

Financial Review

Capital Expenditure, Liquidity, Financial Resources and Gearing Ratio

Capital expenditure during the year amounted to HK\$2,246 million, which was primarily funded by cash from operations. As at 31st December 2004, total external borrowings were HK\$12,997 million (2003 : HK\$13,599 million), comprising unsecured bank loans, unsecured deferred creditors and debt securities in issue. In addition, the Group has undrawn committed bank facilities of HK\$5,376 million (2003 : HK\$3,443 million). Gearing ratio (net debt/shareholders' funds) at 31st December 2004 was 31% (2003 : 37%).

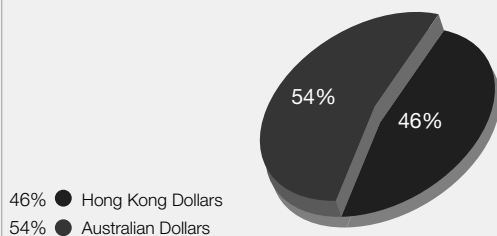
Treasury Policies, Financing Activities and Capital Structure

We finance our operations and business expansion by a combination of internal resources, bank borrowings and debt issuance. It is our policy to ensure that committed facilities are available for refinancing and business growth. In addition, currency and interest risks are actively managed on a conservative basis.

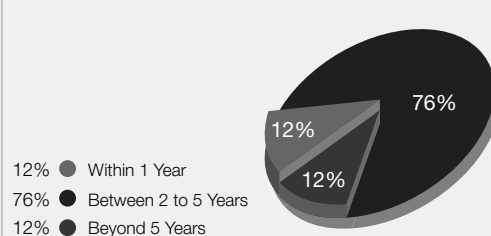
Capitalising on the liquidity in the loan and debt markets, The Hongkong Electric Company, Limited, through its subsidiary Hongkong Electric Finance Limited, issued in November 2004, HK\$500 million fixed rate notes due 2014 out of the Medium Term Note Programme established in 2002. In December 2004, The Hongkong Electric Company, Limited again successfully arranged a HK\$3,000 million 7-year dual tranche term loan facility at very attractive margin, setting a new benchmark for our funding cost.

As at 31st December 2004, external borrowings of the Group amounted to HK\$12,997 million with the following profile, after taking into account currency and interest rate swaps:

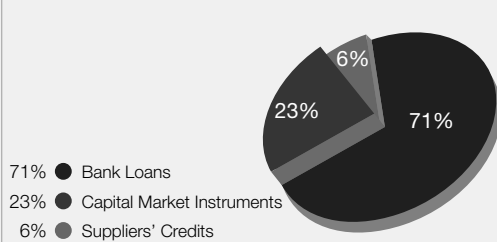
By Currency



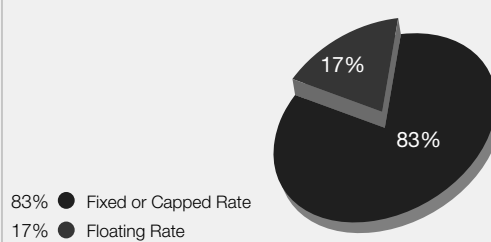
By Maturity



By Structure

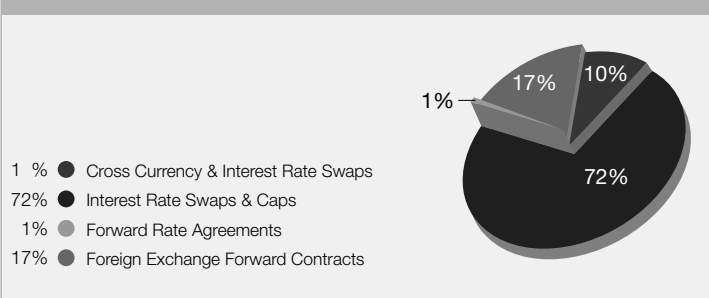


By Interest Rate Structure



It is our treasury policy not to engage in speculative transactions. Derivative financial instruments are used primarily for managing interest rate and foreign currency risks. Foreign currency transaction exposure is managed, utilising forward contracts and interest rate and currency swaps. As at 31st December 2004, over 90% of the Group's transaction exposure was either hedged or denominated in Hong Kong or US dollars. Currency exposure arising from overseas investments is hedged by arranging comparable level of borrowings in the same currency as the underlying investments. The Group's policy is to maintain a substantial portion of its debt in fixed or capped rate. Interest rate risk is managed by either securing fixed or floating rate borrowings or by using interest rate swaps and caps. The contractual notional amounts of derivative instruments outstanding at 31st December 2004 amounted to HK\$20,598 million (2003 : HK\$21,394 million) equivalent.

Off-balance Sheet Financial Instruments



Contingent Liabilities

As at 31st December 2004, the Company has issued guarantees in respect of development security of an associate amounting to HK\$35 million (2003 : HK\$36 million).

The Company has given guarantees and indemnities in respect of bank and other borrowing facilities available to subsidiaries and financial commitments of subsidiaries totaling HK\$11,136 million (2003 : HK\$11,227 million) equivalent. Out of this amount, HK\$9,238 million, while being a contingent liability of the Company, is reflected in the Consolidated Balance Sheet of the Group.

During the year, the Company has agreed to assume the undertaking given to the banks in connection with certain finance facilities of gas distribution networks up to a maximum of HK\$45 million.

A wholly-owned subsidiary of the Company, The Hongkong Electric Company, Limited, has given guarantees to third parties in respect of a loan scheme for electricity charges of HK\$1 million (2003 : HK\$5 million) and the value of leased equipment of HK\$210 million (2003 : HK\$210 million) at expiry of the lease.

Employees

The Group continues its policy of pay by performance and market pay rates are monitored constantly to ensure competitiveness is maintained. The Group's total remuneration costs for the year ended 31st December 2004, excluding directors' emoluments, amounted to HK\$945 million (2003: HK\$1,034 million). As at 31st December 2004, the Group employed 2,045 (2003: 2,117) permanent staff. No share option scheme is in operation.

Apart from well-established training schemes for university graduates, trainee technicians and apprentices, the Group also provides training for staff in language, computer knowledge, and the latest technology relevant to our industry as well as numerous job-related courses to enhance other more general skills and knowledge of our employees.