CHAIRMAN'S STATEMENT

The long-term certainty provided by the new Scheme of Control Agreement will keep us on track to achieve the Government's energy and environmental objectives and its Climate Action Plan 2030+.

CERTAINTY UNDERPINNING A CLEAN ENERGY FUTURE

2017 was a defining year for HK Electric Investments (HKEI) and its wholly owned subsidiary HK Electric, with the signing of the new Scheme of Control Agreement (SCA). The long-term certainty provided by this agreement will help the local electricity sector make the necessary investments to build a clean energy future and reduce emissions. It will keep us on track to achieve the Government's energy and environmental objectives and its Climate Action Plan 2030+.

During the year, we not only worked with the Government to lay the foundation for Hong Kong's long-term energy future, but also fulfilled our commitments to holders of our Share Stapled Units (SSUs) by delivering stable performance, and continuing to supply reliable and affordable electricity to Hong Kong.

We are proud to have honoured our 2013 pledge to freeze tariffs for the five-year period between 2014 and 2018. Overall tariffs had been consecutively reduced for two years in 2016 and 2017, and despite a small tariff rebound from 1 January 2018, our tariff is a significant 16.6% lower than the 2013 level.

FINANCIAL RESULTS AND DISTRIBUTIONS

For the year ended 31 December 2017, HKEI's EBITDA was HK$8,195 million (2016: HK$8,034 million) and audited profits attributable to SSU holders was HK$3,341 million (2016: HK$3,599 million).

The Board of the Trustee-Manager has declared a final distribution by the Trust of HK20.12 cents (2016: HK20.12 cents) per SSU, payable on 11 April 2018 to SSU holders whose names appear on the Share Stapled Units Register on 28 March 2018. This, together with the interim distribution of HK19.92 cents (2016: HK19.92 cents) per SSU, amounts to a total distribution of HK40.04 cents (2016: HK40.04 cents) per SSU for the year.

THE STAGE IS SET FOR LOW-CARBON POWER

One of the most important developments during the year was the signing of the new SCA following more than a year of negotiation with the Government.

We warmly endorse the new SCA and expedited conclusion to the negotiation process. With a strong emphasis on energy efficiency, customer services, promotion of renewable energy, and transparency, it effectively balances the interests and wishes of the various stakeholders in the community. Its emphasis on electricity generation from renewable sources and various measures for energy efficiency will accelerate Hong Kong's transition to a low-carbon economy. This will also enable the Government to meet its target of reducing carbon intensity by 65-70% by 2030, as compared to 2005 levels.

Following the retirement in May 2017 of L1, the oldest coal-fired unit installed at Lamma Power Station (LPS), other coal-fired units will approach the end of their useful lives towards the end of the next decade and will be replaced by new gas-fired units. The new SCA with a 15-year term provides us with the stability and confidence to implement this replacement programme. The longer tenure is beneficial to both the sector and the wider community, allowing us to make a number of large-scale infrastructural investments to meet the Government's emissions and carbon intensity targets.

While HK Electric is permitted a reduced rate of return on average net fixed assets of 8% under the new SCA, we are confident that we will be able to deliver long-term value to SSU holders because of the substantial asset growth resulting from further replacement of HK Electric's generation portfolio from coal to gas over the term of the new SCA.

COMMITTED TO AFFORDABLE ELECTRICITY

In 2013 we promised to freeze tariffs for five years until 2018, and have in fact reduced tariffs across the board by 17.2% in year 2017 as a result of two special rebates, "Special Rent & Rates Rebate" and "Special Fuel Rebate".

In 2018, we continue to offer these two rebates, but the "Special Fuel Rebate" is smaller than before. In conjunction with other adjustments, there has been a slight increase of 1.9% in our net tariff. Despite this, the tariff remains among the lowest in the developed world and is a significant 16.6% lower than the 2013 level.

PREPARING FOR LOW EMISSIONS GENERATION

HK Electric continued to outperform all targets of statutory emissions for sulphur dioxide, nitrogen oxides and respirable suspended particulates in 2017. We have also worked with the Government to further reduce emission allowances from 2022 onwards with the approval of the Seventh Technical Memorandum by the Legislative Council.

To increase the proportion of gas-fired electricity we generate, HK Electric is constructing two new gas-fired generating units, L10 and L11, at LPS. Civil construction of L10 has been progressing at a satisfactory pace with commencement of installation of electrical and mechanical equipment targeted in April 2018. For L11, piling was completed on schedule in September 2017. L10 and L11 will be commissioned in 2020 and 2022 respectively.

We are also in the process of developing an offshore liquefied natural gas (LNG) terminal using Floating Storage and Regasification Unit (FSRU) technology in Hong Kong waters, in partnership with CLP Power, to give us additional access to natural gas transported by ship in liquid form. The Environmental Impact Assessment report for the project will soon be submitted to the Government for approval. Planning for this major item of infrastructure is progressing on track. If Government approvals are received and construction continues as scheduled, the offshore LNG terminal will come into operation by the end of 2020 at the earliest.

UPHOLDING WORLD-CLASS STANDARDS

Hong Kong suffered extreme weather in 2017. In the summer, a number of powerful typhoons affected Hong Kong, bringing gusty winds and severe storms. Extremely high temperature due to the typhoons led to a surge in electricity demand in August, leading to a new record high of 2,513 MW in system maximum demand since 2010. Notwithstanding these extreme weather conditions, I am pleased that we once again maintained our supreme supply reliability rating of over 99.999% for the 21st consecutive year. The average unplanned power interruption per customer was less than one minute for the ninth year in a row.

Sales volume showed a decline of 1.6% from 2016. We believe that per capita electricity consumption in Hong Kong will continue to decrease as a result of increasing public awareness of energy conservation.

PLAYING OUR PART IN A GREEN AND CARING SOCIETY

A change in Government policy from April 2017 has negatively affected the growth in the rollout of electric vehicles (EVs) in Hong Kong. Despite this, we continued to expand the public EV charging facilities we offer, installing eight quick chargers during the year for the convenience of motorists. We also engaged closely with property developers and managers, offering technical consultancy on the installation of charging points in buildings.

Our passionate band of volunteers dedicated more than 5,400 man-hours over the year to the social causes they believe in: from spreading the message of energy awareness among adults and children, to spending time with the vulnerable elderly. Our long-running community programmes have gone from strength to strength over the years, involving tens of thousands of people in activities like country walks, home visits, education and more.

As the trusted energy partner of Asia's World City, we continued to invest the necessary resources to attract and retain the best talent with a year-round calendar of training, staff development, and a healthy culture that encourages work-life balance.

In July, we were presented with the Grand Award of the 2017 HKMA Quality Award in recognition of our commitment to developing and deploying Total Quality Management. The Hong Kong Management Association (HKMA) highlighted our ability to fulfil our mission and "sustain and perform over an extended period due to strong senior leadership, a nurturing staff culture, and excellent operational performance". I am proud of this endorsement by our peers in the Hong Kong business sector.

OUTLOOK

In February 2018, HK Electric entered into a framework agreement with CK Asset Holdings Limited (CKA) to develop a hotel in the site of HK Electric's former operational headquarters and carpark building at Ap Lei Chau. This project will bring in income to the Group and the appreciation in the value of the property.

2018 is the last year of the current SCA, which has been in force since 2009. During this term, we have consistently delivered the highest standards of operational performance and service quality while our tariffs are amongst the lowest in the developed world. We have made significant progress in emissions reduction and energy efficiency as we proceed with increasing our use of natural gas in electricity generation.

Over the following months our key priority will be to complete deliberations with the Government on all outstanding items associated with the implementation of the new SCA, to ensure we are fully prepared for the new framework, including the introduction of feed-in tariffs and renewable energy certificates. We will prepare our upcoming five-year development plan for Government's approval, and finalise any pending operational details.

The move to green, smart energy is accelerating across the world and Hong Kong is no exception. We welcome technological innovation and recognise its potential to shape a cleaner energy future by encouraging public participation in electricity generation from renewable energy sources while reducing emissions.

We will make significant investments to gradually replace our retiring coal-fired units with new gas-fired units to meet the Government's carbon reduction targets and satisfy the community's aspirations for cleaner air. We are confident that the upcoming increase in our assets base will compensate for the reduction of the rate of permitted return and will deliver growth in value to our SSU holders.

There is no question that cleaner energy come at the cost of affordable tariffs, especially so for HK Electric, as we embark on various programmes to considerably expand gas-firing generation capacity. The capital expenditure associated with the new units and greater consumption of natural gas, a more expensive fuel, will inevitably place greater pressure on tariffs going forward.

We can succeed in this changing world only through the dedicated efforts of our team of employees. On behalf of the Board I extend my gratitude to each and every one for their efforts in the past year.

Fok Kin Ning, Canning
Chairman
Hong Kong, 13 March 2018