CHAIRMAN'S STATEMENT

2018 is a transitional year for HK Electric Investments (HKEI) and its wholly-owned subsidiary HK Electric. This year will mark the end of the current Scheme of Control Agreement (SCA), which has been in force since 2009. At the same time we are laying the groundwork for the new SCA which comes into effect in 2019 for a period of 15 years.

The SCA puts HK Electric's rate of return and its operations under very strict scrutiny. Over the years, we are proud of the efforts and achievements made in providing Hong Kong with a world-class electricity supply which is highly reliable in addition to being affordable. We also support the city's transformation into a low-carbon economy. Continuing with this success, the new SCA will also provide a balanced framework that benefits consumers and offers long-term stability to power companies while reducing emissions in line with the Government's Climate Action Plan 2030+.

The highlight of the period under review was the conclusion of the 2019-2023 Development Plan, a key strategic framework that will guide our investments for the next five years, with the Government. Under the Plan, HK Electric will build electricity infrastructure to support Hong Kong's transformation into a low-carbon and smart city. At the same time, it will make all the investments needed to ensure Hong Kong continues to enjoy a highly reliable power supply to meet the city's unique requirements.

Half-year Results

For the six months ended 30 June 2018, HKEI's EBITDA amounted to HK$3,809 million (2017: HK$3,776 million) and unaudited profit attributable to holders of Share Stapled Units (SSUs) was HK$982 million (2017: HK$1,003 million).

Interim Distribution

Distributable income for the period was HK$1,760 million (2017: HK$1,760 million), which will be 100% distributed to SSU holders.

The Board of the Trustee-Manager has declared an interim distribution of HK19.92 cents (2017: HK19.92 cents) per SSU, payable on 17 August 2018 to SSU holders whose names appear on the Share Stapled Units Register on 8 August 2018.

Lamma Power Station Gearing Up for a Clean Energy Future

Following the approval of 2019-2023 Development Plan, HK Electric will invest HK$26.6 billion in generation, transmission and distribution, customer services and corporate development over the next five years. More than half of the investment will be used to implement an extensive capital programme to evolve HK Electric's generation portfolio from coal to gas-fired generation.

During the period, construction of the two new gas-fired combined-cycle generating units, L10 and L11, has been progressing well. Contracts have been awarded for equipment supply and various mechanical, electrical and civil works for both units. Detailed engineering design of the L10 power block was substantially completed and construction works are on schedule for commission in 2020. In tandem, the contract for L11 superstructure works was awarded. These units will jointly raise gas-fired output to 55% of the total when the latter is commissioned in 2022. We have commenced planning of another new gas-fired combined cycle generating unit, L12, which will be built for commissioning by 2023, boosting gas-fired electricity generation further to about 70% of total output.

The direct import of liquefied natural gas (LNG) by sea will enhance the security of natural gas supply and strengthen our negotiating power. We are in partnership with CLP Power to jointly develop an offshore LNG terminal using Floating Storage and Regasification Unit (FSRU) technology in Hong Kong waters to enable oceanic import. The Environmental Impact Assessment report for the project was submitted to the Government on 11 May 2018. This was followed by one month of public inspection from mid of June.

Setting the Stage to Achieve Green Benefits of the New SCA

Under the new SCA, we are planning a series of initiatives under the twin themes of energy efficiency and conservation (EE&C) and renewable energy. These initiatives will help enhance the energy efficiency of Hong Kong's buildings and also facilitate energy saving among the general public. We hope they will also stimulate members of the Hong Kong community to take the first step in proceeding with their own renewable energy installations.

Our EE&C strategy aims to provide support for those lacking in financial resources and technical expertise to modernise their electrical facilities, including households alongside commercial and industrial organisations. Five key Smart Power schemes and services in this area, including the provision of funding for buildings to carry out energy efficiency measures, provision of new energy-efficient household electrical appliances to underprivileged families and enhancing community education, will be offered to our customers.

During the second half of the year, we will launch a Feed-in Tariff (FiT) Scheme and introduce Renewable Energy Certificates for public subscription. Since the announcement of the FiT Scheme by Government in April, we have received an enthusiastic response from the community with many organisations keen to install solar panels on their rooftops. While Hong Kong Island might lack the space for larger-sized renewable energy installations, we believe that the smaller installations still have a role to play in bringing cleaner air to Hong Kong.

Operating Performance

HK Electric delivered strong operational performance in all areas in the first six months of 2018. A cooler winter and record-breaking May temperatures triggered more consumption from all sectors. Electricity sales in the first half of the year showed an increase of 2.1% as compared to the same period in 2017.

We continued to extend two special rebates to our customers in 2018. At HK112.5 cents per unit of electricity, the net tariff remains 16.6% below 2013 levels, and is even better than the pledge we made in 2013 to keep tariffs unchanged until the end of 2018.

Customer service standards remained high and we are proud to have once again met or surpassed all our pledged service standards in the period.

Our maintain-and-upgrade approach is the foundation for the record-breaking reliability of our transmission and distribution network. Our network investments, including upgrades to both physical and cyber assets like mission-critical IT systems, have ensured that we maintained our world-leading reliability level of over 99.999%.

Working to Clean Up the Air and Environment

We made sustained progress in reducing the emissions from our operations and helping the community to do the same.

Notable success has been achieved in meeting or surpassing ever more stringent emissions caps. Our next priority in this regard will be to initiate processes to comply with the increasingly tightened emission allowances for 2019 onwards, which have been agreed with the Environmental Protection Department.

We are pursuing our award-winning project to install a solar power system on Po Toi Island, including a bank of recycled electric vehicle (EV) batteries to store the electricity generated. An Environmental Impact Assessment is in progress and the project is expected to be completed by early 2021.

Our long-running community outreach efforts, including free energy audits for non-residential customers, subsidies under the Smart Power Fund and free charging infrastructure for EVs, continued to support customers and the community in minimising their own carbon footprints.

Care for the Community and Our Employees

As a company rooted in Hong Kong we believe that our value in the community extends beyond power generation. Our volunteer team actively takes part in numerous activities to conserve the environment and care for the underprivileged, especially the elderly.

We aspire to be an employer of choice and I am pleased that HK Electric has ranked the sixth among Hong Kong's top 10 most attractive employers based on Randstad's latest employer brand research findings.

We have the unique opportunity to contribute to the Belt and Road Initiative and are proud to participate in the pathbreaking three-year programme initiated jointly by the State Grid Corporation of China, the Hong Kong Polytechnic University and Xi'an Jiaotong University. During the review period, we hosted a workshop for our senior engineers to share their expertise and experience with professionals from the Belt and Road countries and regions.

Outlook

As we stand at the threshold of a new era in the power industry, we are firmly focused on the success of our infrastructural projects to increase gas-fired electricity generation and successful implementation of the 2019-2023 Development Plan. Smart meters will be installed for all HK Electric customers. With that, customers can have detailed consumption information for managing their use of electricity. This is a key component for transforming Hong Kong into a smart city. These changes will entail a major evolution in our operations, which we are confident in achieving while maintaining our excellent standards of reliability and customer service.

Compared with 2018, the net tariff for 2019 will increase by 6.8% as a result of the substantial reduction of the two special rebates. If the impact of the two special rebates is taken out for both years, the 2019 net tariff will be lower than that of 2018 by 5.9%. It is to be noted that we are entering a period of rising costs. Not only will we be incurring significant capital expenditure to expand gas-fired generation capacity, but fuel costs will also go up in tandem as we consume more natural gas, which is a more expensive fuel. I must caution that these factors will inevitably place greater pressure on tariffs.

In closing, I would like to thank the Board, management, SSU holders and all our employees who all have a great role to play in our sustained success.

Fok Kin Ning, Canning
Chairman

Hong Kong, 24 July 2018