Financial Review

How can you approach our Financial Statements?

Financial Statements Decoded

The purpose of financial statements is to communicate the Group's financial information to its stakeholders. In this Financial Review, we try to explain these in a way that will be accessible to those readers who do not have an accounting background. Of course, the definitions and explanations of the financial statements in this Review are for guidance purposes only. For comprehensive and authoritative definitions and explanations, readers should turn to the relevant accounting standards.

The financial statements comprise two essential components:

- Income statement – a representation of the Group's financial **performance**; and
- Balance sheet – a representation of the Group's financial **position**.

The income statement summarises the flows of economic resources to and from the Group (revenue and expenses) over a period of time, in this case, for the year 2008. It also represents how the Group has moved from its financial position of last year to the current year (as illustrated on pages 24 and 25). The income statement is further analysed on pages 26 and 27.

The balance sheet summarises the Group's economic resources (non-current assets and working capital), obligations and owners' equity (debts and other non-current liabilities, and equity respectively) at a particular point of time, in this case, our year end at 31 December 2008. It also shows how the economic resources contributed by lenders and shareholders are deployed in the business. Further analysis is set out on pages 28 to 32.

Financial Statements Illustrated

The diagram opposite illustrates the relationship between the income statement and the balance sheet, as well as their links with the Group's stakeholders.

On the one hand, the Group earns revenue from customers through the deployment of non-current assets and working capital; on the other hand, it pays operating expenses to suppliers of goods and services. The net balance of revenue and operating expenses is the operating profit available for payment to lenders (interest expenses) and for distribution to shareholders (dividends) in return for their contribution of funds to the Group in the form of debt and equity.

Another key component of the financial statements, not depicted opposite, is the cash flow statement which summarises the Group's operating, investing and financing cash flows. These cash flows are further explained on page 33.

Non-current Assets

Assets which are held long term either for use in operations or for investment (such as fixed assets and investments in jointly controlled entities). They are not expected to be consumed or sold within the normal operating cycle (usually 12 months).

Working Capital

Comprises current assets and current liabilities which are continuously circulating in the business operations (such as bank balances, trade receivables and payables).

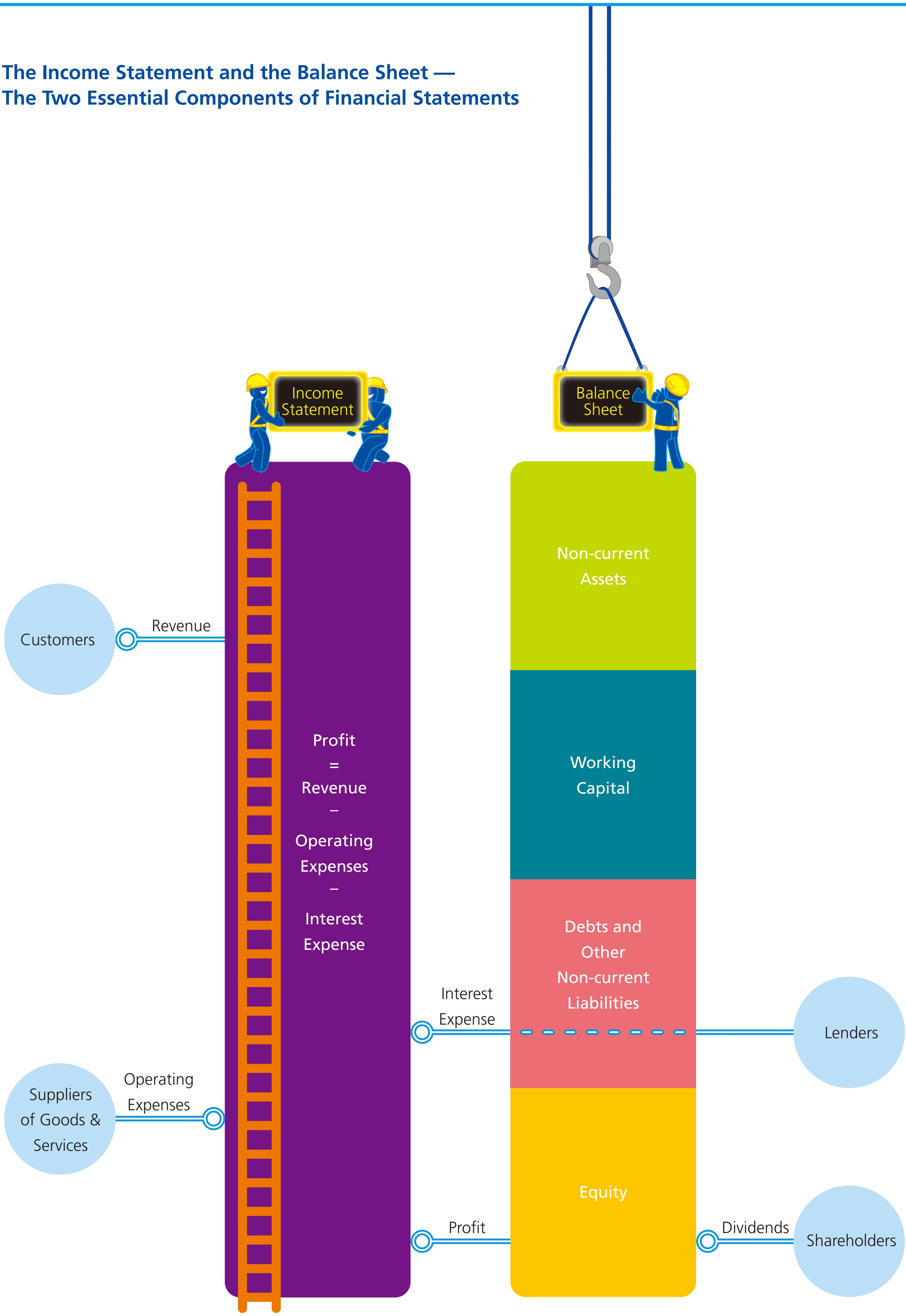
Debts and Other Non-current Liabilities

Funds borrowed from lenders which the Group has obligations to repay and other liabilities (such as deferred tax liabilities) which the Group is obliged to settle after the next 12 months.

Equity

Funds contributed by shareholders either as capital or as profits retained in the Group. This is the residual interest in the Group's assets after all of the Group's liabilities have been paid off.

The Income Statement and the Balance Sheet —
The Two Essential Components of Financial Statements



Fair value, Derivatives, Hedging and CLP

The recent financial turmoil has placed the use of fair value (also known as "mark-to-market"), derivatives and hedging under the spotlight. To help our readers understand this topical yet complex issue, we try to explain in a simple way how it works and how it applies to CLP, without going into the more technical complications. The use of fair value in financial accounting has always been controversial. We applaud the relevance of fair value to the valuation of a company at the balance sheet date. But fair value accounting also introduces greater fluctuation into a company's earnings from year to year, not to mention the issue whether fair value reflects the "real value" of a company. Today fair value is widely used in accounting, from impairment assessment to the valuation of investment properties, securities and derivatives. To put our readers at ease, the use of fair value at CLP is limited and mainly relates to the valuation of our derivatives, including exchange forward contracts, cross-currency and interest rate swaps and energy contracts in Australia.

What is fair value?

It is the price which a buyer is willing to pay and a seller is willing to accept in an arm's length transaction. If the definition is simple, its determination is not always easy, especially when the market is illiquid or comparable transactions are few.

What is a derivative?

In a nutshell, a derivative is a contract for future performance, the value of which is "derived" from the value of something else, like interest rates or foreign exchange rates. Forward contracts, options and swaps fall within the scope of derivatives.

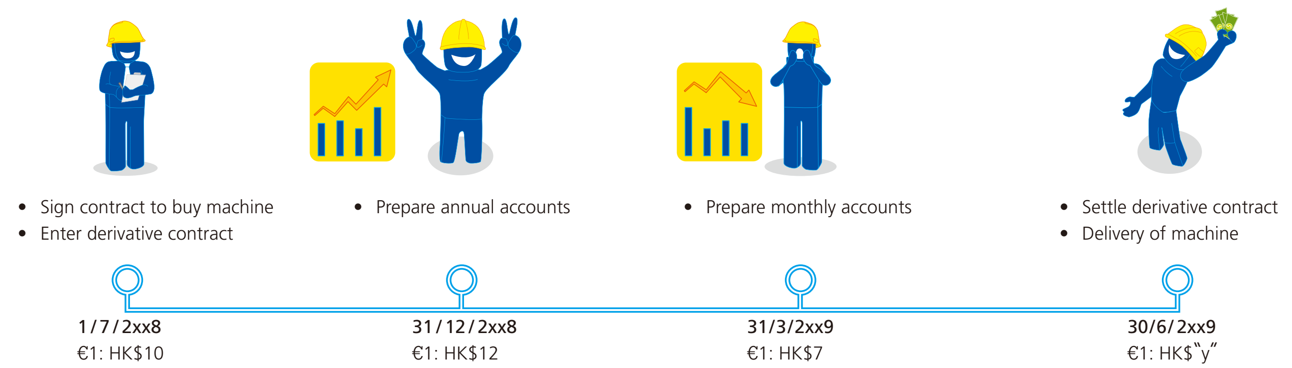
There are many reasons for people entering into derivatives, like speculating on gains or trading for profit, but at CLP there is only one principal purpose – hedging against risks, or in other words, reducing the future uncertainties faced by the Group. The profit or loss associated with derivatives is a "by-product" rather than the motive for entering into those hedging arrangements.

The mechanism for hedging

CLP uses derivatives to hedge its financial risks. To illustrate, assume on 1 July "2xx8", CLP contracts to buy a machine from France at a cost of Euro(€)10 million payable in one year's time (30 June "2xx9"). To reduce the exchange rate risk, CLP also enters into a forward contract to buy €10 million in the same one year's time at €1: HK$10, i.e. HK$100 million.

On 31 December 2xx8, suppose Euro rises in value to €1: HK$12, i.e. HK$120 million is needed to acquire €10 million. CLP holds a forward contract to pay only HK$100 million for the same. This potential saving of HK$20 million represents a fair value (mark-to-market) gain to CLP. This is only a "paper" gain without any "real cash" inflow to CLP and would turn into "real cash" upon settlement of the forward contract on 30 June 2xx9.

Subsequently, suppose on 31 March 2xx9, Euro depreciates to €1: HK$7 and only HK$70 million is needed to acquire €10 million. As CLP is bound to the forward contract to buy at HK$100 million, the extra HK$30 million CLP is required to pay represents a fair value (mark-to-market) loss on the forward contract. Similarly, this is only a "paper" loss without any "real cash" outflow and would be realised in "real cash" only upon settlement.



Merits of hedging

The common feature of both the above scenarios is that, no matter how the Euro exchange rate moves, it is certain that CLP needs to pay HK$100 million to acquire the €10 million on 30 June 2xx9, no more and no less. This is the essence of hedging – to remove the uncertainty on future cash flows by locking / closing out an open position so that we can plan ahead. Observers are often surprised, even shocked, by the reported "paper" gain or loss figures, but overlook the economic motive for hedging.

The previous illustration may over-simplify different hedging scenarios faced by CLP, but the principle holds true whether the derivatives are forward exchange contracts, interest rate swaps or energy contracts in Australia.

Energy contracts in Australia

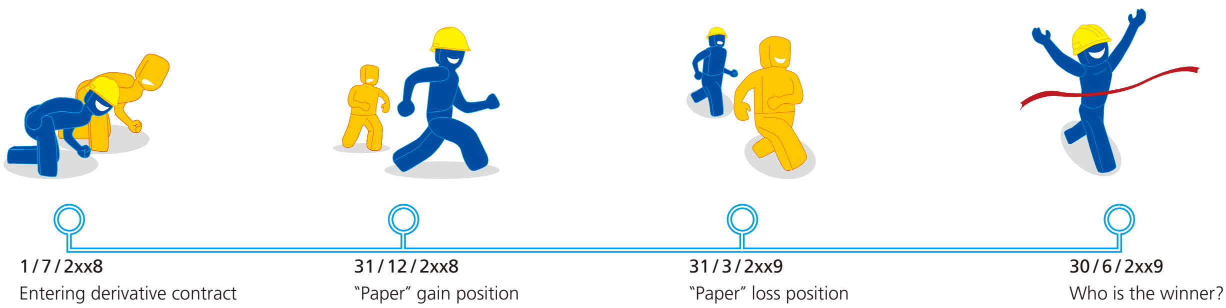
The vast majority of our Australian energy contracts now held are for hedging purposes. The hedging mechanism is analogous to that illustrated above: energy contracts are entered to balance the portfolio position between generation and purchases from a central electricity pool for retail sales in order to minimise exposure to fluctuations in the spot price of electricity. Whilst this approach can limit potential upside to high spot prices in the markets where we are naturally long (i.e. we have spare generating capacity), this prudent approach allows for stable returns to be locked in. In markets where we are naturally short (i.e. our generating capacity may be less than the amount of electricity we are obliged to sell), it prevents negative exposure to the volatile nature of prices and potential for extremely high price outcomes.

The remaining contracts held for trading are extremely small and held within tightly controlled parameters. The purpose is to maintain access to market intelligence (which can only be obtained through transacting) in order to ensure we are in the best position when executing hedge transactions, and in order to facilitate better forecasting.

Pitfalls of fair value accounting

As pointed out above, one of the pitfalls of fair value accounting is that the mark-to-market "paper" gain or loss reported is only a snap-shot of the market position at the close of the year. The gain or loss will continue to fluctuate until final settlement. It is like watching a 26-mile Marathon race on your TV. Each time when you turn to the TV, the leading athlete in the pack (the "paper" gain or loss) will be different. However, until the race finishes (the settlement date), you cannot tell who is the winner ("real cash" gain or loss). In this race, our objective is neither winning nor losing, but to complete the race (certainty in future cash flows).

The "Derivative Marathon"



Another pitfall of fair value accounting is whether the fair value really represents the "true" value of the underlying transaction. At times of vigorous market swings, like the peaks and troughs of fuel prices and exchange rates we have experienced in the past 12 months, fair values can be easily distorted by extreme market conditions and sentiments. The resulting mark-to-market impact on earnings can be a roller coaster.

Economic Hedge versus Accounting Hedge

We have explained the above hedging from the economic perspective – what we call an economic hedge. In reality, these "paper" gains or losses will not affect earnings until final settlement, as they are deferred in reserve during the life of the derivative contract when certain criteria under Hong Kong Financial Reporting Standards (which are beyond the scope of this text) are met. This is what we call an effective accounting hedge. However, if those criteria are not met and the hedge becomes an ineffective accounting hedge, such "paper" gains or losses will directly affect earnings in the current accounting period.

Hedging or Speculating?

Some may say hedging by derivatives is speculating: you are betting that the fair value of derivatives will move favourably to you. We do not necessarily agree. Hedging by derivatives is speculative when you are not sure whether the forecast transaction (the purchase of a machine from France in the previous illustration) will happen or not, or if the expected amount is uncertain (€10 million in the illustration). Otherwise, hedging by derivatives is a way to mitigate risk. In fact, in the case where the forecast transaction is probable and the expected amount is certain, the decision not to hedge is itself a kind of speculation – a bet that the exchange rate or interest rate will not move against you.

Beneficial or detrimental?

Derivatives are a tool we use in hedging. Like any tool, if derivatives are used improperly, the result can be disastrous. However, if used properly and responsibly, derivatives are a powerful tool in financial risk management.

Set out below is a summary of the Group's and CAPCO's positions on derivatives at 31 December 2008. Derivatives entered by the Group's subsidiaries and jointly controlled entities are on their own accounts without recourse to the Company, and except for CAPCO, jointly controlled entities have no significant positions in derivatives.

	As at 31 December 2008	
	Notional Amount HK$M	Fair Value Gain / (Loss) HK$M
CLP Group		
Forward foreign exchange contracts	62,127	696
Interest rate swaps	12,249	(485)
Cross currency & interest rate swaps	2,926	198
Energy contracts	18,236	435
	95,538	**844**
CAPCO		
Forward foreign exchange contracts	1,037	(117)
Interest rate swaps	2,291	(92)
Total	**98,866**	**635**

Financial Analysis

Financial Outlook for 2009

Financial statements are all about historical figures – things that happened in the past. We know people are more interested in the figures for the future. Before embarking on a more detailed review of our 2008 financial performance, let us take a glimpse at our financial outlook for 2009. While we do not have a crystal ball, to help readers better appreciate our business prospectively, we have highlighted those factors which may have a bearing on the Group's financial outlook in 2009:

- The current SoC between CLP Power Hong Kong, CAPCO and the Hong Kong Government took effect from 1 October 2008, immediately following the expiry of the previous one. The framework and principles of the current and previous SoC are similar, except for changes in certain specific terms, most notably the reduction of the permitted return from 13.5% – 15% to 9.99%. Since only three months' impact of the lower permitted return under the current SoC has been reflected in the 2008 results, the full year effect will first be felt in 2009. The ongoing capital investments and the current low interest environment will alleviate part of the impact.
- The proposed Carbon Pollution Reduction Scheme (CPRS) in Australia continues to cast a shadow over TRUenergy's financial outlook, particularly over Yallourn's brown coal-fired generation business. Notwithstanding the issue of the White Paper on CPRS in mid-December by the Australian Government, there remain significant uncertainties on the final terms of the CPRS, mainly about the target emission cuts by 2020 (5% or up to 15%) and the level of assistance to the most emissions intensive electricity generators (like Yallourn itself). Targeted to commence from July 2010, the CPRS will take shape in 2009 as the draft legislation moves forward. Any resulting asset impairment loss could be significant.
- The fluctuations of foreign exchange rates against the Hong Kong dollar have been highly volatile amidst the current financial crisis. These ups and downs may continue well into 2009 and mainly affect the translated figures of our Australian and Indian entities in the consolidated financial statements.
- The business environment for the electricity industry in the Chinese mainland will continue to be challenging, in view of the unresolved disparity between coal prices and electricity tariffs.

Events that Shaped Our Financial Performance in 2008

CLP inevitably felt the weight of the economic downturn. Apart from this, there were several notable events that shaped our business and financial performance in 2008:

- Financial results of CLP Power Hong Kong and CAPCO for the first nine months of 2008 occurred under the previous SoC (with SoC assets at a permitted return of 13.5% – 15%), whilst the last three months are under the current one (with a permitted return of 9.99%). The key features of the current SoC are set out on pages 205 and 206 of this Annual Report.
- In June 2008, TRUenergy disposed of its entire interest in SEAGas, an Australian jointly controlled entity, for a total consideration of HK$895 million (A$119 million) and realised a gain of HK$502 million (after tax HK$432 million).
- CSEC Guohua (formerly known as "CLP Guohua") underwent a restructuring during the year with additional capital being injected from both joint venture partners. Whilst CLP's total investment in CSEC Guohua increased, its interest was diluted from 49% to 27% at year end, giving rise to a deemed disposal gain of HK$225 million. A subsequent cash injection in 2009 will bring CLP's interest back to 30%.
- The Australian dollar and Indian rupee dived 22% and 20% respectively against the Hong Kong dollar as compared to the 2007 year end, having a corresponding downward translation effect on the reported amounts (especially assets and liabilities) for both TRUenergy and GPEC.
- The sharp rise in coal prices, ranging from 17% to 47%, during the year together with the delay in fuel-linked tariff adjustments have driven down the Group's earnings in the Chinese mainland.
- During 2008, Moody's and S&P lowered the credit ratings of the Company and CLP Power Hong Kong. Since the new ratings are still within investment grade, its impact on our finance costs are not significant. Further details are set out in "CLP and our Lenders" on pages 76 to 78.

CLP Group's Financial Results and Position at a Glance

Last Year's Balance Sheet (Consolidated Balance Sheet as at 31.12.2007)

	HK$M
Assets	
Fixed assets, leasehold land and land use rights	88,609
Goodwill and other intangible assets	8,135
Interests in jointly controlled entities	17,684
Finance lease receivables	3,282
Deferred tax assets	3,915
Derivative financial instruments	3,102
Trade and other receivables	7,121
Cash and cash equivalents	2,160
Cash restricted for specific purposes	619
Bank balances, cash and other liquid funds	2,779
Other assets	1,650
	136,277
Equity and Liabilities	
Share capital, premium & reserves	20,616
Retained profits	43,285
Shareholders' funds	63,901
Minority interests	95
Borrowings	28,360
Obligations under finance leases	22,216
SoC reserve accounts	2,300
Deferred tax liabilities	6,344
Derivative financial instruments	2,248
Customers' deposits	3,589
Trade and other payables	6,023
Other liabilities	1,201
	136,277

Earnings For The Year (Consolidated Income Statement for the year ended 31.12.2008)

	Note	2008 HK$M	2007 HK$M	Increase / (Decrease) %
Revenue		**54,297**	50,789	
Expenses		**(41,717)**	(39,607)	
Other income	1	**727**	2,122	
Share of results of jointly controlled entities and associated companies, net of tax		**2,597**	3,025	
Net finance costs		**(4,121)**	(4,881)	
Income tax expense		**(1,349)**	(837)	
Profit attributable to minority interests		**(11)**	(3)	
Earnings attributable to shareholders		**10,423**	10,608	(1.7)
Analysis of Earnings				
Electricity business in HK	2	**7,549**	7,589	(0.5)
Other investments / operations				
Sales to Chinese mainland from HK		**80**	102	
Generating facilities in Chinese mainland serving HK	3	**931**	712	
Other power projects in Chinese mainland	4	**5**	241	
Energy business in Australia	5	**604**	227	
Electricity business in India	6	**320**	409	
Power projects in Southeast Asia and Taiwan	7	**116**	409	
Other earnings	8	**508**	20	
		2,564	2,120	20.9
Unallocated net finance costs		**(21)**	(90)	
Unallocated Group expenses		**(345)**	(305)	
Operating earnings		**9,747**	9,314	4.6
Other income	1	**657**	1,797	
Deferred tax write back for TIPS		**–**	379	
TIPS related contracts – MTM amortisation	9	**(108)**	(299)	
Yallourn coal mine subsidence insurance recovery / (costs)		**127**	(126)	
Costs of TRUenergy's outsourcing		**–**	(457)	
Total earnings		**10,423**	10,608	(1.7)

1. Other income comprised the gain of HK$502 million (after tax HK$432 million) on the sale of SEAGas in Australia and also the deemed disposal gain of HK$225 million (after tax HK$225 million) arising from the restructuring of CSEC Guohua (formerly "CLP Guohua") in the Chinese mainland.
2. As expected, there was a slight fall in the SoC earnings owing to the reduction in the permitted return from 13.5% – 15% to 9.99% under the current SoC effective 1 October 2008. This fall was mitigated by the continuing investment in our transmission and distribution network to provide reliable supply to our local customers.
3. This represents earnings from our investments in Guangdong Nuclear Power Joint Venture Company, Limited (GNPJVC) and Hong Kong Pumped Storage Development Company, Limited (PSDC), whose generating facilities serve Hong Kong. Increased earnings were mainly the result of higher generation output and lower expenses at Daya Bay Nuclear Power Station.
4. Our earnings from the Chinese mainland have continued to suffer from the upsurge in coal prices, while fuel-linked tariff adjustments were not adequate to compensate for the increase in cost. This was worsened by a reduction in electricity demand in the Chinese mainland as economic growth slowed down.
5. Increased operating earnings in Australia were due to higher gross margin on account of higher rates and volumes for electricity and gas retail sales, as well as on portfolio management as a result of better hedge contract positions. Improved performance at Yallourn power station also contributed to the increase.

Cash Flow For The Year (Consolidated Cash Flow Statement for the year ended 31.12.2008)

	Note	HK$M
Cash inflow from operating activities		15,238
Dividends paid less dividends received		(3,297)
Investments in / advances to jointly controlled entities		(1,347)
Capital expenditure	10	(6,569)
Net increase in borrowings		380
Repayment of finance lease obligations		(1,558)
Other net outflow, including exchange effect		(4,227)
Net decrease in cash		(1,380)
Cash and cash equivalents at 31.12.2007		2,160
Cash and cash equivalents at 31.12.2008		780

Profits Retained For The Year (Consolidated Retained Profits for the year ended 31.12.2008)

	HK$M
Earnings attributable to shareholders	10,423
Dividends paid for the year	
– 2007 final	(2,216)
– 2008 interim	(3,757)
Repurchase of shares	(101)
Others	65
Net increase in retained profits	4,414
Retained profits at 31.12.2007	43,285
Retained profits at 31.12.2008	47,699

Today's Balance Sheet (Consolidated Balance Sheet as at 31.12.2008)

	Note	HK$M
Assets		
Fixed assets, leasehold land and land use rights		89,123
Goodwill and other intangible assets		6,324
Interests in jointly controlled entities		17,791
Finance lease receivables		2,515
Deferred tax assets		2,992
Derivative financial instruments		2,879
Trade and other receivables		8,239
Cash and cash equivalents		780
Cash restricted for specific purposes		2
Bank balances, cash and other liquid funds		782
Other assets		2,186
		132,831
Equity and Liabilities		
Share capital, premium & reserves		15,318
Retained profits		47,699
Shareholders' funds		63,017
Minority interests		105
Borrowings	11	26,696
Obligations under finance leases		21,765
SoC reserve accounts		1,826
Deferred tax liabilities		6,435
Derivative financial instruments		2,035
Customers' deposits		3,722
Trade and other payables		5,919
Other liabilities		1,311
		132,831

6. Higher profit for India in 2007 mainly arose from the release of dividend distribution tax provision no longer required. GPEC's power station continued to operate at a high level of availability.

7. Earnings from Southeast Asia and Taiwan dropped, mainly because of higher coal prices at Ho-Ping with delays in the compensating tariff increase, and lower share of profit from EGCO.

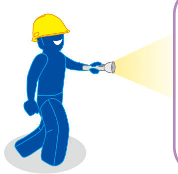
8. Other earnings in 2008 included the write-back of HK$389 million deferred tax resulting from a reduction in the Hong Kong profits tax rate from 17.5% to 16.5% for the fiscal year 2008/09.

9. This relates to electricity contracts transferred from AGL as part of the consideration on the asset swap of Torrens Island Power Station (TIPS) in July 2007. The forward electricity price at that time was at an exceptionally high level, resulting in high valuation of the contracts. The mark-to-market (MTM) gain, booked as part of the gain on the sale of TIPS, is being reversed and amortised over the life of the contracts.

10. The commencement of the new SoC during the year has not interrupted our capital works nor undermined our commitment to improve and develop our electricity generation facilities and supply network in Hong Kong. Elsewhere, new power plants are under construction in India.

11. Notwithstanding the shrinking credit market, the Group arranged new bank loan facilities of HK$3 billion and issued HK$740 million fixed-rate bonds under the Medium Term Note Programme during the year. The Group's gearing remained healthy, with the total debt to total capital ratio decreased from 30.7% to 29.7% and the net debt to total capital ratio slightly increased from 28.6% to 29.1%.

Group's Financial Results



Against the adverse economic environment and the negative factors we identified in the previous pages, CLP's earnings remained robust at HK$10.4 billion, close to the HK$10.6 billion in 2007. An overview of earnings from different business streams is on pages 24 and 25 of this Financial Review. Each business stream is discussed in more detail on pages 38 to 67 of this Report.

Financial Results	*Accounting Policy*	*Notes to the Financial Statements*	2008 HK$M	2007 HK$M	Increase / (Decrease) HK$M	%
Revenue	*8*	*3*	**54,297**	50,789	3,508	6.9
Expenses			**(41,717)**	(39,607)	2,110	5.3
Other income		*5*	**727**	2,122	(1,395)	(65.7)
Finance costs	*21*	*7*	**(4,245)**	(5,041)	(796)	(15.8)
Share of results of jointly controlled entities, net of income tax	*11*	*15*	**2,624**	3,024	(400)	(13.2)
Income tax expense	*22*	*8*	**(1,349)**	(837)	512	61.2
Earnings attributable to shareholders			**10,423**	10,608	(185)	(1.7)

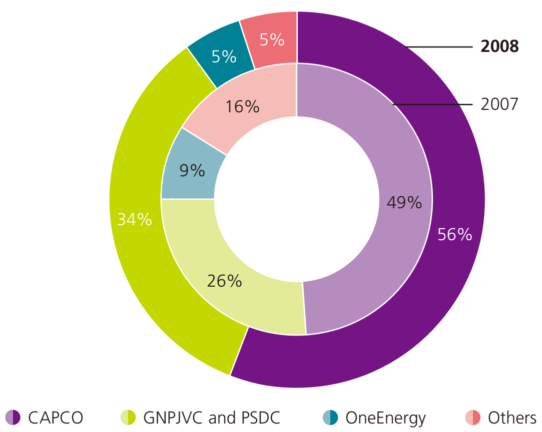
Income Tax Expense

The considerable rise in income tax expense is in line with higher operating earnings this year, notably from Australia. The end of a tax holiday enjoyed by GPEC in India also contributed to the increase. Partly offsetting the increase is the decrease in the profits tax rate in Hong Kong from 17.5% to 16.5%, coupled with a write-back of deferred tax of HK$327 million in Hong Kong owing to this reduced profits tax rate.

Share of Results of Jointly Controlled Entities, net of Income Tax

In the Chinese mainland and Ho-Ping in Taiwan, our performance in 2008 continued to be affected by our not being allowed to make timely increases in tariffs to offset surging coal prices. This largely accounted for the drop of 13% to HK$2.6 billion in our share of the results of jointly controlled entities.

Contribution from Jointly Controlled Entities



Revenue and Expenses

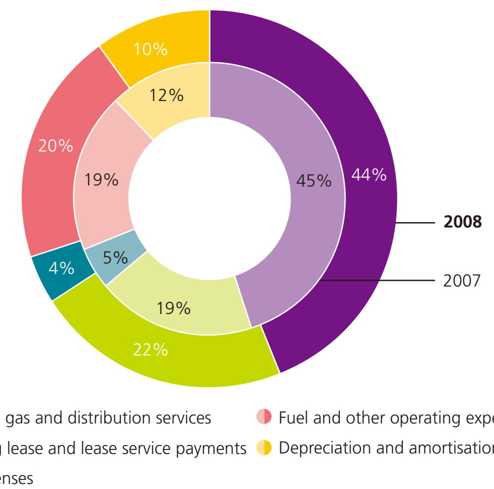
The Hong Kong electricity business continued to contribute more than half of our total revenue. A majority of the increase in total revenue relates to TRUenergy in Australia and GPEC in India, even though both the Australian dollar and Indian Rupee depreciated during the year. TRUenergy benefited from higher electricity and gas sales in terms of both rates and volume. GPEC's increased revenue arose from higher fuel purchases and the consequent higher fuel cost recovery from the off-taker under the pass-through mechanism.

The overall HK$2.1 billion increase in expenses was mainly ascribed to the HK$1.7 billion increase in "operating lease and lease service payments" and HK$858 million for "fuel and other operating expenses". The increase in the former resulted largely from higher fuel expenses (accounted as part of lease service payments under HKFRS-Int 4) for CAPCO. For the latter, the increase stemmed mainly from higher fuel cost experienced by GPEC, India, owing to its relying heavily on spot fuel purchases amidst rising prices of re-gasified LNG. Mitigating this fuel price increase is the cost cutting exercise, including the outsourcing to IBM, undertaken by TRUenergy in Australia. On the other hand, depreciation and amortisation decreased by 12.8% owing to the extended depreciable lives of the SoC fixed assets effective 1 January 2008.

	Revenue		Expenses	
	2008 HK$M	2007 HK$M	**2008 HK$M**	2007 HK$M
Hong Kong	**30,471**	29,909	**19,632**	18,465
Australia	**19,432**	18,018	**17,912**	18,299
India	**4,197**	2,687	**3,669**	2,335
Others	**197**	175	**504**	508
	54,297	50,789	**41,717**	39,607

Note: About 39% (2007: 41%) of our revenue from the retail sales of electricity and gas in Australia is paid as network charges to third party network operators.

Analysis of Expenses



Other Income

Other income comprised the gains of HK$502 million from the disposal of SEAGas and HK$225 million on the deemed disposal from the CSEC Guohua restructuring. This is opposed to the gains of HK$1 billion on the injection of Ho-Ping into OneEnergy and of HK$1.1 billion on the TIPS-Hallett power station swap with AGL in Australia in 2007.

Finance Costs

Finance costs consist mostly of finance charges under finance leases as well as interest on bank loans and other borrowings. Finance costs dropped 16% to HK$4.2 billion, mainly due to lower finance charges under finance leases which are linked to the reduction in the rate of SoC permitted return on generating assets leased from CAPCO.

Group's Financial Position

A healthy balance sheet remains one of CLP's strengths. Despite total assets now standing at HK$132.8 billion, our gearing stays relatively low at 29.7% based on total debt (29.1% based on net debt).

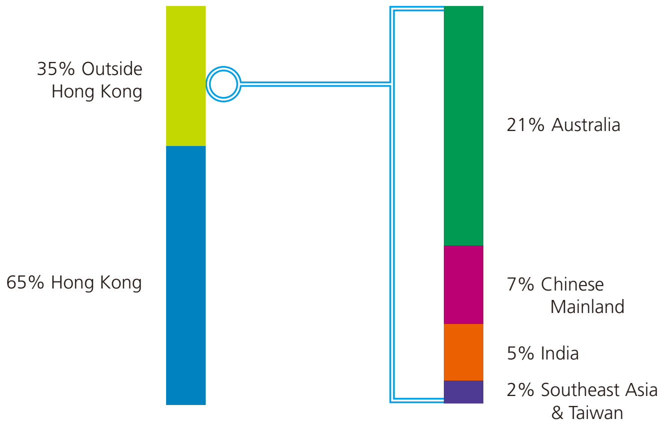
On the balance sheet

Non-current assets	*Accounting Policy*	*Notes to the Financial Statements*	**2008 HK$M**	2007 HK$M	Increase / (Decrease) HK$M	%
Fixed assets	*13*	*12(A)*	**86,873**	86,413	460	0.5
Leasehold land and land use rights	*13*	*12(B)*	**2,250**	2,196	54	2.5
Goodwill and other intangible assets	*14*	*13*	**6,324**	8,135	(1,811)	(22.3)
Interests in jointly controlled entities	*11*	*15*	**17,791**	17,684	107	0.6
Deferred tax assets	*22*	*24*	**2,992**	3,915	(923)	(23.6)
Total assets			**132,831**	136,277	(3,446)	(2.5)

Total Assets

Total assets dropped 2.5% to HK$132.8 billion, attributed mainly to lower exchange rates at 2008 year end for translating our investments in Australia and India. Alongside conventional power infrastructure assets (fossil-fuelled power stations and power grids), we are building a portfolio of renewables which includes wind, hydro, solar and biomass power projects in Australia, India and the Chinese mainland.

Total Assets by Geographical Location



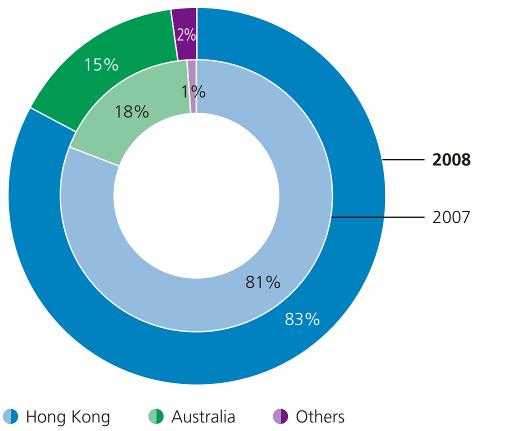
Deferred Tax Assets

Most of the deferred tax assets relates to TRUenergy's unused prior year tax loss. As noted, the improved earnings of TRUenergy this year has utilised part of these tax losses. Coupled with the effect of depreciation of the Australian dollar, deferred tax assets dropped 23.6% to HK$3 billion.

Fixed Assets, Leasehold Land and Land Use Rights

As electricity is a basic necessity of modern life, we have maintained our capital investment to improve and develop our transmission and distribution network in Hong Kong. Together with other capital works, fixed asset additions amounted to HK$7.6 billion in 2008. On the other hand, the depreciation periods of certain SoC fixed assets have been extended (up to 60 years for some categories) effective 1 January 2008, resulting in a lower depreciation charge in current and subsequent years.

Fixed Assets, Leasehold Land and Land Use Rights by Geographical Location



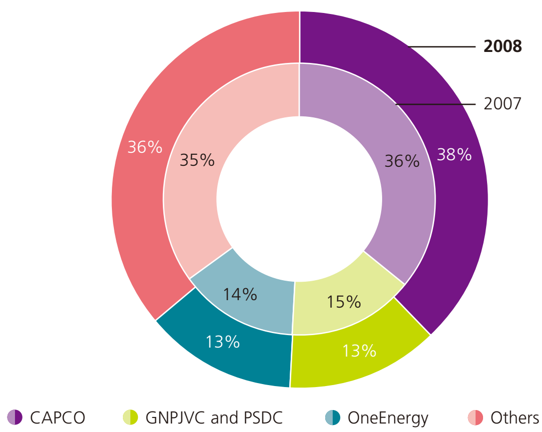
Goodwill and Other Intangible Assets

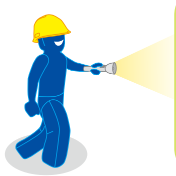
The impact of the decrease in the Australian dollar exchange rate can best be illustrated in the value of goodwill and other intangible assets. Almost all of the HK$1.8 billion net decrease in the balance is accounted for by currency depreciation, as most of the goodwill and intangible assets relates to TRUenergy.

Interests in Jointly Controlled Entities

Additional investment in CSEC Guohua of HK$494 million was offset by the disposal of SEAGas for HK$492 million and hence our interests remain comparable with the prior year balance.

The Group's Major Jointly Controlled Entities





In accordance with accounting standards, the Group has separately presented its interests in jointly controlled entities and associated companies as a single-line item on the face of the consolidated balance sheet. To enhance transparency, the Group's financial obligations in respect of these interests are presented on pages 36 and 37.

Group's Financial Position

On the balance sheet

Working capital, Debts and other non-current liabilities and Equity	*Accounting Policy*	*Notes to the Financial Statements*	2008 HK$M	2007 HK$M	Increase / (Decrease) HK$M	%
Derivative financial instrument assets (current & non-current)	*16*	*18*	2,879	3,102	(223)	(7.2)
Derivative financial instrument liabilities (current & non-current)	*16*	*18*	(2,035)	(2,248)	(213)	(9.5)
Trade and other receivables	*18*	*19*	8,239	7,121	1,118	15.7
Bank balances, cash and other liquid funds	*19*	*20*	782	2,779	(1,997)	(71.9)
SoC reserve accounts		*26*	(1,826)	(2,300)	(474)	(20.6)
Bank loans and other borrowings (current & non-current)	*21*	*22*	(26,696)	(28,360)	(1,664)	(5.9)
Obligations under finance leases (current & non-current)	*6*	*23*	(21,765)	(22,216)	(451)	(2.0)
Shareholders' funds			63,017	63,901	(884)	(1.4)

Shareholders' Funds

Shareholders' funds represents our shareholders' net interest in the Group. Though our earnings remained stable, shareholders' funds dropped to HK$63 billion, a 1.4% decrease from 2007 on account of lower exchange rates at 31 December 2008 in translating our investments in Australia and India. At 31 December 2008, HK$21.4 billion of the reserves are distributable to shareholders.

Obligations under Finance Leases

The obligations under finance leases are mostly related to CLP Power Hong Kong and CAPCO's power purchase arrangement accounted for as finance lease under HKFRS-Int 4. Regular payments under the arrangement (lease payment) during the year reduced the balance.

Bank Loans and Other Borrowings

Excluding the translation effect of the Australian dollar denominated loans, bank loans and other borrowings increased by HK$0.9 billion. Against the backdrop of a worldwide credit crunch, the Group successfully arranged new bank loan facilities of HK$3 billion and issued HK$740 million fixed-rate bonds under the MTN programme during the year.

SoC Reserve Accounts

The Tariff Stabilisation Fund and Rate Reduction Reserve make up the SoC reserve accounts balance. Rebates and special rebates of HK$739 million were made to our customers this year, thereby reducing the balance in these accounts.

Derivative Financial Instruments and Hedging

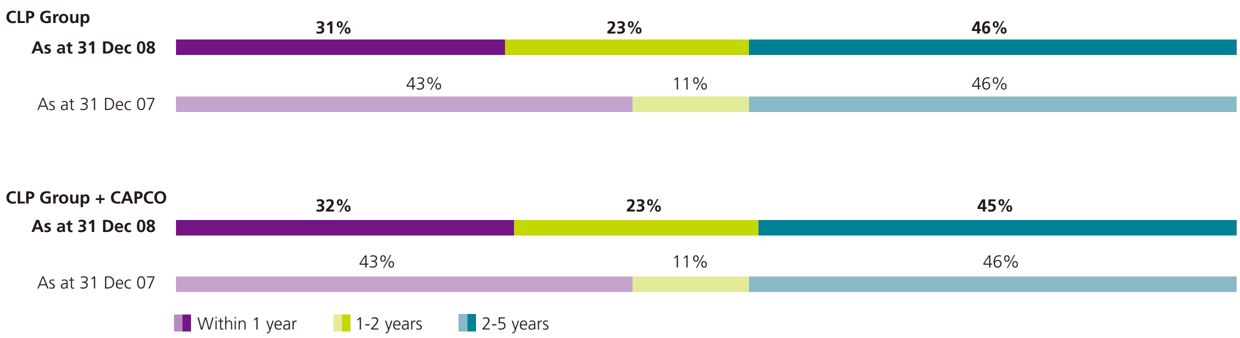
CLP uses derivative financial instruments solely for hedging purposes, except for limited energy trading activities by TRUenergy which are gradually phasing out. The type and maturity profile of the derivative financial instruments are set out below:

	Notional Amount		Fair Value Gain / (Loss)	
	2008 HK$M	2007 HK$M	2008 HK$M	2007 HK$M
CLP Group				
Forward foreign exchange contracts [1]	62,127	41,425	696	(24)
Interest rate swaps [2]	12,249	14,191	(485)	336
Cross currency & interest rate swaps	2,926	2,340	198	96
Renewable energy certificates	608	502	53	108
Energy hedging & trading caps & options	140	–	–	(198)
Energy hedging & trading swaps	17,488	31,578	382	536
	95,538	90,036	844	854
CAPCO				
Forward foreign exchange contracts [3]	1,037	–	(117)	–
Interest rate swaps	2,291	2,915	(92)	(36)
Total	98,866	92,951	635	818

Notes:

1. Increased notional amount resulted from the increased hedging of the U.S. dollar fuel payments, and the foreign currency requirements for the construction project at Jhajjar, India. The fair value gain is due to higher U.S. dollar forward exchange rates against the HK dollar.
2. The fair value loss is due largely to our unfavourable position in interest rate swaps, which effectively locked the Group into fixed interest rates higher than the unprecedented low interest rates in the market prevailing at year end.
3. This mainly refers to the new hedging requirement for the emissions control project at Castle Peak "B".

Maturity Profile



Trade and Other Receivables

The increase is mainly due to the dividends receivable from GNPJVC and CSEC Guohua totalling HK$447 million and deposits of HK$817 million for the acquisition of land and construction contracts for the Jhajjar project in India.

Bank Balances, Cash and Other Liquid Funds

The reduction of HK$1,997 million in 2008 is mainly due to the utilisation of cash for investment in Jhajjar and other renewable projects, as well as for increasing purchases of naphtha as fuel (previously gas was purchased on credit) in India.

Group's Financial Position

Beyond the balance sheet

CLP carefully manages its off-balance sheet exposures including contingencies and commitments. They are summarised below to give readers a full picture of the Group's financial position.

Charges on Assets

GPEC, Huaiji and Boxing assets of HK$3 billion (2% of the Group's total assets) are charged against their respective borrowings of HK$1.4 billion in total. These secured borrowings are to satisfy local financing needs without recourse to the Company.

Operating Commitments

The Group's operating commitments predominantly (76%) arose from the application of lease accounting in respect of CLP Power Hong Kong's obligation to purchase electricity from CAPCO for supply to the Hong Kong customers. The remainder of the commitments mainly relates to the right to request electricity supply under the Master Hedge Agreement between TRUenergy and Ecogen.

Contingent Liabilities

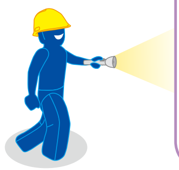
The Group did not identify any material contingent liabilities except for the dispute between GPEC and its off-taker over the payments of "deemed generation incentive". The issue, which has been explained in our financial statements for a number of years, is gradually working its way through the Indian regulatory and legal system. The claim plus interest amounted to HK$1.2 billion at year end. No provision has been made in our financial statements, on the basis of legal advice that we have a strong case on the merits. The matter is treated as a contingent liability and disclosed in Note 32 to the financial statements.

Capital Commitments

Capital commitments totalled HK$22 billion (2007: HK$12.3 billion) at year end. Major commitments include the commencement of construction of Jhajjar Power Plant and continued investment in our transmission and distribution network in Hong Kong.

CLP Power Hong Kong has committed to provide all necessary shareholders' advances to CAPCO to finance the installation of emissions control facilities at Castle Peak "B" Power Station. The maximum advance is estimated to reach HK$5.5 billion in 2011.

Cash Flow



The existence of a company depends on its ability to generate cash. While CLP Power Hong Kong continues to provide strong liquidity to the Group, we ensure appropriate cash flows are available in time to meet the Group's operation, investment and financing needs. Before exchange effect, cash and cash equivalents decreased by HK$1,241 million in 2008. The different types of cash flows and a reconciliation between operating profit and operating cash flows are set out below.

	2008 HK$M	2007 HK$M	Increase / (Decrease) HK$M	%
Operating activities	15,238	14,823	415	2.8
Investing activities	(5,153)	1,549	(6,702)	N/A
Financing activities	(11,326)	(15,394)	4,068	26.4
	(1,241)	978	(2,219)	

Financing Activities

The main financing cash outflows during the year were the payments of interest to lenders (HK$4.1 billion) and dividends to our shareholders (HK$6 billion).

Investing Activities

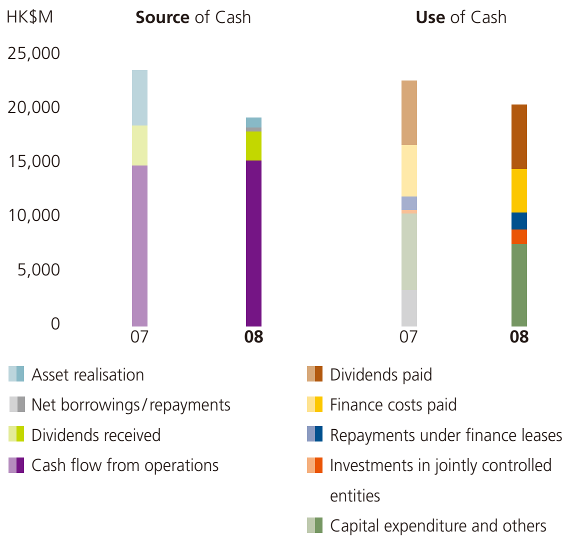
The Group's capital expenditure on fixed assets in Hong Kong and overseas and the additional investment in CSEC Guohua were the major investing cash outflows in the year.

Operating Activities

Even in a tough climate, CLP improved its operating cash inflow slightly by HK$0.4 billion.

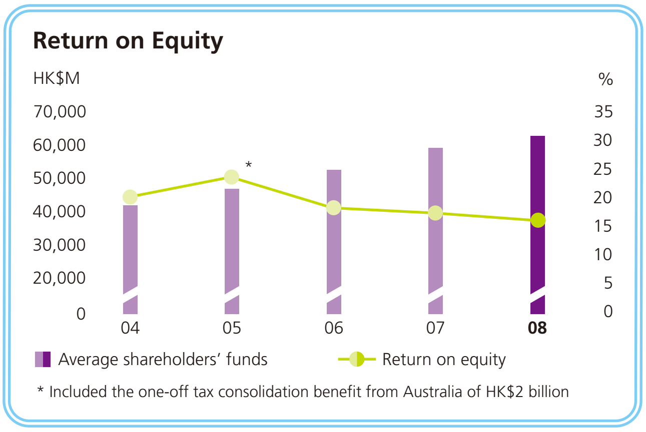
From "Operating Profit" to "Cash from Operating Activities"	HK$M
Operating profit	13,307
Depreciation and amortisation	4,055
Impairment charge	131
Net gain on asset realisation	(587)
SoC items	(1,061)
Changes in working capital	(714)
Others	107
Net cash inflow from operating activities	15,238

Cash Utilisation



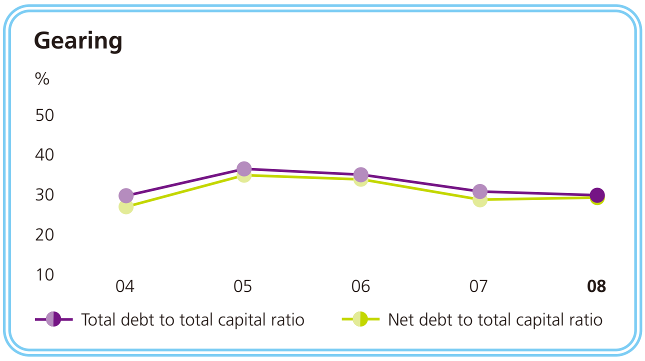
A Broader Perspective

The market falls of recent months may have shifted investors' focus towards the short term. However, we believe the strategy and "real value" of a company can only be judged over the long term, especially in the electricity industry. The following long-term analyses may be helpful.

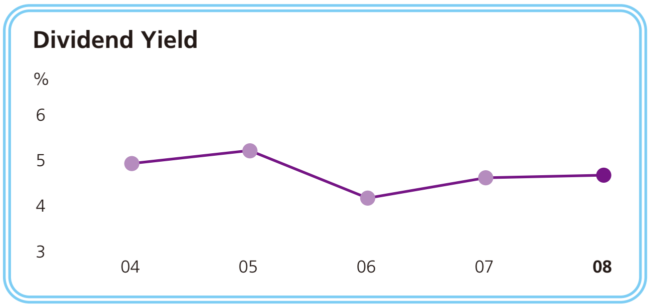


* Included the one-off tax consolidation benefit from Australia of HK$2 billion

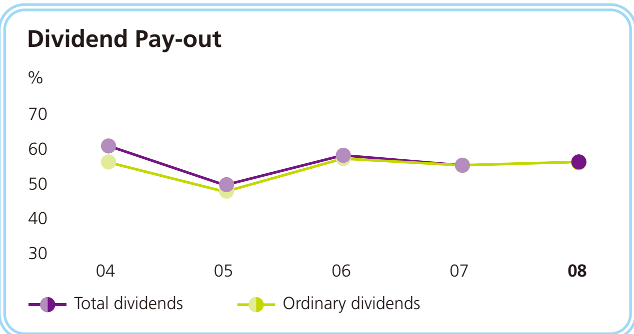
Shareholders' funds have built up considerably over the past five years. Part of the increase in earnings over this period has been retained and ploughed back into the business. This inevitably has a negative effect on our return on equity. Nevertheless, the average return of 19% (excluding the 2005 one-off Australian tax consolidation benefit of HK$2 billion) is still reasonable considering the size and business nature of the Group.



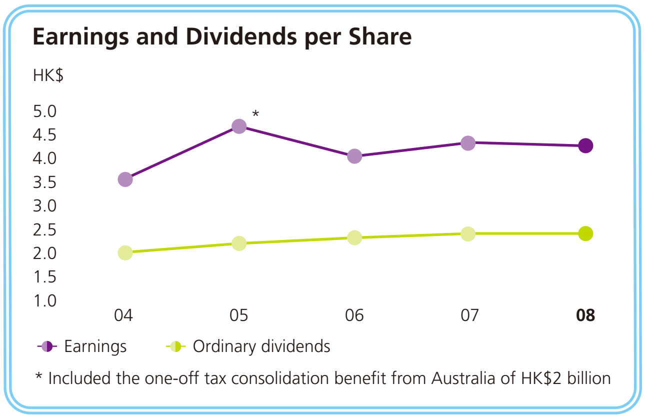
Whilst we have maintained a prudent gearing between 29% to 37% during the past five years, we have adopted a more liberal approach to the use of debt to finance new business opportunities whenever appropriate borrowings can be sourced. However, the build-up of equity (as explained above) has kept the overall gearing ratio within a healthy level.



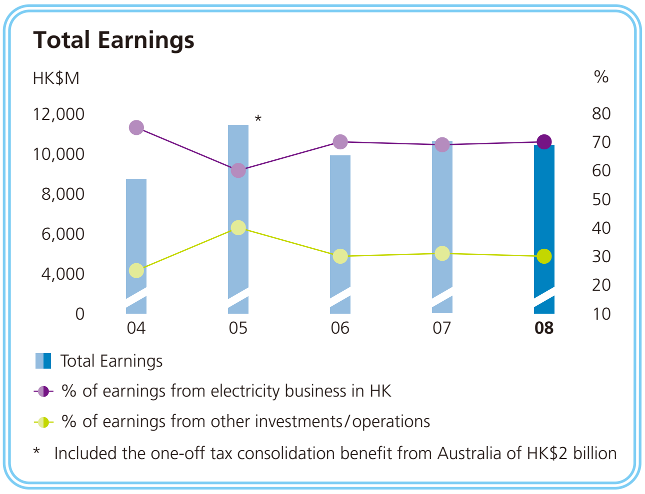
The considerable capital growth of CLP's share price might have obscured the average annual dividend growth of 5.8% over the past five years. Despite the current economic circumstances, CLP's dividend yield of 4.7% in 2008 is consistent with the past trend for the period under review, whilst its share price performed strongly in a bear market.



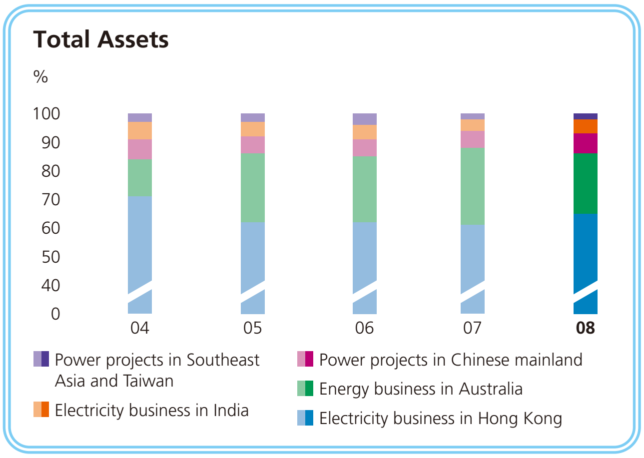
At times of severe financial disturbance, a steady and stable dividend policy is of real value to our shareholders. With a reduced SoC permitted return and an uncertain business climate, we have been able to preserve an ordinary dividend pay-out of around 57%, owing to our consistent cash flows and strong asset base.



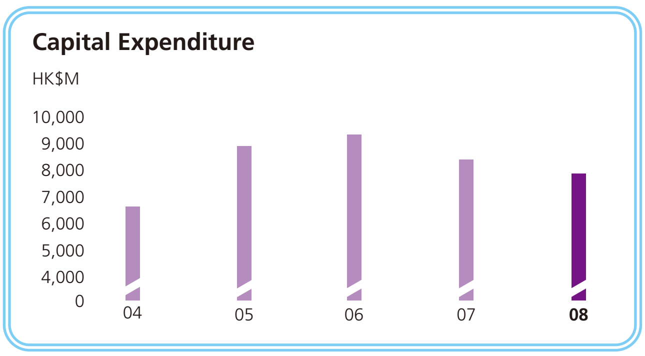
One of the two inputs to the widely used Price/Earnings (P/E) ratio is earnings per share (EPS). Our consistent EPS growth is matched by the rise in our share price leading to a relatively stable P/E ratio over the years. The growth of dividends per share is also in line with that for EPS as we aim at a consistent dividend pay-out ratio.



Total earnings have risen by 35% over the past five years. There are three main factors underlying this growth – first, our business expansion across the region; secondly, appreciation of the Australian dollar (until recently) translated into higher earnings; last but not least, the gradual and yet steady growth of our SoC business in Hong Kong.



Assets outside Hong Kong have grown from 29% of total assets in 2004 to 35% in 2008. This trend reflects our strategy to grow outside Hong Kong. The prudent business strategy we have pursued in recent years has well positioned us to weather the current economic storm and to capture investment opportunities in our targeted markets.



We place a high priority on capital expenditure. This stems from our commitment to offer our customers a reliable electricity supply. We have invested an accumulated sum of HK$40 billion over the past five years. Capital projects in the pipeline include the Castle Peak "B" emissions control project and the Jhajjar project in India.

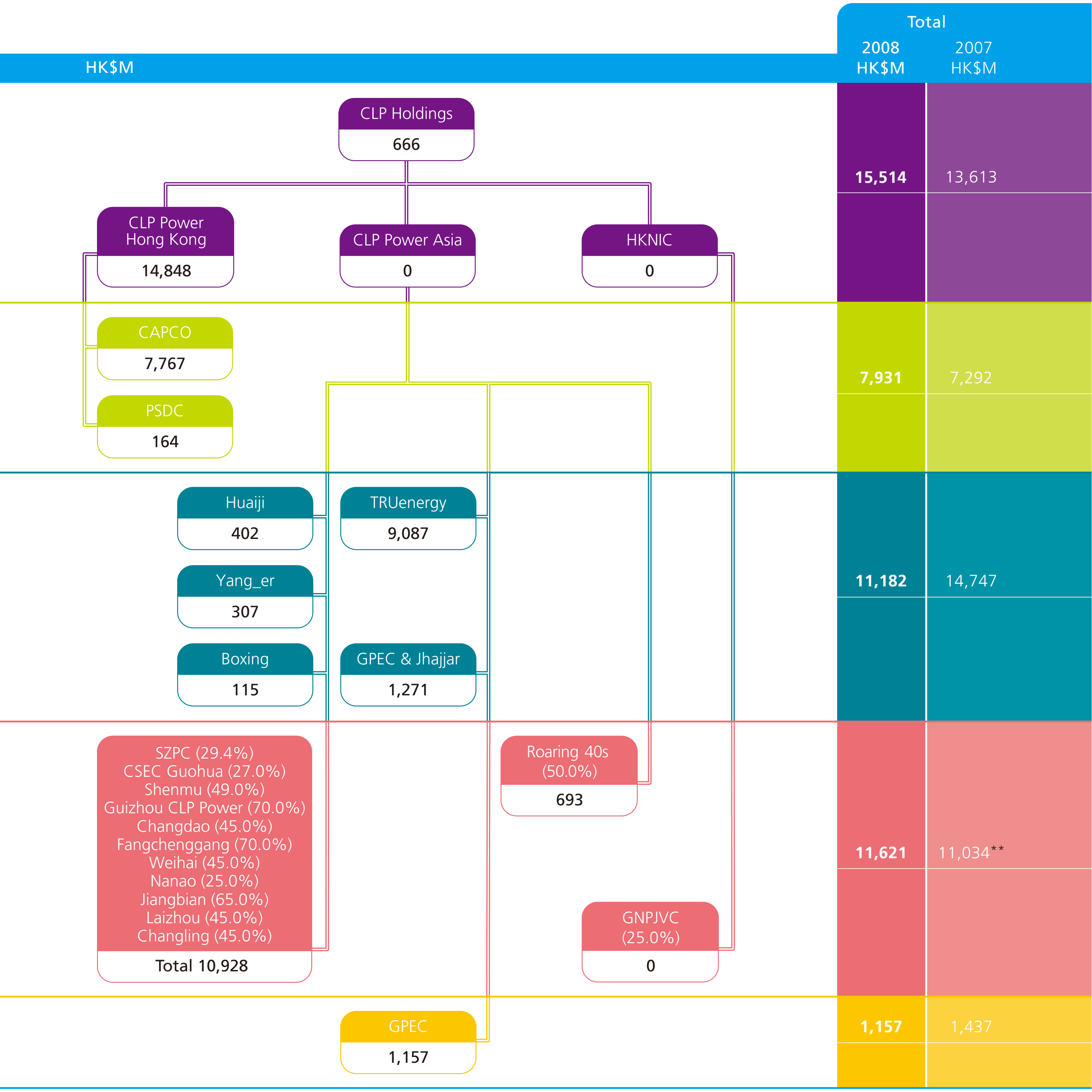
CLP Group's Financial Obligations at a Glance

as at 31 December 2008

The financial risks associated with borrowings and unconsolidated financial obligations of listed companies continue to be of market concern, especially amidst the recent financial turmoil. Our policy is to adopt a conservative approach to such matters. The purpose of the following chart is to explain the total financial obligations of the CLP Group by classifying them into five categories according to their degree of recourse to CLP Holdings. Obligations under finance leases have not been included in the chart.

Category	
1 Borrowings of CLP Holdings & Principal Direct Subsidiaries	Debts of CLP Holdings and its principal direct subsidiaries.
2 Borrowings of CAPCO & PSDC	100% of the debts of CAPCO and PSDC. Although the Group holds only a 40% interest in CAPCO and a 49% interest in PSDC, CLP Power Hong Kong has commitments to these companies through power purchase and service agreements, as explained in the Scheme of Control Statement on pages 205 to 207 and Note 31 to the financial statements.
3 Borrowings of TRUenergy, GPEC, Jhajjar, Huaiji, Boxing and Yang_er	These debts are non-recourse to CLP Holdings.
4 Share of Debts of Major Jointly Controlled Entities and Associated Companies*	These debts are non-recourse to CLP Holdings and its subsidiaries.
5 Contingent Liabilities	Contingent liabilities of CLP Holdings and its subsidiaries. Details of these are set out in Note 32 to the financial statements.

* In respect of Category 4, the share of debts is calculated by reference to the Group's shareholding in the relevant jointly controlled entities and associated companies.



** Including the share of debt amounting to HK$973 million in SEAGas which was disposed of in 2008.