

Chairman's Statement



Business Performance

Owing to the Group's efforts and the ongoing benefits from synergies due to the merger of its operations with The Hong Kong and China Gas Company Limited ("HKCG"), the Group recorded favorable growth in 2009. Total turnover of the Group's piped gas business was HK\$2,025 million, an increase of 22.2% compared with 2008. Earnings before interest, taxation, depreciation and amortisation ("EBITDA") amounted to HK\$725 million, an increase of 7.1% when compared to last year. Profit after taxation attributable to shareholders of the Company amounted to HK\$265 million, an increase of approximately 31.0% over 2008, while basic earnings per share were 13.54 HK cents. In light of the improving business performance, the board of directors of the Company ("the Board") has recommended a final dividend of two HK cents per share, representing a 100% increase over last year.

The achievements of Towngas China Group have been fully recognised by international rating agencies. Both Standard & Poor's and Moody's Investors Service maintained the Group's investment grade credit ratings, reflecting their confidence in Towngas China's operating management and business outlook.

Becoming a Subsidiary of HKCG

On 31 December 2009, HKCG gained effective control over the Company following a change in directorship of the Board. Since then, the Company has become a subsidiary of HKCG. In future, the Company will receive stronger support from HKCG in respect of its future development, and hence march towards a new era of business operations.

China's Economy, Environmental Policies and Gas Business Development

China has been one of the countries around the world to recover fastest from the financial tsunami. Through measures such as stimulating domestic demand, improving economic structure and boosting domestic investment, the country has succeeded in both attaining its GDP growth target of 8% and reinvigorating its property and stock markets. Following gradual economic recovery of countries around the globe, China's import, export and industrial enterprises will resume rapid growth. Looking ahead, China is well positioned to maintain stable and relatively rapid economic growth and accelerate its urbanization, industrialization and modernization processes, thus ushering in a new optimistic outlook for the country's city gas industry.

On 26 November 2009, China officially announced a target for limiting greenhouse gas emissions, i.e. to cut carbon dioxide emissions per unit of GDP by 40-45% by 2020 from the 2005 level. This target will be incorporated into the country's 12th Five Year Plan and form a mid-to-long-term planning for the country's domestic economy and social development. Natural gas is a clean, highly efficient energy well suited to become a prime energy source for densely-populated cities. At the same time, it can also substitute for more polluting coal and fuel oil usage, thus serving as a clean energy source for the industrial sector. According to forecasts for China's development plans, the country's demand for natural gas will reach nearly 100 billion cubic metres by 2010 and 200 billion cubic metres by 2020. In the next 15 years, domestic demand for natural gas will grow at an average rate of 11%-13%.

In summary, China's rapid economic development, the continually improving living standards of its people and incessantly rising pace of urbanization is driving up a sustained demand for city piped gas. In 2007, China announced natural gas utilization policies (NDRC Energy [2007] 2155), under which "gas consumption by urban and township residents for cooking and water heating" was to be given foremost priority. In the past few years, many developed cities across the country have been moving towards supplying gas via pipeline networks with comprehensive coverage. Purchase agreements have also been signed with foreign natural gas suppliers through large state-owned enterprises such as China National Petroleum Corporation. The direction of such developments, whether in policies, infrastructure construction or natural gas resources, will be favorable to China's city gas businesses.

A CNG refilling station at Yuechi, Sichuan, which provides clean energy and contributes to the cause of environmental protection at the county.



China's Natural Gas Price Policy and Seasonal Natural Gas Shortage Incident

The West-to-East pipeline project in 2004 heralded the entry of China's city gas businesses into an era of rapid development. As city gas prices affect social livelihoods, local authorities from various regions have been exercising extraordinary prudence when adjusting city gas prices, with hearing procedures mandated on every such occasion. And with several natural gas purchase agreements signed between China and other countries about to be successively implemented, China is even more resolved to undertake natural gas pricing reforms. Furthermore, as natural gas becomes an increasingly market-oriented commodity, the country is considering establishing an interactive price mechanism for natural gas, designated for industrial and commercial use, as well as abolishing the requirement for hearing committees to be held every time adjustments to gas prices are proposed by city gas enterprises. In the long term, natural gas pricing reforms will portend a positive change for China's city gas enterprises. In the wake of these developments, Towngas China Group will maintain close liaison with its industry peers and trade associations, so that reform packages on natural gas prices will sufficiently take into account the interests of the city gas industry.

During the winter of 2009, China was hit by a large-scale gas shortage which aroused a high level of concern from the country and its people alike. In the aftermath of this gas shortage, which occurred despite prevailing positive conditions underscored by a 15% increase in annual gas sales in the country, a common belief has arisen in relevant departments and amongst industry specialists that the incident was a manifestation of imbalanced market developments. Hence, apart from a greater intensity of effort made to exploit more natural gas sources in the country, imports of natural gas and installations of gas storage amenities to facilitate seasonal supply adjustments have also been accelerated following the incident. China has also started to emphasize the need to implement nation-wide city gas consumption plans to avoid repercussions of imbalanced developments. Hence, downstream market competition by resources capitalization in the past few years is now gradually being replaced by superior business solutions, high-calibre management and service satisfaction. These changes will have very positive implications for Towngas China Group.



With natural gas, commercial customers gain the access to an energy source which is safe, efficient and clean, thereby empowering their profitability.



A CNG transmission facility at Huangshan, Anhui demonstrates a strong architectural style in the local region.

Business Development and Strategic Planning of the Group

During the year, the Group realigned its investment policy so as to develop new projects through existing projects in their peripheral cities. In 2009, the Group established projects in Xinjin and Xindu of Sichuan province, Chiping of Shandong province, Huizhou District and Huangshan District in Huangshan City of Anhui province, Changjiu of Jiangxi province, and Yangdong of Guangdong province, and signed an agreement for a project in Linqiu of Shandong province. In February 2010, an agreement was also signed to establish a project at the New Industrial District in Anshan City of Liaoning province. These successful exploration and acquisition initiatives have considerably consolidated the Group's market status and strengthened momentum for subsequent developments. Concurrently, the Group also made considerable headway with many of its projects in Southern, Central and Southwestern China. It is expected that the Group will eventually set up joint ventures in these regions.

Corporate Social Responsibility

It is a longstanding tradition for the Group and its workforce to actively join community activities to demonstrate the Group's concern for the underprivileged. In 2009, the Group and its subsidiaries launched a "Book Donation with Love and Care Programme" with HKCG for school children in the disaster-stricken regions of Sichuan province, so as to provide them with more learning opportunities.

In light of this outstanding corporate social responsibility achievement, the Group was awarded both the prestigious "The China Best Corporate Citizenship Award" and the "2009 China 'Harmony • Responsibility' A Brand with Love" Award this year. For environmental protection, at the beginning of 2010, the Group also secured the "2009 National Enterprise Environmental Excellence Award". All these awards are a testament to the Group's corporate social responsibility endeavors in participating in charity and community activities while providing safe gas supply and quality services.

Chairman's Statement

Outlook

In 2010, China will embrace imports of natural gas, which will be transmitted by the Second West-to-East gas pipeline and the Sichuan-to-East gas pipeline. The city gas industry will be provided with sufficient natural gas sources to develop the downstream gas consumption market, thus creating, at the same time, a more extensive platform for the Group to develop its new markets. All these factors will contribute to far-reaching healthy developments in the operating environment for China's city gas industry in 2010.

In 2010, the Group will focus its work on the following areas:

Elevating corporate efficiency and business strategy implementation through improved performance management so as to brace itself for market opportunities arising from a new era of dual gas supply from imported and domestically-produced gas.

In developing new projects, the Group will leverage the relative advantage it enjoys from its large number of project companies and their extensive network close to the West-to-East pipeline and the Sichuan-to-East pipeline and to coastal liquefied natural gas receiving terminals. Based on this competitive edge, the Group will endeavor to explore new market opportunities.

In order to strengthen competitiveness of existing projects, the Group will draw on the robust strengths of HKCG and implement an investment strategy focusing on economic efficiency. With the Group's corporate culture, continuing effort will be made to raise the standard of its employees in areas of service quality, gas supply safety and market developments. Collectively, these initiatives will boost profitability, establish a sustainable competitive edge for the Group and its employees. They also enable the Group to secure a leading industry position in the rapid developing city gas industry propelled by diversified natural gas sources in China.

Appreciation

On behalf of the Board, I would like to thank all staff for their dedication and hard work, and to thank all shareholders and investors for their long-standing support.

CHAN Wing Kin, Alfred
Chairman

Hong Kong, 15 March 2010

