

Review of Operations



Natural gas is considered a clean energy which has become a substitute for traditional energy such as coal and crude oil. In response to the targets set by the Chinese government to reduce energy consumption and emissions while also building a low-carbon society, Towngas China is committed to expanding the application of natural gas in urban areas with a view to fully support the national development in improving the environment and air quality. During the “13th Five-Year Plan” period, the percentage of natural gas as a primary energy is expected to reach 10% by 2020, in order to satisfy the long-term goal of reducing dependency on traditional energy resources, optimising the energy structure and moving towards clean and low-carbon development.

Although 2016 saw unstable global markets and the economic slowdown in China, the Group, leveraging our customer network, was able to actively expand our existing markets and customer resources, thus has paved the way for rapid business growth in the future. We have also enhanced our strategic partnership so that we are ideally placed

to capture any opportunities arising from periodic economic rebounds and gradual recovery with added impetus in our operations.

In the first year of the “13th Five-Year Plan” period, the Group adhered to favourable policies that accelerated both the urbanisation process and environment protection, resulting in an active extension of our business scope, expansion of our one-stop household gas product line and more diversified extended services. All these enable our customers to benefit from a creative and stylish living experience, while creating value for our investors.

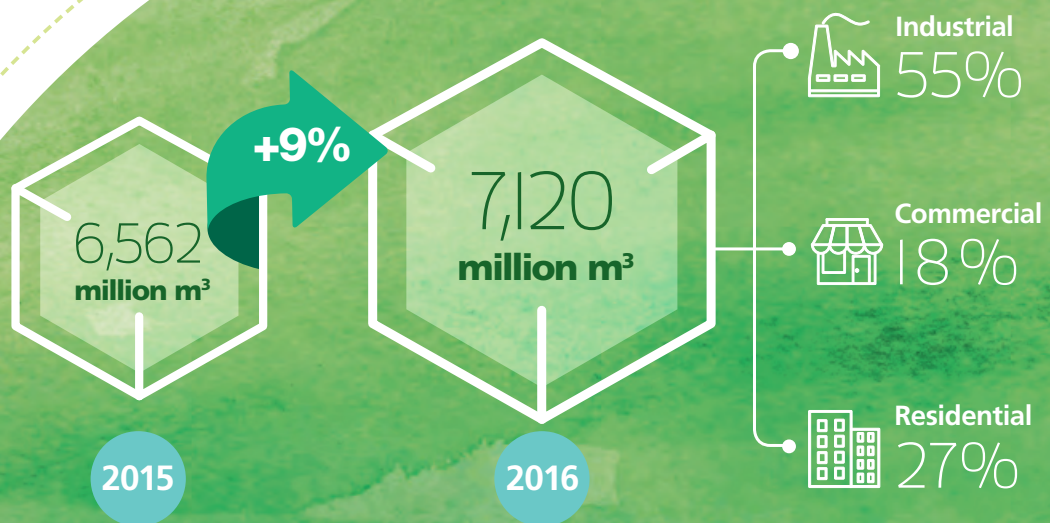
Riding on the trend of “Internet plus”, Towngas China offered customers with convenient online platforms and mobile applications to allow them to log into their accounts anytime and anywhere to manage their gas account and to make enquires, in order to enjoy the comfort of shopping in their own homes.

In pursuit of excellence, we have been promoting the corporate culture of “Master Craft” spirit across the Group to reinforce our total quality management. While we strive to provide the best service to customers, we continue to make an active contribution to society.

Sales of Piped Gas

In 2016, the Group sold a total of 7,120 million cubic metres of piped gas, representing a steady increase of 9%, with a total of 10.91 million customers. Industrial gas sales amounted to 3,918 million cubic metres, accounting for 55% of the total volume of gas sold by the Group, while commercial gas sales reached 1,285 million cubic metres, accounting for 18% of the total volume of gas sold. Residential gas sales accounted for 27% of the total volume of gas sold by the Group.

In view of the volatile global economy and the Chinese Government's economic reform policies, the development of the industrial and commercial market is facing immense pressure that indirectly leads to a shrink in overall gas consumption of the industrial and commercial markets. However, the Group has made the best use of its extensive network to further develop our existing market, launching a new line of ancillary gas products in order to explore more business opportunities. We have also ridden on our abundant gas supplies to capitalise on the rise of the clean energy market to actively take part in natural gas development projects, which created an ongoing growth driver for future gas sales.



Total Number of Customers in 2016

10.91 Million

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Development of New Projects

In 2016, the Group's scope of business continued to expand to include two new distributed energy projects: SCEI Distributed Energy Systems Co., Ltd. ("SCEI") and Towngas China Energy Investment (Shenzhen) Limited ("TCEI"). A distributed energy project uses natural gas as fuel and is able to achieve energy cascade utilisation by adopting combined cooling, heating and power model. The energy efficiencies of these projects can reach 70% or more. In addition, state-of-the-art power supply methods are being adopted close to load centres to achieve higher efficiency of natural gas utilisation.

SCEI's primary market targets are regions with substantial energy consumption, such as metropolitan areas and industrial parks, where the use of distributed renewable energy technology will be extensively applied and actively promoted. SCEI intends to establish its leading market position within Sichuan Province and gain an initial foothold outside Sichuan in 2016 to 2017. In 2018 to 2020, it aims to become the market leader within the Province while extending its business to cover all of China. To date, SCEI has an operating project, a project in trial operation and 4 projects under construction. 4 projects have also gained approvals.

The Group has actively promoted the use of clean energy in line with the "13th Five-Year Plan of Energy Development" and unswervingly pursued the development of integrated energy service operations in response to the policy guideline – "reducing carbon emission and smog". By establishing its base in Shenzhen's Qianhai Free Trade Zone, TCEI has been taking advantage of the supportive policies and regulatory regime on capital and financing in this free trade zone, and leveraging the Group's huge client base and market resources in the mainland, to invest primarily in natural gas distributed energy and central heating projects. It also provides Group members with energy planning, energy saving consultancy and other services. With the Group's advantages in natural gas sources, safety management and quality services, TCEI expects to provide all-around support for investments in distributed energy projects, continuing to drive growth in the integrated energy operations of the Group. Currently, TCEI has undertaken over ten key projects.

At the beginning of 2017, the Group acquired a new city gas project in Huji Town, Zhongxiang City, Hubei Province. The project mainly involves the production of phosphate compound fertiliser and is wholly owned by the Group. This project marks the Group's maiden expansion into Hubei Province.



Industrial and Commercial Markets

Under the shadow of the global economic downturn, China being seen as the world's factory, saw a decline in export volumes for the second consecutive year. A number of industrial enterprises experienced weak growth due to production cuts. With the implementation of energy-saving measures in the commercial market, growth in energy demand has also slowed down.

Despite challenges in the macro-economy, the Group has formulated visionary strategies to strengthen our core competence. We will continue to expand the existing markets and client resources to capture opportunities under a favourable energy policy framework to pick up growth momentum in future businesses.

Industrial

Distributed Energy

In line with the new electricity system reform and policy update on combined heat and power projects while coping with the increasing demand of distributed energy from different client groups, the Group has completed two distributed energy projects during the year. These projects can provide industrial parks, commercial buildings and other industrial and commercial customers with a comprehensive energy solution that combined cooling, heating and power.



Snow Brewery in Xindu district, Chengdu City of Sichuan Province has installed a distributed energy system that makes use of natural gas to generate electricity and residual heat for cooling and steam production. This marked a new era for energy efficiency and productivity.

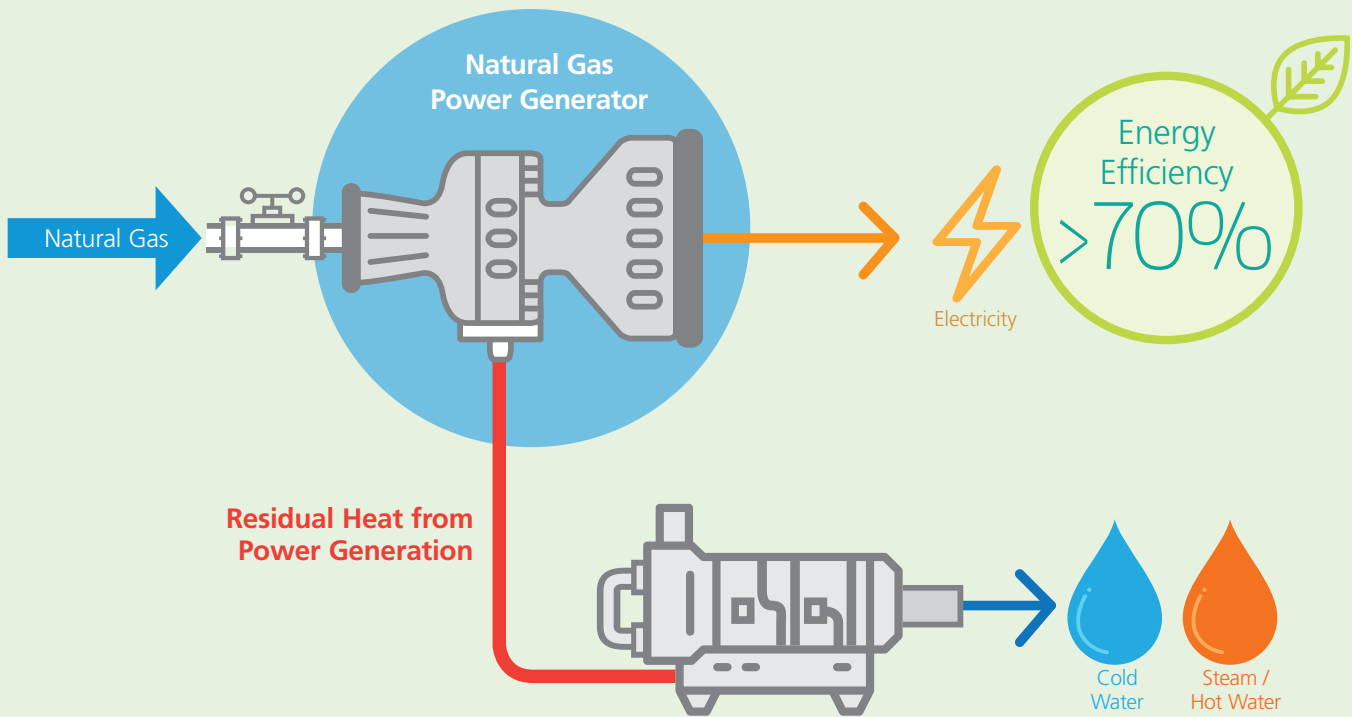


The Group has made significant investment in distributed energy projects. One of these is the Luoshanhu Travel Holiday Area in the city of Guilin.

Such technology makes use of a synthetic energy system that incorporates cooling, heating and power generation functions, with clean natural gas being used as the fuel for electricity generation. As the residual heat of electricity production processed by natural gas can be used for steam production and cooling, it realises the progressive use of energy with energy efficiency reaching over 70%.

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Distributed Energy System



Natural gas-powered distributed energy is an energy efficient approach and is widely applicable in different markets, ranging from hospitals, key commercial buildings, hotels, industrial customers and industrial parks. Such technology can help China achieve its objectives of energy diversification, environmental protection, energy saving etc.

The Group has strategically expanded its business by establishing TCEI to explore new business opportunities and to invest in natural gas distributed energy projects while to provide energy consultancy services for potential customers, with a view to expand the distributed energy market. With the aforesaid strategic moves, the Group has managed to take up a leading position and will continue to capture opportunities aroused from the growing market.

Boiler Conversion from Coal to Natural Gas

In support of the Chinese government's environmental policy to promote the use of clean energy, the Group has carried out strategic market research to better understand customers' needs for boiler conversion so that we can offer them energy-saving solutions and encourage them to shift from coal to gas.

A good management and visionary marketing strategy has helped the Group to focus on expanding the industrial market that consumes a larger volume of gas. This has proven to be a success and the scale of gas consumption has increased. The gas consumption by coal-to-gas boiler conversion projects grew by nearly 80% as compared to the same period of last year.



The boiler conversion at Yupei Logistics in Changchun City, Jilin Province is a good example of the Group's effort in offering our customers with environmentally-friendly solutions.

Commercial

Small and Medium-sized Food Outlets

The Group continued to offer its customers with cost-saving proposals. These have continued to improve through market research exercises and preliminary preparation, the optimisation of relevant procedures through the reduction of quotation times, as well as the laying of pipelines in advance at construction sites. We also provided substitute energy that is more convenient and safer than traditional liquefied gas cylinders.

The Group is well-positioned in the market of small and medium-sized food outlets, with double-digit growth recorded in gas consumption during the year. Our visionary strategies are expected to be the long-term driving force of the market.

The Chengdu Tianfu International Airport Piped Gas Project

Ongoing effective communication with the Government has gained us support during the year. The Group will collaborate with CNPC in supplying gas to Chengdu Tianfu International Airport, which will be completed in 2019, and its adjacent economic zone. It involves the investment, construction and operation of gas pipelines and infrastructure. A concession will be granted for the supply of compressed natural gas or liquefied natural gas.



Mr. Chan Wing Kin, Alfred, Chairman and Executive Director, officiated at the unveiling ceremony of Sichuan Airport Gas Co. Ltd.

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Residential

In 2016, the number of our residential customers increased by approximately 9% year-on-year, leading to another year of moderate growth in gas sales. This accounted for approximately one-fourth of the Group's total gas sales.

Our customer service network has also expanded accordingly. A total of 8 new customer centres were opened during the year to meet growing customer needs.

In order to enhance our customer service experience, we have been promoting our long-standing service culture that emphasizes the delivery of "Customer-oriented, Professional and Efficient" services. In addition, we have introduced a new set of key elements that promotes politeness, caring and etiquette as we strive for customer service excellence.

Through service training programmes and cultural promotions, for example, the "Dandelion Scheme" which specialises in training customer service tutors internally, we pass on customer service techniques, etiquette and management. During the year, the first "Star Officer of Politeness, Caring and Etiquette Competition" was kicked off with the "Service with a Smile Ambassador Competition" which is organised every three years to encourage customer service representatives to provide caring, professional and sincere services.



The service culture of "Customer-oriented" penetrates all of our project companies.

Gas Appliances and Extended Services

In recent years, given the sufficient supply of natural gas source in China and the Chinese government's increasing demand for energy conservation and emission reduction, the Group has ridden on the opportunities to diversify its business scope. We have expanded from our core gas business to provide a wide selection of household gas products and extended services. With the aim to bring customers with a better living experience, especially the middle-class from the Chinese market, not only did the Group create a safe and reliable living habit for customers, it also generated new business opportunities for the Group to support its sustainable development.

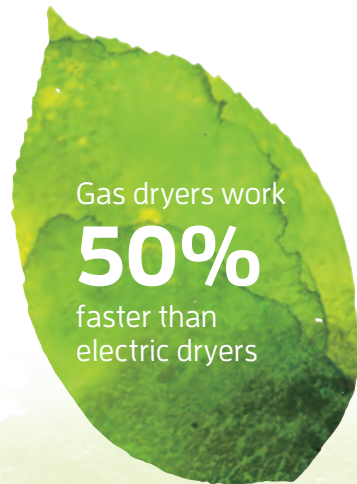
Bauhinia Gas Appliances

With over 10 years of history, Bauhinia, the gas appliances brand established by Towngas China, is well known for its quality, safety and reliability.

Bauhinia covers a wide range of gas appliances ranging from cookers to water heaters and space heaters. Over the years, the products have gained tremendous popularity among the public with a significant increase in sales volume over the years. With the reliable brand image and our successful marketing strategies, Bauhinia gas appliances recorded a total sales of 360,000 gas appliances units during the year, and was again named as Hong Kong Top Brand.



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The gas dryer utilises heat temperature of 65°C to dry clothes with sterilisation, germicidal and anti-mite functions. Dried clothes are softer in texture with fewer wrinkles as compared to those undergo traditional sun-drying or old-fashioned dryers using water vapourisation as the drying medium. Gas dryers can save up to 50% in time when compared to electric dryers and can reduce energy consumption. These advantages have made gas dryers a popular choice.

Gas Dryers

In 2016, the Group rode on the successful launch of gas dryers into the Hong Kong market by HKCG, its parent company, while Towngas China launched the first gas dryer model in China. Outdoor clothes drying condition and hygienic issues have been worsened due to the thickening haze in China. Therefore gas dryers with anti-mite and germicidal functions have become popular. Though the gas dryers have been launched for nine months only, close to 4,000 units have already been sold. With the installation of gas dryers, the average household gas consumption has increased by 30% and has generated growth momentum for our business.

Gas Cookers

Over the years, we have continuously brought forward innovative ideas and developed a large selection of gas cookers to cope with growing household needs. To date, our newly designed products have met stringent safety standards and grade 2 of the national energy standard.



Bauhinia offers a wide range of gas cookers to cater for the diverse needs of different households.

Gas Heating Appliances

Dating back to 2005, the Group started a cooperation with the North China Municipal Engineering Design & Research Institute to develop household heating appliances, providing users with alternatives to the central heating system. With an independent gas heater installed, users can enjoy more comfortable living and can adjust the room temperature based on their own needs.

The demand for household gas heating appliances has continued to grow in respect to the improved quality of living. Riding on the booming needs, the Group has actively promoted the usage of gas heating appliances in eastern, southern and south-western parts of China during the year. With strategic alliance formed with contractors, the Group has managed to pre-plant gas pipes in newly-built residential buildings. The Group also offered bulk buying promotions for gas heating appliances in newly developed projects. During the year, total sales grew by nearly 30%.



During the year, we have added a wall-mounted gas boiler to the catalogue which the boiler is operated in smart system and has swept the European market. The boiler itself goes with a water tank that can enhance stability and water storage. Our active promotions in eastern, southern and south-western parts of China have stimulated sales growth of our gas heating products.

Gas Water Heaters

We strive to promote innovation across the Group. Gas and solar-energy compatible heaters were launched during the year. It can improve water temperature stability that used to be an issue associated with the old model powered by renewable energy. With the new heaters installed, customers can enjoy a stabilized water temperature with instantaneous heating function as well as being environmentally-friendly. Compared to electrical heaters, water heaters emit close to 80% less carbon dioxide with a significant saving in power expenses, bringing customers dual advantages.



Gas water heater is a must-buy item for modern households. The multi-functional gas water heater not only can instantly offer users with hot water, the temperature stability function is enhanced while being environmentally friendly.

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Extended Services

With our aim to provide a quality lifestyle, “Towngas Lifestyle” provides a wide range of exceptional cooking utensils and services, including premium cabinets, kitchen goods, household gas detector alarms, gas insurance services and the sourcing of healthy food ingredients. The Group established a virtual customer centre and in light of the ever-growing social media trend, a WeChat service account under the name “Towngas Lifestyle” was also being launched during the year. The new platforms offer customers more flexibility and a cost effective approach in managing their gas related services while enabling the purchase of ancillary gas products anywhere at anytime.

Mia Cucina Cabinets with New Complementary Gas Appliances

Mia Cucina, which comes from the Italian word “my kitchen”, is a high-end cabinet brand name owned by the Group. Its product design has incorporated the essence of a “people-oriented” philosophy. The brand uses first class materials imported from Europe along with automated and buffering devices. On the design perspective, it has adopted ergonomic minimalist designs to create stylish cabinets and cooking areas.

With the growing property market in China, there is an increasing demand for fine decorated rooms. We have therefore extended our business to cover every part of the kitchen and also to provide modern kitchen design services to customers. Under the brand name of Mia Cucina, we offered a full range of services ranging from consultation, product sales, design and installation of cabinets and gas appliances to household customers for their modern and stylish living experience. In 2017, Mia Cucina will be expanding its catalogue to offer top notch cooking utensils, bringing customers the concept of a “Total Kitchen Solution”.



Our brand Mia Cucina is widely recognized for its spectacular design and best quality standards, tailor-making elegant and stylish kitchens.



A wide range of imported colourful kitchen accessories are available for purchase in the showrooms.

Kitchen Goods

We source stylish kitchen products from all over the world to enhance the cooking experience for our customers. For example, we have imported top-selling rose ceramic pots from the Republic of Korea, taro mini pans, candy-coloured Swiss multi-purpose stainless steel knives and measuring devices.

During the year, we have extended our footsteps by launching new showrooms selling kitchen furniture and accessories in Shandong and Anhui Provinces. There are currently four showrooms in China to cater for the growth of customers while to provide them with enhanced cooking experience.

Household Gas Detector Alarm

Following the launch of gas insurance last year, we are at the trial launch phase of the household gas leakage detecting service. With the gas alarm installed, it can detect gas leakage with an added value of safety protection. It also provides reassurance to our customers with a safe environment.

Online Customer Centre and Social Media Platform

Riding on the trend of "Internet Plus" and the successful launch of "Ganghua Pay" which has attracted over 600,000 users in over a year, the Group has newly launched the "Towngas VCC (Virtual Customer Centre)" platform (Website: <http://www.towngasvcc.com>) together with the "Towngas Lifestyle" WeChat public account during the year, extending our quality customer services to the internet and smart phone platform. Customers can now manage their gas accounts anytime and anywhere while purchasing ancillary gas products through both online and offline platforms. To provide customers with a more flexible and cost-effective experience, a mobile application is currently under development and is expected to be launched in the near future.

Food Ingredients Sourcing

By utilising our extensive business coverage across China, the Group also sources seasonal and fresh food ingredients for purchase, such as mixed grains and rice from northeastern China, wild camellia oil from Zhejiang and Jiangxi, Tian purple tea from Yixing, etc. These products are all available for group buying purchase at the Wechat platform of "Towngas Lifestyle" which aims to provide quality food ingredients at an affordable price for customers in pursue of a healthy diet.

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We provide free on-site inspections for our residential customers on a regular basis to ensure their safe use of gas.

Engineering and Safety

The Group has always regarded gas safety as our top priority. Not only are we concerned about customers' safety when using gas, the safety of our employees and contractors is of utmost importance.

To reassure our engineering projects are of the best quality, we have established our own technical and management guidelines for new pipelines and facilities. Leveraging advanced technologies, we strictly managed our project companies to meet the highest safety standards in construction works and day-to-day operation. The Group also produces precast pipeline parts in its own factories,

which is part of its prefabricated scheme. By improving project planning and implementation as well as standardising production, the scheme enhances the overall efficiency and precision of projects, shorten project duration and reduce cost without compromising the quality.

Adhering to the well-established safety standards of our parent company, the Group has replicated a similar management system led by our Chairman and the Chief Executive Officer, for which they also take on safety supervision and inspection roles. Our management team is heavily involved in monthly safety inspections, safety cross-check exercises in project companies which are held twice a year, and also the annual General Manager Safety Inspections.

On the community level, our project companies hold at least one joint drilling exercise with local police and fire service authorities every two years. We also organise community promotional campaigns in the safe usage of gas as a further precautionary measure.

In light of our outstanding safety performance, we were once again invited to participate in the preparation of national technical standards on engineering during the year. This contribution included both the review and proposal of amendments to industrial standards and codes. Widely known for our gas safety, we also play a part in the Industry Codes and Standards Preparation and Formulation Committee under the Ministry of Housing and Urban-Rural Development of China.



Apart from regular joint drilling exercise, the Group has also sent staff to participate in training sessions on fire-fighting and courses covering risk management topics run by the Hong Kong Fire Services Department to reinforce the precautionary knowledge and skills of our staff.



The second generation of Zhuojia production line in Maanshan city, Anhui province, commenced operations during the year, which marks a new milestone in regards to the Group's prefabrication scheme.

Human Resources

Adhering to the “people-oriented” principle we uphold, we attach high importance in talent retention while fostering sustainable development for both our employees and the Group. It has always been our goal to align employees’ career development with our business direction, staying well prepared whenever opportunities arise from the rapid development of the Group.

As at the end of 2016, the Group employed a total of 22,129 staff. With a comprehensive and effective talent retention strategy in place, the staff turnover over the years has only recorded at around 2%.

We have also set up a well-established career progression programme with a series of training schemes in place, including the Professional Talent Development, the Talent Nurturing and the Reserve Pool for General Manager schemes. On top, we organised customized management courses to equip our future managers with advanced skill sets, getting them ready prior to their promotions.

We invest substantial resources both in training courses and in online training sessions, targeting staff in different functions and levels, in our attempt to ensure the long-term development of our people and to enable them to grow in parallel with the Group. We provide on-the-job trainings through the Hong Kong and China Gas Training Institute set up by HKCG in Shandong. Together with training institutes elsewhere, we have a total of 5 training bases to provide engineering-related trainings to help our people earning professional qualifications. During the year, over 3,000 participants attended these engineering training sessions.

We also cooperate with well-known organisations, such as HKMA and University of Technology Sydney to offer a Master of Engineering Management programme, and help our staff broaden their horizons and obtain internationally-recognised qualifications.

Through partnering with a series of universities and education institutions, the Group actively recruits fresh graduates to join and provide them with a full range of on-the-job training schemes, including the Undergraduate Internship, the Graduate Training and Development as well as the Management Trainee schemes.

During the year, we are dedicated to promoting the spirit of “Master Craft”, to encourage all employees, not limited to engineering staff, to improve their professionalism and service quality. We also encourage them to apply the same spirit as seen in traditional craftsmanship, to their scope of work, all in the pursuit of ongoing excellence, innovation and continuous progression.



Through contests and exhibitions of winning projects, the pursuit of excellence and our Total Quality Management culture as encapsulated in our “Master Craft” initiative, were extensively promoted.



Professional trainers at our Hong Kong and China Gas Training Institute worked with trainees to strengthen their engineering knowledge and technical skills.



Comprehensive talent training programmes were organised to enhance the management and leadership capabilities of staff who were recently promoted to management positions.

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Corporate Social Responsibilities

We keep our corporate social responsibilities in mind and strive to integrate sustainability into every aspect of our daily operations. Building on a solid foundation of resources, we thus work to help the underprivileged in society. Apart from monetary sponsorships, our volunteers contribute both time and expertise to help create a better community as well as a greener environment.



Through "Gentle Breeze Movement" programme, the Group donated resources to schools in remote areas in Liaoning and Sichuan Provinces. The teaching building was refurbished and a library was built for impoverished students.



The Group's signature community programme, the "Rice Dumplings for the Community" initiative, our corporate volunteers prepared rice dumplings in person and delivered them to the children.

Community Support

The "Gentle Breeze Movement", one of the Group's annual charitable events, celebrated its fourth anniversary. To date, the Group has donated more than RMB1.8 million to 20 schools in remote mountainous areas in provinces such as Jiangxi, Anhui, Shandong, Guizhou, Liaoning, Sichuan, etc. The donations are used to refurbish school buildings together and to set up "Towngas China Charity Libraries" for impoverished students. It also provides uniforms, sports equipment, computers and other materials. In 2016, this education assistance scheme expanded to cover provinces, such as Liaoning and Sichuan. The learning environment for approximately 800 local teachers and students has been improved in respect to the newly built libraries and teaching equipments we supplied.

Rice Dumplings for the Community

Our "Rice Dumplings for the Community" initiative, another annual signature event, was again held to celebrate the Dragon Boat Festival with the needy. Under this initiative, we have prepared and distributed traditional rice dumplings to the elderly and people in need. The management and nearly 40 of our project companies came together to make more than 36,000 dumplings, which were distributed to charitable organisations, health and construction workers across the country. At the same time, we have distributed festive gifts to more than 7,000 beneficiaries in celebration of the festival.



Supporting the "Firefly Project", we constructed a multi-media classroom for a resource-strapped school in Taian City, Shandong Province during the year. This is the fifth "Firefly Centre" funded by the Group.

Firefly Project

During the year, we continued to support the “Firefly Project” which is run by the “Shanghai Soong Ching Ling Foundation – BEA Charity Fund”, to construct multi-media classrooms for resource-strapped schools. Our fifth “Firefly Centre” was completed in Taian City, Shandong Province during the year. We also donated equipments such as computers, textbooks and stationery as well as a range of equipments to the schools in order to improve teaching quality.

Environmental Protection

We remain committed to environmental protection. Not only are we a clean energy supplier, we also play an active role in promoting urban greening movements, low-carbon lifestyles and community care initiatives that demonstrate our commitment to apply environmental conscious concepts in every aspect of our business operation.

During the year, we rolled out an environmental campaign across the Group, named “Contest of Low Carbon Creativity”, to encourage staff members with their family, customers and the general public to participate in more than 30 innovative environmentally friendly activities. As part of the campaign, community greening events took place, including tree planting activities where more than 1,400 trees were planted, covering an area of over 3,600 square metres. We also organized a competition to call for staff entries with low-carbon ideas, putting the concept of “trash to treasure” and surplus recycling into action. The Towngas volunteer team also organised community cleaning activities in building a better community.



During the year, the Group together with our project companies planted more than 1,400 trees in total, covering a green area of over 3,600 square metres.

Our staff made good use of worn safety helmet (left) and PE tubes and anti-dust covers (right), to produce plant pots. Not only do they reduce general waste, the items can help lighten up both the household and the workplace.



A beach cleaning volunteer event was initiated by our staff in Longkou City, Shandong Province during the year.

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Long-term Development Strategy

Towngas China's mission is to provide our customers with a safe, reliable supply of gas and the caring, competent and efficient services they expect, while working to preserve, protect and improve our environment.

Moving forward, we will continue to focus on gas-related investments, exploration, and sales and operation management. We will continue to uphold the principle of financial management while at the same time grasping every business opportunity to boost reasonable returns for our shareholders.

According to China's "13th Five-Year Plan", the country's clean energy policies will continue to foster city-gas development. It will also play an important role in the government's response to climate change. Looking forward, we will keep leveraging our strengths, which include our existing customer network, outstanding industry safety record, reputable gas and stove brands as well as our professional and reliable customer services, to capture the benefits of being the first in the market, to seize every opportunity to expand business horizons and to strengthen our leading position in the industry.

While the Group is leading project companies to focus on expansion into new areas, we will remain committed to our corporate social responsibilities and charity spirit and to working tirelessly to give back to the community and to protect our environment, spurring our sustainable and ongoing business development.

