

Chairman's Statement



Economic Landscape

Subject to the challenges of decelerating growth and increasing volatility, the global economy weakened generally in 2019. Clouded by the China-US trade conflict and lessening demand, China's economy overall faced substantial downward pressures. Economic growth hit a low of 6.0% in the third quarter, the lowest since 1992; the manufacturing Purchasing Managers' Index ("PMI") stood below 50% for several consecutive months; while the exchange rate of Renminbi ("RMB") against the United States ("US") dollar also slid below the critical psychological level of "7.0".

In view of the many challenges posed by this complex environment both at home and abroad, the Chinese government applied proactive fiscal policies and prudent monetary policies to drive the country's greater access to the outside world. It lowered value-added tax and social security premium rates together with the introduction of tax and fee reduction initiatives amounting to more than RMB2 trillion throughout the year. During the year, three cuts were also made in the deposit-reserve ratio while local governments were allowed to make reasonable use of special bonds for infrastructure construction. The Negative List was cut and restrictions on domestic investment by foreign capital were lifted to help stabilise the economy.

Together with the more conciliatory stance taken by the US, as it shifted from a rate hiking stand to a rate cutting cycle, more positive progress was made in the first phase of China-US trade talks. The RMB exchange rate also began to pick up in the fourth quarter and the manufacturing PMI rose to 50.2% at the end of the year. As a result, annual economic growth rate hit 6.1%, in line with anticipated targets. Although the uncertainties weighing on China's economic growth still exist, the quality of economic development of mainland China is expected to improve, maintaining a positive trend in the medium to long term.



Reforms in the Marketisation of Natural Gas

With the acceleration of the Chinese government's market reforms in the natural gas sector in 2019, a market structure of "regulating the core and relaxing the ends" has started to emerge. With the issuing of "Special Administrative Measures (Negative List) for Foreign Investment Access (2019 Edition)" and "Opinions on Creating a Better Development Environment to Support the Reform and Development of Private Enterprises", restrictions on foreign investments in upstream gas explorations, developments and sales were removed to encourage private business organisations to get engaged in this sector.

In December 2019, the China Oil & Gas Pipeline Network Corporation was formally established to reorganise the oil and gas facilities as well as the assets (such as certain pipelines, liquefied natural gas (LNG) receiving stations and gas storage facilities) of state-owned petroleum companies. In line with this new version relating to "Measures for Regulation of Fair and Open Access to Oil and Gas Pipeline Facilities", the sector will be proactively opened to third parties whenever appropriate, together with a natural gas by-capacity pricing mechanism, which will be established within the next two years to facilitate market transactions in a convenient and equitable manner. Downstream reforms will also take place with a focus on the pricing mechanism.

Chairman's Statement

In 2019, the gas volume of bilateral transactions, concluded on the Shanghai Petroleum and Natural Gas Exchange at market prices, topped 80 billion cubic metres. Regional gas exchanges were also under planning in many areas, a prime example being the Guangdong-Hong Kong-Macao Greater Bay Area. In November 2019, the National Development and Reform Commission ("NDRC") published the "Central Pricing Catalog" (revised draft) aiming to remove "city-gate natural gas prices in various provinces (autonomous regions and municipalities)" from the main text, to prepare for the introduction of market-oriented pricing of city-gate natural gas. Measures for upstream and downstream natural gas-linked mechanisms were also published in more prefecture-level cities. These major reform initiatives will have a profound impact on the development of the domestic natural gas industry as well as the industry's value chain. Additionally, according to the "Guiding Opinions on Strengthening Gas Distribution Price Regulation" and the "Guiding Opinions on the Regulation of Installation Fees for Gas Facilities in Cities and Towns" issued by the NDRC in June 2017 and in June 2019 respectively, many places have taken action to determine the sale prices and the engineering installation charging standards for gas users of city gas enterprises' pipelines successively. The Group will reduce cost through work procedures optimization regarding gas engineering and installation fees, so as to minimize the impact of reduced engineering and installation fees.

Market Prospects for Natural Gas Business

The growth rate in domestic natural gas consumption decelerated in 2019, but supply and demand remained rational and stable. The China-Russia East-Route Natural Gas Pipeline came on stream on 2 December 2019 with a supply of 5 billion cubic metres of natural gas at the first phase. After the pipeline is fully operational in 2023, the plan is to supply 38 billion cubic metres of natural gas a year. The arrival of Russian gas, which will become the main source of gas in northeastern China, will completely change the landscape of natural gas supply in the region. The substantial increase in supply capacity will reverse the previous problems of limited natural gas development due to insufficient gas sources and bring swifter tailwinds to the market development of our companies in northeastern China. As the coal-to-gas policy becomes more deeply entrenched in the years ahead, the proportion of clean energy for heating purposes will increase year-on-year. At the same time, sufficient natural gas resources will greatly promote the transformation of industrial customers' energy consumption and increase the utilisation rate of natural gas. Furthermore, the generation of power by natural gas will drive new growth in the development of the Chinese energy market.

Additionally, the ongoing construction of LNG receiving stations, the continuing operation of underground gas storage as well as eased supplies from international LNG markets, have all helped to mitigate the imbalance between supply and demand in the mainland natural gas market. These positive factors have also been conducive to the healthy and sustainable development of the industry. At the end of 2019, China's natural gas consumption accounted for approximately 8.3% of primary energy consumption. However, it still lags behind the global average of 24% and highlights that there is still tremendous scope for the market's ongoing growth into the future.

The protection of our environment together with the prevention and control of pollution as a national policy provide strong assurances for an increase in the demand for natural gas. The Central Economic Work Conference held at the end of 2019 emphasised that the direction and intensity of pollution prevention and control would not change. As such the “coal-to-gas” reforms on boilers and heating facilities using clean energy in key areas will continue to expand. For instance, the “Guiding Opinions on Stringently Controlling Total Coal Consumption and Promoting Clean and Efficient Utilisation” issued by Shandong province in June 2019, proposed a cut in coal consumption by 50 million tonnes across the province in the next five years or so. Additionally, all coal-fired boilers with a capacity of below 35 tonnes of steam per hour are to be phased out by 2020 in cities with air pollution transmission channels. In July 2019, four ministries and commissions (including the Ministry of Ecology and Environment) jointly issued the “Integrated Treatment Plan for Air Pollution from Industrial Furnaces”. Under this proposal, industrial enterprises in key regions will be required to meet all emission standards by the end of 2020 and be banned from building new fuel-related coal gas generators. This is expected to boost more “coal-to-gas” reforms where industrial furnaces are being used. The increasing urbanisation levels in China are also providing growing impetus for natural gas demand. As China lifts restrictions on residing in cities with a population of less than three million and implements national development strategies such as the “Guangdong-Hong Kong-Macao Greater Bay Area” and “Integration of the Yangtze River Delta Region”, more people will move in cities, boosting the greater use of natural gas both for residential and commercial purposes. We thus remain fully confident of the sound development of the domestic natural gas industry into the future.

An outbreak of novel coronavirus disease (COVID-19) causing pneumonia, starting in early 2020, is severely impacting the country. Faced with the dire situation of the epidemic, we have united our staff at all levels to respond actively and deploy comprehensively, ensuring the stable and safe supply of gas while making every effort to conduct epidemic prevention and control. These include our full range of customer services from our hotline facilities to our maintenance and emergency response and opening an online business platform to provide the various services needed to meet customers’ demands. Group companies also rounded up anti-epidemic and protective supplies such as masks, thermometers and disinfectant, not only working to disinfect office areas and business centres constantly, but Safety and Risk Department also established a monitoring mechanism to better ensure epidemic prevention and control for the safety of our customers and employees while resuming our operations, production and services.

As the epidemic develops, different kinds of production and business premises nationwide have been closed for some time whilst resumption of work after the Chinese New Year holiday was postponed. Consumers spending and production have shrunk significantly, having an impact on industrial and commercial gas consumption. At the same time, local governments on the mainland have launched measures to support the on-going development of small and medium-sized enterprises in response to the epidemic by requiring gas enterprises to implement preferential policies such as reducing fees and deferring fee payment, which will, inevitably, impact the results of the Group for the year 2020.

Chairman's Statement

Business Outlook

The rapid restructuring of China's "green and efficient" energy consumption profile continues to increase the proportion of natural gas in primary energy consumption while greater emphasis is also being placed on raising energy utilisation efficiencies and the reduction of carbon dioxide emissions per unit of Gross Domestic Product. As such, Towngas China expects to see relatively satisfactory increases in the sales volumes of natural gas and to reap positive results in the field of integrated green energy services in the next few years. However, some pressures will be felt from China's ongoing economic restructuring together with the rapid development of, and changes in, the market-oriented reforms in the natural gas sector. In line with these, and other new developments in the economic landscape and industry development, we will continue to strengthen our upstream, midstream and downstream strategies across the natural gas industry chain. At the same time, we will continue enhancing our capacities to make sure that we will be able to cater for peak requirements and maintain supply assurances. We are also working hard to reduce the cost of gas at source in our aim to deliver clean energy and quality services to our customers while furthering our innovative and ongoing development.

In terms of upstream gas sourcing, we also made solid progress in our LNG trading activities both in northern China and southern China. The underground gas storage in Jintan district in Jiangsu province ("Jintan Gas Storage"), owned by The Hong Kong and China Gas Company Limited ("HKCG"), our parent company, is at the forefront to sell peak shaving gas storage products on the Shanghai Petroleum and Natural Gas Exchange, marking a major innovation in the marketisation of gas storage facility services. Jintan Gas Storage currently has external gas transmission capacities of more than 76 million cubic metres, with a project plan scheduled to further expand production capacities. Looking forward, Jintan Gas Storage will be collaborating with Towngas Natural Gas Sales Co., Ltd., a Group company, to better serve a greater number of customers with market-oriented approach.

In the midstream sector, following Jintan Gas Storage's interconnection with PetroChina Company Limited's "West-to-East Gas Pipeline", the Group will also be able to interconnect with China Petroleum & Chemical Corporation's "Sichuan-to-East Gas Pipeline" in 2020, making it possible to supply gas to both the Group's internal and external customers. We are also furthering the interconnection of pipeline networks in various regions in a planned and systematic manner.

With regard to the downstream market, the Group is oriented in line with environmental policies, continuing to develop "coal-to-gas" conversion projects for coal-fired boilers and industrial furnaces to increase gas usage for industrial and commercial purposes. The Group's city-gas project companies are encouraged to look for business opportunities arising from integrated green energy services with the sale of strategic products and services – hot water for commercial purposes, laundry as well as steaming and heating services with heat supply networks, for example – to increase energy efficiencies and save costs for customers with our energy efficient solutions. Our residential customers together with average monthly gas consumption will continue to increase along with the growing population in Chinese cities.

Given the remarkable sales records of our Bauhinia gas appliances, we will continue our innovative developments into the future, particularly as we focus on smart homes. Our Towngas Lifestyle services, through various strategic collaborations, will expand the range of our facilities from the sale of gas insurance and our Mia Cucina kitchen cabinets, to the provision of smart living services on our online cloud service centre, Virtual Customer Centre (VCC).



Towngas China Energy Investment Limited (“TCEI”), a Group subsidiary, which adopts the strategy to “provide heating services first then electricity”, is training professionals in the field of electricity whilst exploring and expanding synergistic applications of both gas and electricity. The benefits gained will heighten our competitive advantages in the market. U-Tech (Guang Dong) Engineering Construction Co., Ltd (“U-Tech Guang Dong”) was established during the year, to proactively expand our city gas engineering advisory and consulting services.

We are promoting “courtesy”, “craftsmanship” and “integrity”, the core values of our Total Quality Management (TQM) programme, across the Group. These values provide the springboard for our business, enabling greater innovation and vitality. They have also enhanced our safety and quality service performances and received a great deal of recognition and many commendations from various sectors of the community.

As China continues on its journey to building a well-off and all-rounded society by 2020, there will be ever stronger demand for a better quality of life together with a pleasant and friendly environment. As such, new business opportunities will continue to arise. Moving forward, all of us at Towngas China, are fully confident that we will maintain the sustainable growth of business through innovative development, applying new technology, striving to promote environmental protection and constantly improving product and service quality.

Alfred Chan Wing-kin

Chairman

Hong Kong, 16 March 2020