

NOTES TO THE UNAUDITED INTERIM FINANCIAL STATEMENTS OF THE TRUST AND OF THE COMPANY

(Expressed in Hong Kong dollars)

1. Review of unaudited interim financial statements

These unaudited consolidated interim financial statements have been reviewed by the Audit Committees.

2. General information

HK Electric Investments Limited (the "Company") was incorporated in the Cayman Islands on 23 September 2013 as an exempted company with limited liability under the Companies Law 2011 (as consolidated and revised) of the Cayman Islands.

On 1 January 2014, HK Electric Investments (the "Trust") was constituted by a Hong Kong law governed Trust Deed entered into between HK Electric Investments Manager Limited (the "Trustee-Manager", in its capacity as the trustee-manager of the Trust) and the Company. The scope of activity of the Trust as provided in the Trust Deed is limited to investing in the Company.

3. Basis of presentation

Pursuant to the Trust Deed, the Trust and the Company are each required to prepare their own sets of interim financial statements on a consolidated basis. The unaudited consolidated interim financial statements of the Trust for the period ended 30 June 2016 comprise the unaudited consolidated interim financial statements of the Trust, the Company and its subsidiaries (together the "Trust Group"). The unaudited consolidated interim financial statements of the Company for the period ended 30 June 2016 comprise the unaudited consolidated interim financial statements of the Company and its subsidiaries (together the "Group").

The Trust controls the Company and the sole activity of the Trust during the six months period ended 30 June 2016 was investing in the Company. Therefore, the consolidated results and financial position that would be presented in the unaudited consolidated interim financial statements of the Trust are identical to the consolidated financial results and financial position of the Company with the only differences being disclosures of share capital of the Company. The Directors of the Trustee-Manager and Directors of the Company believe that it is clearer to present the unaudited consolidated interim financial statements of the Trust and of the Company together. The unaudited consolidated interim financial statements of the Trust and the unaudited consolidated interim financial statements of the Company are presented together to the extent they are identical and are hereinafter referred as the "unaudited consolidated interim financial statements of the Trust and of the Company".

The Trust Group and the Group are referred as the "Groups".

4. Basis of preparation

The unaudited consolidated interim financial statements of the Trust and of the Company have been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34, *Interim financial reporting* issued by the HKICPA and comply with the applicable disclosure provisions of the Listing Rules.

The interim financial statements have been prepared in accordance with the same accounting policies adopted in and should be read in conjunction with the 2015 annual financial statements, except for the accounting policy changes that are expected to be reflected in the 2016 annual financial statements. Details of these changes in accounting policies are set out in note 5.

The preparation of the interim financial statements in conformity with HKAS 34 requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses on a year to date basis. Actual results may differ from these estimates.

The interim financial statements and selected explanatory notes thereon do not include all of the information required for full set of financial statements prepared in accordance with HKFRSs.

5. Changes in accounting policies

The HKICPA has issued a few amendments to HKFRSs that are first effective for the current accounting period of the Groups. Of these, the following developments are relevant to the Trust's and the Company's unaudited consolidated interim financial statements:

- Amendments to HKAS 1, *Disclosure initiative*
- Amendments to HKAS 16 and HKAS 38, *Clarification of acceptable methods of depreciation and amortisation*
- Annual Improvements to HKFRSs 2012-2014 Cycle

The adoption of these amendments to HKFRSs has no material impact on the Groups' results and financial positions for the current or prior periods. The Groups have not applied any new standard or amendment that is not effective for the current accounting period.

6. Revenue

The principal activity of the Groups is the generation and supply of electricity to Hong Kong Island and Lamma Island. Revenue is analysed as follows:

	Six months ended 30 June	
	2016 \$ million	2015 \$ million
Sales of electricity	5,311	5,211
Concessionary discount on sales of electricity	(3)	(3)
Electricity-related income	18	24
	<u>5,326</u>	<u>5,232</u>

7. Segment reporting

The Groups have one reporting segment which is the generation and supply of electricity to Hong Kong Island and Lamma Island. All segment assets are located in Hong Kong. The Groups' chief operating decision-maker reviews the consolidated results of the Groups for the purposes of resource allocation and performance assessment. Therefore, no additional reportable segment and geographical information has been presented.

8. Profit before taxation

	Six months ended 30 June	
	2016 \$ million	2015 \$ million
Profit before taxation is arrived at after charging/(crediting):		
Finance costs		
Interest on borrowings and other finance costs	684	549
Less: Interest and other finance costs capitalised to assets under construction	(56)	(36)
Interest transferred to fuel cost	(8)	(9)
	620	504
Depreciation		
Depreciation charges for the period	1,373	1,336
Less: Depreciation capitalised to assets under construction	(54)	(53)
	1,319	1,283
Amortisation of leasehold land	<u>96</u>	<u>96</u>

9. Income tax

	Six months ended 30 June	
	2016	2015
	\$ million	\$ million
Current tax		
Provision for Hong Kong Profits Tax for the period	466	462
Deferred tax		
Origination and reversal of temporary differences	(144)	(126)
	<u>322</u>	<u>336</u>

The provision for Hong Kong Profits Tax is calculated at 16.5% (2015: 16.5%) of the estimated assessable profits for the six months ended 30 June 2016.

Pursuant to the rules and regulations of the Cayman Islands and the British Virgin Islands, the Groups are exempt from any income tax in these jurisdictions.

10. Scheme of Control transfers

The Scheme of Control transfers are mid-year notional transfers. The actual Scheme of Control transfers can only be determined in accordance with the Scheme of Control at the year end. Notional Scheme of Control transfers during the period represent transfer to the following:

	Six months ended 30 June	
	2016	2015
	\$ million	\$ million
Tariff Stabilisation Fund	370	390
Rate Reduction Reserve	–	–
Smart Power Fund	–	–
	<u>370</u>	<u>390</u>

11. Earnings per Share Stapled Unit/share of the Company

The calculation of basic and diluted earnings per Share Stapled Unit/share of the Company are based on the profit attributable to the holders of Share Stapled Units/shares of the Company of \$1,101 million for the six months ended 30 June 2016 (2015: \$1,205 million) and the weighted average of 8,836,200,000 Shares Stapled Units/ordinary shares of the Company (2015: 8,836,200,000 Shares Stapled Units/ordinary shares of the Company) in issue throughout the period.

12. Property, plant and equipment and interests in leasehold land

\$ million	Site formation and buildings	Plant, machinery and equipment	Fixtures, fittings and motor vehicles	Assets under construction	Sub-total	Interests in leasehold land held for own use under finance leases	Total
Net book value at 1 January 2016	15,573	44,776	363	3,809	64,521	6,472	70,993
Additions	5	168	27	762	962	-	962
Transfers between categories	17	289	-	(306)	-	-	-
Disposals	-	(26)	-	-	(26)	-	(26)
Depreciation/amortisation	(254)	(1,078)	(41)	-	(1,373)	(96)	(1,469)
Net book value at 30 June 2016	15,341	44,129	349	4,265	64,084	6,376	70,460
Cost	16,569	48,942	525	4,265	70,301	6,844	77,145
Accumulated depreciation and amortisation	(1,228)	(4,813)	(176)	-	(6,217)	(468)	(6,685)
Net book value at 30 June 2016	15,341	44,129	349	4,265	64,084	6,376	70,460

13. Trade and other receivables

The ageing analysis of trade debtors based on invoice date, which are neither individually nor collectively considered to be impaired, is as follows:

	30 June 2016 \$ million	31 December 2015 \$ million
Current and within 1 month	864	625
1 to 3 months	34	36
More than 3 months but less than 12 months	16	17
Trade debtors	914	678
Other receivables	712	463
	1,626	1,141
Derivative financial instruments (see note 17)	12	2
Deposits and prepayments	27	17
	1,665	1,160

Electricity bills issued to residential, small industrial, commercial and miscellaneous customers for electricity supplies are due upon presentation whereas maximum demand customers are allowed a credit period of 16 working days. If settlements by maximum demand customers are received after the credit period, a surcharge of 5% can be added to the electricity bills.

14. Bank deposits and cash

	30 June 2016 \$ million	31 December 2015 \$ million
Deposits with banks and other financial institutions with 3 months or less to maturity when placed	245	5,712
Cash at bank and in hand	<u>62</u>	<u>265</u>
Cash and cash equivalents in the consolidated cash flow statement	307	5,977
Deposits with banks and other financial institutions with more than 3 months to maturity when placed	<u>-</u>	<u>180</u>
	<u>307</u>	<u>6,157</u>

15. Trade and other payables

	30 June 2016 \$ million	31 December 2015 \$ million
Due within 1 month or on demand	453	700
Due after 1 month but within 3 months	260	529
Due after 3 months but within 12 months	<u>1,417</u>	<u>1,328</u>
Creditors measured at amortised cost	2,130	2,557
Derivative financial instruments (see note 17)	<u>143</u>	<u>29</u>
	<u>2,273</u>	<u>2,586</u>

16. Non-current bank loans and other interest-bearing borrowings

	30 June 2016 \$ million	31 December 2015 \$ million
Bank loans	20,537	34,057
Current portion	<u>(5,500)</u>	<u>–</u>
	15,037	34,057
Hong Kong dollar medium term notes		
Fixed rate notes	5,879	4,486
Zero coupon notes	<u>644</u>	<u>633</u>
	6,523	5,119
Current portion	<u>(900)</u>	<u>(900)</u>
	5,623	4,219
United States dollar medium term notes		
Fixed rate notes	11,898	6,087
Zero coupon notes	<u>2,002</u>	<u>1,954</u>
	13,900	8,041
	<u>34,560</u>	<u>46,317</u>

17. Derivative financial instruments

	30 June 2016		31 December 2015	
	Assets	Liabilities	Assets	Liabilities
	\$ million	\$ million	\$ million	\$ million
Derivative financial instruments used for hedging:				
Cash flow hedges:				
– Cross currency swaps	1	(316)	–	(69)
– Interest rate swaps	–	(119)	–	(88)
– Forward foreign exchange contracts	180	(3)	3	(67)
Fair value hedges:				
– Cross currency swaps	372	(4)	313	(5)
– Forward foreign exchange contracts	–	–	–	(1)
	<u>553</u>	<u>(442)</u>	<u>316</u>	<u>(230)</u>
Derivative financial instruments not qualifying as accounting hedges:				
– Cross currency swaps	–	(43)	–	–
– Interest rate swaps	–	(20)	–	(6)
– Forward foreign exchange contracts	9	(1)	–	–
	<u>562</u>	<u>(506)</u>	<u>316</u>	<u>(236)</u>
Analysed as:				
Current	12	(143)	2	(29)
Non-current	550	(363)	314	(207)
	<u>562</u>	<u>(506)</u>	<u>316</u>	<u>(236)</u>

18. Scheme of Control Fund and Reserve

The Tariff Stabilisation Fund, Rate Reduction Reserve and Smart Power Fund of the Groups' major subsidiary, HK Electric, are collectively referred to as Scheme of Control Fund and Reserve. The respective balances at the end of the period/year are:

	30 June 2016 \$ million	31 December 2015 \$ million
Tariff Stabilisation Fund	575	204
Rate Reduction Reserve	–	1
Smart Power Fund	10	10
	<u>585</u>	<u>215</u>

19. Share capital

The Company

	Number of shares	30 June 2016 Nominal value \$	31 December 2015 Nominal value \$
Authorised:			
Ordinary shares of \$0.0005 each	<u>20,000,000,000</u>	<u>10,000,000</u>	<u>10,000,000</u>
Preference shares of \$0.0005 each	<u>20,000,000,000</u>	<u>10,000,000</u>	<u>10,000,000</u>
Issued and fully paid:			
Ordinary shares of \$0.0005 each	<u>8,836,200,000</u>	<u>4,418,100</u>	<u>4,418,100</u>
Preference shares of \$0.0005 each	<u>8,836,200,000</u>	<u>4,418,100</u>	<u>4,418,100</u>

There were no movements in the share capital of the Company during the period.

20. Fair value measurement

The following table presents the fair value of the Groups' financial instruments measured at the end of the reporting period on a recurring basis, categorised into the three-level fair value hierarchy as defined in HKFRS 13: *Fair value measurement*. The level into which a fair value measurement is classified is determined with reference to the observability and significance of the inputs used in the valuation technique as follows:

- Level 1 valuations: Fair value measured using only Level 1 inputs i.e. unadjusted quoted prices in active markets for identical financial assets or liabilities at the measurement date
- Level 2 valuations: Fair value measured using Level 2 inputs i.e. observable inputs which fail to meet Level 1, and not using significant unobservable inputs. Unobservable inputs are inputs for which market data is not available
- Level 3 valuations: Fair values measured using significant unobservable inputs

(a) Recurring fair value measurements

	Level 2	
	30 June 2016 \$ million	31 December 2015 \$ million
Financial assets		
Derivative financial instruments:		
– Cross currency swaps	373	313
– Forward foreign exchange contracts	189	3
	562	316
	562	316
Financial liabilities		
Derivative financial instruments:		
– Cross currency swaps	363	74
– Interest rate swaps	139	94
– Forward foreign exchange contracts	4	68
Medium term notes subject to fair value hedges	4,618	4,554
Bank loans subject to fair value hedges	–	3,097
	5,124	7,887
	5,124	7,887

20. Fair value measurement *(Continued)*

(b) Fair values of financial assets and liabilities carried at other than fair value

Trade and other receivables, trade and other payables and external borrowings are carried at cost or amortised cost which are not materially different from their fair values as at 30 June 2016 and 31 December 2015.

(c) Valuation techniques and inputs in Level 2 fair value measurements

The fair values of forward foreign exchange contracts are determined using forward exchange market rates at the end of the reporting period. The fair values of cross currency swaps and interest rate swaps are determined by discounting the future cash flows of the contracts at the current market interest rates.

The fair values of medium term notes are estimated as the present value of future cash flows, discounted at current market interest rates for similar financial instruments.

The fair values of bank loans are estimated as the present value of future cash flows, discounted at current market interest rates for similar financial instruments.

21. Interim distribution/dividend

The distributable income for the period was as follows:

	Six months ended 30 June	
	2016	2015
	\$ million	\$ million
Consolidated profit attributable to the holders of Share Stapled Units for the period	1,101	1,205
After:		
(i) eliminating the effects of the Adjustments (see note (a) below)	2,742	2,611
(ii) adding/(deducting)		
– movement in Fuel Clause Recovery Account	979	775
– changes in working capital	(423)	(478)
– adjustment for employee retirement benefit schemes	12	8
– taxes paid	(233)	(238)
	335	67
(iii) capital expenditure payment	(1,340)	(1,099)
(iv) deducting		
– debt repayment	(6,296)	(520)
– net finance costs	(639)	(485)
	(6,935)	(1,005)
(v) deducting		
– reserve for future capital expenditure/debt service	(439)	(19)
Distributable income for the period	(4,536)	1,760
(vi) adding discretionary item		
– early repayment of debt during the period	6,296	–
Distributable income after adjustment of discretionary item	1,760	1,760
Distribution amount for the period (see note (d) below)	1,760	1,760
Number of Share Stapled Units/ordinary shares of the Company	8,836,200,000	8,836,200,000
Interim distribution per Share Stapled Unit/first interim dividend per ordinary share of the Company (see note (e) below)	19.92 cents	19.92 cents

21. Interim distribution/dividend *(Continued)*

- (a) Pursuant to clause 1.1 of the Trust Deed, “Adjustments” includes, but not limited to (i) transfers to/from the Tariff Stabilisation Fund and the Rate Reduction Reserve under the Scheme of Control; (ii) unrealised revaluation gains/losses, including impairment provisions and reversals of impairment provisions; (iii) impairment of goodwill/recognition of negative goodwill; (iv) material non-cash gains/losses; (v) costs of any public offering of Share Stapled Units that are expensed through the consolidated statement of profit or loss but are funded by proceeds from the issuance of such Share Stapled Units; (vi) depreciation and amortisation; (vii) tax charges as shown in the consolidated statement of profit or loss; and (viii) net finance income/costs as shown in the consolidated statement of profit or loss.
- (b) The Trust Deed requires the Trustee-Manager (on behalf of the Trust) to distribute 100% of the dividends, distributions and other amounts received by the Trustee-Manager in respect of the ordinary shares from the Company, after deduction of all amounts permitted to be deducted or paid under the Trust Deed.
- (c) The distributions received by the Trustee-Manager from the Company will be derived from the Group Distributable Income which is referred as audited consolidated profit attributable to the holders of Share Stapled Units for the relevant financial year or distribution period, after making adjustments in respect of items as set out in the Trust Deed.
- (d) In determining the distribution amount, the Company Board has taken into account the Group’s financial performance achieved during the period under review and its stable cashflow from operations, and consider it appropriate to adjust the distributable income for the six months ended 30 June 2016, as calculated pursuant to the Trust Deed, by the above discretionary item, pursuant to clause 14.1(c) of the Trust Deed.
- (e) Interim distribution per Share Stapled Unit/first interim dividend per ordinary share of the Company of 19.92 cents (2015: 19.92 cents) is calculated based on the interim distribution of \$1,760 million for the six months ended 30 June 2016 (2015: \$1,760 million) and the number of Shares Stapled Units/ordinary shares of the Company of 8,836,200,000 in issue as at 30 June 2016 (2015: 8,836,200,000).

22. Capital commitments

The Groups' outstanding capital commitments not provided for in the financial statements were as follows:

	30 June 2016 \$ million	31 December 2015 \$ million
Capital expenditure for property, plant and equipment authorised and contracted for	<u>2,734</u>	<u>2,248</u>
Capital expenditure for property, plant and equipment authorised but not contracted for	<u>8,369</u>	<u>9,588</u>

23. Material related party transactions

The Groups had the following material transactions with related parties during the period:

(a) Holder of Share Stapled Units

Support service charge recovered from Power Assets group

Other operating costs included support service charge recovered from Power Assets group amounting to \$18 million (2015: \$18 million) for provision of the support services and office facilities to Power Assets group. The support service charge was based on the total costs incurred in the provision or procurement of the provision of the services and facilities and allocated to Power Assets group on a fair and equitable basis, taking into account the time spent by the relevant personnel when providing such services.

At 30 June 2016, the total outstanding balance receivable from Power Assets group was \$3 million (31 December 2015: \$4 million).