

Chairman's Statement



Economic Landscape

In 2018, the global economy saw sustained and moderate growth, though with less momentum. The economy of the United States (the "US") delivered a better-than-expected performance. As the US Federal Reserve continued to raise interest rates, emerging market currencies experienced varying degrees of exchange rate volatility while the depreciation of the Renminbi faced greater pressures during the second half of the year. At the same time, the Sino-US trade dispute has given rise to continuing uncertainty over China's economic growth prospects in 2018. To stabilise economic growth, a number of government policies were implemented. This included lowering the value-added tax (VAT) rate on major commodities and services by 1%, amending the Individual Income Tax Law, cutting the reserve requirement ratio four times, as well as promulgating certain targeted policies to facilitate the economic development of non-public sectors and relieve operating pressures faced by private enterprises. The Central Government is also placing significant emphasis on the importance of providing greater support with strong fiscal policies, together with substantial tax cuts and fee deductions. These macro-policies have played a significant role in improving business sentiment in mainland China, helping to restore corporate investment confidence while also increasing national disposable income and spurring growth in domestic consumption. In 2018, the economy maintained a growth of 6.6%.



Market Prospects for Natural Gas Business

2018 marked a critical year for China as the country worked towards its goal to “build a prosperous society in all respects”. Introducing and implementing anti-pollution measures is also seen as a key strategy to achieve this goal. The Chinese government released a “Three-Year Action Plan to Win the Battle for a Blue Sky”. Under this initiative, the aim is to ensure that by 2020, the percentage of days with good air quality in prefecture-level cities or above must reach 80% annually. At the same time, the number of pilot cities under the central-funded “Plan for Clean Heating in Winter in Northern Areas (2017-2021)” increased from “2+26” to “2+38”. To improve gas storage capacities, the National Development and Reform Commission (“NDRC”) also issued policies stipulating that the gas storage capacity of upstream gas suppliers and urban gas companies must reach 10% and 5% of the annual contract gas volume respectively. Gas storage capacities of local governments must also reach the three-day gas consumption level of their administrative divisions. Additionally, policies on the construction of local gas storage facilities were successively issued in provincial regions such as Jiangsu, Shandong, Sichuan and Henan.

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In August 2018, the State Council issued "Several Opinions on Promoting the Coordinated and Stable Development of Natural Gas", stating that the output of domestic natural gas is expected to rise to 200 billion cubic metres or more by 2020. Further policies are being launched, seeking to strengthen interconnect systems between the nation's various natural gas trunk pipelines; open up facilities to third-party markets in a fair manner; introduce differential seasonal prices and suspend gas supply contracts with variable pricing; These initiatives will enhance the stability of natural gas supplies, strike a reasonable balance between supply and demand and encourage the greater use of natural gas, a clean source of energy, among end uses. With the help of these measures, the natural gas industry in mainland China is set to enter a new stage of both sustainable and rapid development.

Reforms in the Marketisation of Natural Gas

In May 2018, the NDRC issued the "Circular on Adjusting Residential City-Gate Natural Gas Prices", under which the gate station prices of residential and non-residential piped gas are centrally managed for greater alignment. Regulations on price adjustments for end users were therefore formulated and price-linked policies for residential users have been successively issued in Shaanxi, Hubei, Shandong and Guangdong together with other provinces and municipalities in the country. Rationalisation of residential gate station prices is seen as crucial to the marketisation reforms of natural gas, and will be conducive to the development of the entire natural gas industry chain in the long term. The Group is keeping abreast of the latest developments in these pricing reforms, ensuring that we will formulate corresponding strategies in a timely manner.

Business Outlook

China is dedicated to implementing environmental protection policies and expanding the use of clean energy. Under this backdrop, the Group is working to seize every opportunity as we tap market potential, promote innovative development and achieve stable business growth.

In the industrial and commercial markets, the Group will actively coordinate efforts to maximise our growth. With the gradual implementation of clean energy improvement projects based on natural gas supply as the country is continuing on its road to "gas conversion" with increasing numbers of coal-fired furnaces being converted through "expanding geographic outreach and capacity" in key regions. At the same time, the Group is leveraging advanced energy-saving technologies to improve energy efficiencies and reduce overall energy costs for customers, so as to encourage the "coal to natural gas" boiler (furnace) conversion of industrial and commercial customers. Riding on the benefits of this encouraging environment, the Group strives to achieve our business development goals and are committed to making every possible contribution to improving the quality of life for the general public and the overall environment.

As for the residential market and our extended business, the promotion and application of Bauhinia safety gas appliances entered a new stage. With customers leaning towards ever more sophisticated and safe gas appliances, Bauhinia recorded outstanding sales performances, and the Group has also improved its safety performance significantly. Mia Cucina, our upmarket and stylish kitchen cabinets maintained steady business revenues while our gas dryers and residential household heating installations recorded ongoing growth. Towngas Lifestyle's online customer centre, Virtual Customer Centre (VCC) served 36 project companies covering more than 5 million users with the number of registered members also exceeding 1.3 million. This online customer centre not only provides more convenient and efficient internet services, it also lays solid foundations for offering more diversified and value-added services for over 12 million customers.

Operating under the Group's subsidiary, Towngas China Energy Investment Limited ("TCEI"), our distributed energy business is thriving. In conjunction with Tsinghua University, TCEI jointly established a research and development centre in December 2018 with a view to promoting cooperation in the integrated energy field and pushing forward the development of distributed energy projects in the country. We are also exploring emerging energy business development models such as micro-grids, additional grids and energy storage initiatives, as we work towards providing clean and environmentally friendly integrated energy services.

The first phase of construction of the underground salt-cavern gas storage project in Jintan city, Jiangsu province, owned by The Hong Kong and China Gas Company Limited ("HKCG"), the Group's parent company, has been completed. Commencing operations in October 2018, it will replenish natural gas supply during peak consumption periods in winter, easing pressures and ensuring adequate supplies in the cold weather. The contract of the second phase of the project was also officially signed in November 2018. By 2023, the total gas storage and working gas storage capacities of this facility is expected to amount to 1,000 million and 600 million cubic metres respectively. With these increasing gas storage capacities, our ability to provide gas safely will be further strengthened, securing our leading position in the industry as we satisfy government requirements with regard to gas storage capacities in urban areas. We are also actively engaged in strategic cooperations, working with upstream enterprises to secure additional gas sources. At the same time, in synergy with our gas storage operations, we are working on joint investment and construction projects with regard to liquefied natural gas ("LNG") receiving stations in the coastal areas of northern China, eastern China and southern China while also making advance plans for importing LNG. Lowering the cost of gas purchases and being able to adjust gas supplies during peak consumption periods will not only promote our further business development, but also allow us to meet our customers' needs more effectively.

Building on our values for "courtesy" and "craftsmanship", and riding on the successful implementation of our Total Quality Management (TQM) initiative, we continue to promote the spirit of "integrity" across the board and embrace our total commitment to quality service. We believe that these contributions to both the economy and society will help to promote social harmony and improve service quality, apart from also initiating innovative and advanced technology. Moving forward, China's market will be more open, placing greater emphasis on the improvement of the environment, balancing regional development and facilitating concerted development between the urban and rural areas. In turn, the Group will continue to focus on innovation and environmental-friendliness, moving with the times and exploring new business opportunities. Looking forward, we will ride on our advantages to overcome challenges and set new milestones for our ongoing business development.

Alfred Chan Wing-kin

Chairman

Hong Kong, 19 March 2019