportunities and reduce business concentration risks. We have focused our diversification in selected markets in Asia Pacific, including Australia, India, the Chinese mainland and in Southeast Asia. In these regional markets, we focus on parts of the electricity supply chain where foreign investors are able to establish a reasonable-sized business.

Hong Kong

In 2009, we issued *Towards a Greener Pearl River Delta – a Roadmap for Clean Energy Generation for Hong Kong*, which sets out CLP's vision for energy over the next decade. As our Energy Vision explains, the outlook for our Hong Kong business includes the development of clean and reliable electricity supplies on three levels:

- strengthening infrastructure integration;
- adopting a cleaner fuel mix; and
- promoting energy efficiency.

In 2013, we made some significant decisions that allow us to realise the commitments in our Energy Vision.

First and foremost, as noted by the Chairman in his Statement, we announced our plan to take control of CAPCO, which owns CLP's three power stations in Hong Kong, by teaming up with CSG to jointly acquire the 60% stake in CAPCO held by ExxonMobil. At completion, CLP will own a controlling 70% stake in CAPCO, up from 40% currently, while CSG will own the remaining 30%. Separately, CLP will also purchase ExxonMobil's 51% stake in Hong Kong Pumped Storage Development Company, Limited.

The CAPCO acquisition is significant as it gives CLP majority control over our core generating assets, enabling us to better coordinate our generation business with our transmission and distribution operations. It also reflects our confidence in the future of Hong Kong's power sector and reaffirms CLP's commitment to this city. As we have done in the past, we intend to continue to invest in our core market. In the run up to the completion of the transaction, we will continue to work with ExxonMobil and CSG to ensure a smooth transition. Importantly, as the Chairman has written, we look forward to further collaboration with CSG to bring further long-term benefits to Hong Kong. I believe this closer relationship with CSG puts us on a clear path to strengthen our infrastructure integration with Guangdong.

Notwithstanding the change in ownership, I want to stress that our action will in no way diminish our drive to providing a safe and reliable electricity supply, with continually improving environmental performance, excellent service and value for money for our customers. That is the CLP's way, and is not about to change now or in the future.

"Investing in our customer service is one of the most important aspects of our business that we need to get right, and I believe we have succeeded in doing so."

SoC Interim Review

Turning to the regulatory front, the 2013 Interim Review of the SoC Agreement with the Government was satisfactorily concluded in November 2013. One of the initiatives introduced by the Interim Review is the establishment of an Energy Efficiency Fund to carry out improvement works to enhance the energy efficiency of non-commercial buildings. CLP expects to contribute some HK$70 million to it. We welcome this as another significant step towards our Energy Vision, our goal of actively encouraging the community to use electricity wisely and our commitment to promoting energy efficiency and conservation.

Development Plan and Tariff Profile

Our Development Plan for January 2014 – September 2018 sets out what we will do over the five-year period to maintain CLP's supply reliability, meet growing demand and enhance environmental performance through supply and demand side measures, with projected capital expenditure totalling HK$34.1 billion. We are committed to delivering these capital projects on schedule, within budget and in a quality manner as we always have.

The Development Plan also establishes the approved Basic Tariff profile for the five years it covers. From now to 2018, the approved capital spending, together with operating costs, is expected to increase Basic Tariff by around 1.8% annually. This modest increase is the result of very prudent financial management and various initiatives to improve our work processes.

However, rising fuel costs remain a major challenge. While CLP does everything in its power to control the cost of producing electricity and distributing to our customers, there is little we can do to control the cost of the fuel we need to procure from the international marketplace which is determined by global supply and demand. As a result, rising fuel costs will continue to put pressure on our customers in Hong Kong. To meet tighter statutory emissions caps for power generation which come into effect in 2015, we will need to use more gas to generate electricity in place of cheaper coal. Our gas consumption in 2015 may need to double from 2014 levels to meet these requirements. Fuel cost pressures will continue to intensify with the increased use of more expensive gas, which is priced at international market levels. These pressures are particularly acute for CLP as we and our customers are shouldering about 90% of the territory-wide responsibility under the tighter emission caps.

CLP's key commitment is to make every effort to mitigate the impact of this tremendous challenge. At the same time, we will continue to care for the community by implementing a range of programmes to help our customers save energy and reduce their bills. To enhance information transparency and enable our customers to better understand the costs of fuels required to generate the electricity they need, we have been publishing data on energy costs for electricity generation and electricity sales each month on CLP's website.

We take no pleasure from having to pass on increases of any kind, but as a commercially and socially responsible company, we must act in a way that will enable us to continue the kind of safe and reliable service to our customers in a sustainable manner that is, frankly, the envy of other places around the world. It is worth repeating that the 99.999% reliability of our services in Hong Kong is one of the highest in the world. At the same time, our tariffs are among the lowest when compared to major cities such as Sydney, London and New York. I believe our customers expect and deserve nothing less.

Fuel Mix Consultation

In Hong Kong, our current balanced fuel mix of gas, coal and nuclear has served our society extremely well, providing a remarkably reliable electricity supply and giving CLP the flexibility to change our actual fuel mix year by year to optimise fuel costs and help manage tariffs. The Government is expected to launch a public consultation on the fuel mix to be used for future electricity generation in the first half of 2014. Great care and detailed planning are needed if this balanced portfolio of energy sources is to be changed significantly, so as to ensure that reliability can be maintained. On our part, CLP will provide information on the options available to help our community determine an appropriate policy, as we have pledged in our Energy Vision. After the Government and the community decide what the most appropriate future fuel mix for Hong Kong is, we will support the direction adopted and continue to deliver a reliable supply of electricity to our customers.

Australia

In 2013, the performance of EnergyAustralia continued to be affected by the decrease in wholesale electricity prices, continuing high levels of competition in energy retailing and extra costs associated with the implementation of the new Customer First (C1) billing and customer care system.

In the retail market, there has been a pronounced decline in electricity demand caused by rising prices, higher network costs, government renewable and energy efficiency programmes, growing popularity of rooftop solar photovoltaic systems and energy efficiency savings. The situation has not been helped by keen price competition amongst retailers. Business demand, meanwhile, has been hindered by a slowing manufacturing environment, in part due to rising energy costs, a high value Australian dollar and a slowing global economy.

2020 VISION

In 2009, the Board set out a "2020 Vision" of CLP as a diversified electricity company which:

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- maintains its base and core operating business in Hong Kong;
- holds a significant stake in a leading listed Australian energy supplier;
- 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;
- invests in and operates, if available, transmission and distribution assets in India and in the Chinese mainland;
- has largely exited minority positions in conventional coal-fired generation in the Mainland; and
- is one of Asia's largest investors in clean and renewable energy.

Note: CLP remains on track towards this "2020 Vision", other than for the aspiration to become a controlling shareholder of a listed energy company in Southeast Asia due to capital constraints, the lack of opportunities for private sector participants and the availability of investments elsewhere.

Internally, EnergyAustralia is making good progress with the issues related to the implementation of C1 that have weighed on the company's performances for months. In the second half of 2013, C1 was stabilised and the registrations backlog and number of unbilled accounts have reduced substantially. C1 now provides a solid platform on which we can integrate the 1.4 million customer accounts currently being serviced by Ausgrid under a Transition Services Agreement. Once this is complete, we should see significant cost reductions in the retail business.

At the Yallourn Power Station and mine, the Morwell River Diversion reconstruction was completed and labour disputes have been resolved. We look forward to working together with our employees there to secure the future of the plant.

Simply put, we are actively addressing these internal issues and we are seeing improvement in the operation of the business.

Externally, the wholesale electricity market is continuing to see suppressed prices resulting from an oversupply of generation and falling demand. Demand is dropping due to a combination of factors including the closure of some energy-intensive industries and the growing popularity of domestic solar panels, often assisted by generous feed-in tariffs. As mentioned, the oversupply of electricity generation, aggravated by a rush to build renewable energy projects to meet Australia's Renewable Energy Target, is an industry-wide issue. It may take some years for the supply and demand situation to return to balance and this will require the closure of older, less competitive generation facilities.

In 2013, EnergyAustralia took a number of steps to improve the fundamentals of its business with the aim of reducing costs, increasing efficiency and enhancing capabilities. In the retail area, the focus has been on the stabilisation of our C1 system and planning for the integration of our Ausgrid customer base, as well as gaining efficiencies from reduction in bad and doubtful debt and labour costs. A corporate cost efficiency programme has already delivered saving and will continue to seek improvements across our support functions.

A number of initiatives have also been undertaken within our generation portfolio. We completed a majority sell-down of Waterloo Wind Farm, realising proceeds of A$228 million, while at Yallourn, a major optimisation study has resulted in modification of our maintenance investment strategies.

In addition, our acquisitions of Mount Piper Power Station and Wallerawang Power Station in New South Wales (NSW) enhance our operational flexibility and reduce the costs associated with operating these plants. Subsequent to a review of our capital and operating strategies in line with market conditions, we removed one of Wallerawang's two units from service.

In light of the challenging operating environment expected over the coming years, we have taken a decision to recognise a non-cash accounting impairment and other charges of HK$3,106 million after tax, primarily in relation to our investment at Yallourn and our gas-fired assets. Yallourn has suffered from declining demand and oversupply of base load energy in Victoria, which has led to overall lower actual and forecast wholesale electricity prices. Our gas-fired assets are impacted by declining demand and rising gas prices. Additionally, the strong likelihood of the removal of the current carbon tax regime may adversely affect our gas plants.

In spite of these impairments, there is considerable strength in our underlying portfolio, which is well diversified by geography, fuel type and operational mode. It is concentrated in Victoria and NSW, the largest retail markets in Australia. At the same time, our generating assets are supported by brown coal reserves, black coal supply contracts and development options, long-term gas contracts and gas storage operations. This diversity and flexibility allows us to effectively manage opportunities and risks across our portfolio in response to market conditions. EnergyAustralia will continue to assess market conditions and will actively review the optimum size, operating strategies and holding structure of its generation portfolio in response to these conditions.

Chinese Mainland

Our operation in the Chinese mainland had a record year as we continued to benefit from the reliable operating performance of Fangchenggang Power Station in Guangxi Region and the improved performance of our renewable portfolio. This underlines the merit of our focused strategy on the Mainland of selective investments in nuclear power, coal-fired generation and renewable energy, accompanied by the divestment of minority stakes in joint ventures with limited growth prospect. In line with this strategy, we sold our biomass plant at Boxing given the project has limited potential for growth.

Consistently good performance at Fangchenggang convinced us to embark on an expansion plan for the project, of which final approval is expected in the first half of 2014.

We aim to increase our renewable energy portfolio and, on top of our existing very successful wind and hydro projects, plan to develop more solar power projects. Thanks to the growing maturity of solar photovoltaic technology, a significant reduction in solar panel prices and attractive feed-in tariffs, we will continue to explore solar investment opportunities in addition to the Jinchang Solar Power Station in Gansu, our first majority-owned solar project.

While shareholders may note that we announced in September 2013 that talks with China General Nuclear Power Corporation regarding the acquisition of a 17% equity share in Yangjiang Nuclear Power Station have been discontinued, we remain confident of prospects for the Mainland's nuclear sector.

India

Fuel security, or the lack of it, has been a serious issue affecting our performance in India and the power industry as a whole. But I am pleased to report that we are seeing some turnaround in the situation for coal. Looking ahead, we are cautiously optimistic about the market.

For CLP India, the second half of 2013 was much better than the first half largely because we are now receiving both imported and domestic coal from various sources. As a result, our coal-fired power station at Jhajjar has been operating reliably with availability reaching 62.8% for the year despite the coal shortages earlier in the year. We finished 2013 strongly with the plant recording its highest ever availability figure of 98.2% in December. We are confident in sustaining this much improved operating position.

Affordable gas supply, meanwhile, remains sporadic following the depletion of existing domestic natural gas reserves. Although the underlying profitability of our gas-fired plant at Paguthan is protected under the existing Power Purchase Agreement as long as it is available for despatch, we will continue to explore other sources of reasonably-priced domestic gas to support the plant. Given these severe gas shortages, we have had to renegotiate some of the terms of the PPA at the request of the off-takers to address the resulting low levels of despatch and we have successfully reached agreement with them. In addition, we have revised the outlook on the residual value of the post-PPA operation. As a result, we made a one-off provision of HK$293 million in 2013 to reflect these changes. We believe that the renegotiated agreement will place the contractual arrangements for Paguthan on a sounder footing for the remainder of the PPA term.

A remarkable moment – our CEO shakes hands with Mr Wang Jiuling, Board Vice President of CSG, and Mr Steve Kane, Vice President of ExxonMobil International Holdings, at the contract signing ceremony of the CAPCO and PSDC acquisitions

For now and for the foreseeable future until the fuel security issues are addressed, while we continue to evaluate opportunities in the conventional space, we will focus our new investment on wind projects. We are already the leading wind project developer in India with over 1,000MW of committed assets. In future, we expect wind to continue to be an integral part of CLP's growth plans for India and our commitment to combatting climate change.

Southeast Asia and Taiwan

At present, we have two greenfield coal-fired power stations that have been under development for some years in Vietnam. These projects are maturing and, over the next 12 to 18 months, may advance to a point where CLP will have to decide whether to proceed or to monetise the value of the development work which has been completed.

CLP's remaining 20% stake in Ho-Ping Power Station in Taiwan might be regarded as a legacy investment, in the sense of being a minority shareholding with little expansion potential. However, Ho-Ping has provided a regular and stable contribution to the Group's earnings and cash flow, whilst making few demands on management time and resources.

Managing Climate Change

In 2007, we published our *Climate Vision 2050*, which laid out our voluntary commitment to reduce the carbon intensity of our generation portfolio by 2050. In 2010 after reviewing our performance, we decided to set new and more ambitious interim targets for 2020.

In 2013, the acquisition of the coal-fired Mount Piper and Wallerawang power stations in Australia and the planned increase in our shareholding of CAPCO will have moved us further away from those targets, but we remain firmly committed to our 2020 targets and confident of seeing them through to fruition. Given the scale of the acquisitions coming close together, we saw a significant increase in carbon intensity in 2013. However, with continued, steady investment in non-carbon emitting energy, we are optimistic that this trend will be reversed.

Funding Our Business

To fund the HK$14 billion CAPCO and PSDC acquisitions, we have executed loan facility agreements for HK$10 billion in addition to internal available resources and existing available banking facilities. We have not made the final decision on the long-term financing for this investment. The options and implications to our capital structure are still under review with a decision likely to be made closer to completion of the transaction. In any event, I can assure you that CLP remains financially strong and will continue to maintain our longstanding financially prudent strategies to obtain diversified funding from banks and capital markets at competitive rates.

The refinancing we completed in Australia in 2013 highlighted the strong support we received from our relationship banks. EnergyAustralia signed a A$2.1 billion loan syndication to extend and refinance its existing bank loan facilities, notwithstanding the fact that the company was on credit watch at the time.

We will continue to gauge our long-term financing needs in all markets and review our financing options from time to time. These options may include, but are not limited to, loans, bonds, hybrid securities and equity. We will regularly assess our portfolio and capitalise on our assets, if and when the right opportunities arise.

Controlling Costs

Owing to substantial rises in material, contract and labour costs in recent years, we are under heavy cost pressures both in and outside of Hong Kong. To ease those pressures, we will continue our prudent financial management, improve our work processes and efficiencies and control costs. One initiative we have employed is transferring staff from the Group to operating business units to take advantage of synergies and efficiency gains.

Investing in Customers

In my experience, customer service is one of the most important aspects of our business. We need to get it right, and by and large, I believe we have succeeded in doing so. CLP is in the business of delivering energy to the people of the Asia-Pacific region. We are delighted to be able to work with a range of business partners and suppliers who have helped us strengthen our customer service and become what we are today – one of the largest and most responsible energy providers in the region. On top of that, we have been highly privileged to serve our retail customers in Hong Kong and Australia. Continuing and improving on our excellent standards of customer service is a top priority.

Looking Ahead

For many years, CLP has been enjoying the service of a group of very loyal and long-serving colleagues. The consequence of this is a significant portion of staff including Senior Management have approached or are approaching retirement. 2013 saw some senior executives stepping down including Andrew Brandler and Peter Greenwood. The Managing Director of EnergyAustralia, Richard McIndoe, announced his resignation in December 2013 and we have begun a global recruitment process to identify and appoint his successor. In March 2014, Mark Takahashi, our Chief Financial Officer, will also leave CLP to join his family and pursue his future career in the United States while Peter Littlewood will retire from his current position as Group Director – Operations after 36 years of service at CLP. I would like to express my sincere thanks to them for their hard work and contribution to the Company over the past decades. Our sound succession planning process has ensured a smooth transition. Notwithstanding the changes, we will continue to adhere to the strategic direction set out by our Board.

In summary, 2013 has been a challenging yet exciting year, involving, as the Chairman has remarked in his Statement, the agreement to acquire a controlling share of CAPCO, the successful and satisfactory resolution of a number of regulatory issues in Hong Kong and improvements to some of our investments in Asia Pacific. None of this is to suggest complacency as we move into the next phase of growth. The changing socio-political environment in Hong Kong, the issues we continue to face in our regional investments and the ever-changing environment within our industry mean that as a team, we need to continue to focus and build on the strengths that have served the Group so well over such a long time. With the support of my colleagues, I intend to put my best efforts to that purpose.

Richard Lancaster
Hong Kong, 27 February 2014

Mr Chung Ka Kui, Ken
Engineer Trainee,
CLP Power Hong Kong

CLP has witnessed the departure of some senior managers recently. Will it affect the Company's operations?

Absolutely not. CLP has been in business for over 110 years. Our operations are mature and we have a depth of very experienced and talented managers throughout the organisation. All businesses face the reality of senior managers retiring or leaving for personal reasons. What is important is that we plan ahead and have a good succession planning process in place. As part of this process, we identify potential successors well in advance of vacancies arising and action development programmes to ensure that successors are ready with the necessary skills and experience to take over. In some cases it may be beneficial to hire externally to bring in new or specialised skills and expertise, but if the organisation's succession planning is working well then this should be the exception rather than the rule. In recent months, CLP has seen a smooth transition of several senior managers, including the CEO, and the majority of their successors have been internal appointees.

Richard Lancaster
Chief Executive Officer