Chairman's Statement

Economic Landscape

The global economy continued to recover albeit at a slow pace in 2016. Against the backdrop of Brexit, the strong US Dollar and complicated geopolitical conditions in the Middle East and the Asia-Pacific region, international oil prices continued to stumble. During the year, China's economy focused on the reform of supply management and de-capacity, to facilitate its structural adjustments and the transformation of development mode. Its domestic economy grew steadily throughout the year – the Gross Domestic Product (GDP) expanded by 6.7% in the first three quarters and 6.8% in the fourth. According to the National Bureau of Statistics, China's contribution to global economic growth was as high as 33.2%, was still the world's primary economic driver. The country's purchasing managers' index (PMI) for 2016 recorded small increases for four consecutive seasons with a rebound to 51.9% in the fourth quarter. The annual average of 50.3% represented an increase of 0.4 percentage points over 2015. This macro-economic data reflects favourable signs underpinned by rejuvenated market demand as well as an improving operating environment for businesses. Despite the potential depreciation of the RMB against the US dollar in the short term, the Chinese government stabilised the exchange rate by actively adjusting its foreign exchange reserves in US Dollars. Therefore, in the mid-to-long term, the RMB exchange rate is expected to remain steady.

Reforms in the Liberalisation of Natural Gas

In recent years, the Chinese government has been working towards market-oriented reform in the natural gas industry. In view of the government's core principle to relax gas sourcing and pricing in the market and its transformation to market-orientation – the government currently only regulates the prices for network transmission and distribution that fall into the natural monopoly through network category ("regulate the core and relax the ends"), this reform is continuing to pick up pace. In April 2016, the National Energy Administration of China issued a "*Notice on Actively Promoting the Mode of Public-Private-Partnership in the Energy Field*" in a bid to attract private capital for investment in the natural gas infrastructure. Following an attempt to open up the construction market for natural gas infrastructure with fair and equal participation in 2014, relevant policies were launched in 2016 to facilitate similar development for

the natural gas infrastructure under the three largest energy corporations in China (CNPC, Sinopec and CNOOC) and across different provinces. With regard to the price of transportation through pipelines, the Chinese government promulgated "*Measures for the Administration of the Price of Natural Gas Pipeline Transportation*" and "*Measures for the Supervision and Examination of the Pricing and Costs of Natural Gas Pipeline Transportation*", which set out details in the pricing methodology for domestic natural gas supply through transmission networks and established the pricing principle. It also sets the standard entry charge for third-party piped gas suppliers when the market opens up to the public. Service prices for gas storage facilities, which have not been subject to independent determination in the past, will also be market-driven from now on. Fujian Province also commenced its pilot scheme for market-oriented reforms in the natural gas industry. As such the gateway prices for natural gas are no longer divided into residential and non-residential rates. Residential prices are linked to upstream gas prices and adjusted accordingly, while non-residential prices are determined by supply and demand. The experience generated in these trial reforms in Fujian Province is expected to act as a model for larger scale market-oriented reforms in the natural gas industry throughout the country in the future. In addition to these developments, the Shanghai Petroleum and Natural Gas Exchange commenced official operations, which in turn was followed by the Chongqing Petroleum and Natural Gas Exchange. China has so far established two national trading platforms for bulk energy products while a market-oriented mechanism for the trading and pricing of natural gas is just around the corner.

Chairman's Statement

Market Prospects of the City Gas Business

China underwent changes on energy consumption patterns in 2016, transforming into the adoption of clean, low-carbon and efficient sources as the new standard for energy consumption. Being a clean energy, development and application of natural gas remain a priority for the Chinese government, particularly in view of the worsening haze in the country. The National Development and Reform Commission and National Energy Administration is seeking to accelerate the progress of "coal-to-gas" substitution nationwide. The country's "13th Five-Year Plan of Energy Development" and the "13th Five-Year Plan of Natural Gas Development" propose an increase in the consumption of natural gas to 10% of primary energy consumption in 2020 with a comprehensive guaranteed supply of up to 360 billion cubic metres, a total pipeline length of up to 104,000 kilometres and a gas supply ratio for urban residents of up to 57%. During the term of the 13th Five-Year Plan, "coal-to-gas" substitution works will boost gas consumption by 45 billion cubic metres and replace 189,000 steam tonnes in coal-fired boilers. In 2020, approximately 10 million natural gas vehicles are expected to be in operation, supported by the operation of 12,000 gas refilling stations together with 200 gas refilling stations for marine vessels. These policies and the market environment will thus promote the ongoing development and growth of the city gas industry.

Business Outlook

In view of our operational environment, which has been subjected to structural adjustments in China's economy, the slowdown in energy demand, de-capacity and cost reduction, together with escalating competitive pricing for alternative energies, the Group is sparing no efforts to improve innovation and explore new markets to enhance corporate efficiencies. As such, we are implementing our "creative development" strategy. Actively exploring the industrial and commercial customer base, as well as conventional urban gas markets (including "coal-to-gas" boilers), we continue to leverage our wide client base in China together with our many advantages with regard to gas sourcing coordination, safety management and quality services. These advantages are helping us to lay the foundations for natural gas distributed energy and central heating operations in the domestic gas market. To this end, we provide energy planning and energy savings consultancy together with other services to over 100 member companies in the Group. We are also proactively exploring the new integrated energy supply market. In the development of our distributed energy business, Towngas China Energy Investment (Shenzhen) Limited was established in Qianhai, Shenzhen in 2016.

The "13th Five-Year Plan of Natural Gas Development" has firmly set out objectives to promote the gas utilization in the transportation sector. The implementation of these policies will bring additional opportunities for the Group's gas refilling business for vehicles and marine vessels. Furthermore, there have been constant improvements in technology and additional investments in international gas exploration and development. With an increasing sufficiency in gas supplies and a significant decrease in price in the Asia-Pacific region, imported liquefied natural gas has become much more cost effective. As a result, the Group is planning to tap these sources to complement piped gas supplies, both to lower the costs, as well as to explore opportunities in the trading market of liquefied natural gas.

With regard to the residential market, apart from the active development of the gas heating and water heating markets, the first gas dryer was launched in China in 2016. This move is injecting a new momentum in the Group's "customer oriented" service philosophy.

With signs of economic recovery in mainland China and the continuous expansion of its urban population, demand for energy and green industries remain strong. Looking forward, the Group will continue to promote innovative development and explore new sectors such as clean energy, technology advancement, safety levels and service quality with a view to achieve further growth and improve our overall performance. We believe that in light of the favourable policies and direction for clean energy and the increasing sufficiency of gas supplies, prospects for the further advancement of our business are bright and will achieve not only stable, but outstanding growth. We are on the threshold of a new chapter in our development!

Chan Wing Kin, Alfred
Chairman
Hong Kong, 15 March 2017