

## 8 CHAIRMAN'S STATEMENT



### The Year's Results

The performance of the Group's town gas business in Hong Kong remained steady in 2015. In comparison, the Group's city-gas businesses in mainland China maintained stable growth; concurrently the Group's emerging environmentally-friendly energy businesses are continually developing. However, given the slowdown in economic growth in mainland China and a drastic fall in international oil prices during the year, the results of the Group's overall recurrent businesses remained stable in 2015.

Profit after taxation attributable to shareholders of the Group for the year increased by approximately 3 per cent to HK\$7,302 million, an increase of HK\$193 million compared to 2014. Earnings per share for the year amounted to HK63.2 cents. During the year, the depreciation of the renminbi affected the performance of the Group's profit. However, there was a rise in the revaluation surplus from an investment property, the International Finance Centre complex, in 2015 compared to 2014, which drove profit growth.

During the year under review, the Group invested HK\$6,356 million in production facilities, pipelines, plants and other fixed assets for the sustainable development of its various existing and new businesses in Hong Kong and mainland China.

### Town Gas Business in Hong Kong

The local economy continued to grow modestly in 2015. Favourable overall employment conditions maintained stable growth in local consumer spending. However, gas sales in the hotel sector were

impacted by a decrease in the number of inbound tourists during the second half of 2015. Residential gas sales were also affected as the average temperature in Hong Kong in 2015 reached the highest in local records. Overall, total volume of gas sales in Hong Kong for the year was 28,404 million MJ, a decrease of 1.5 per cent, in contrast to appliance sales revenue which increased by 6.4 per cent with a total of 255,730 sets sold, both compared to 2014.

As at the end of 2015, the number of customers was 1,839,261, an increase of 19,326 compared to 2014, slightly up by 1.1 per cent.

### **Business Development in Mainland China**

The Group's mainland businesses continued to progress steadily in 2015 with stable growth in both the number of projects and profit.

Overall, inclusive of projects of the Group's subsidiary, Towngas China Company Limited ("Towngas China"; stock code: 1083.HK), the Group had 222 projects on the mainland, as at the end of 2015, 20 more than at the end of 2014, spread across 25 provinces, autonomous regions and municipalities. These projects encompass upstream, midstream and downstream natural gas sectors, water sectors, environmentally-friendly energy applications, energy resources' exploration and utilisation, as well as telecommunications.

Diversification and an increase in the number of projects has gradually transformed the Group from a locally-based company in Hong Kong centred on a single business into a sizable, nation-wide, multi-business corporation focussing on environmentally-friendly energy ventures and utility sectors.

The Group's development of emerging environmentally-friendly energy businesses and related research and development of new technologies, through its wholly-owned subsidiary ECO Environmental Investments Limited and the latter's subsidiaries (collectively known as "ECO"), are progressing steadily forward. With a number of environmentally-friendly and energy conservation projects under construction or already commissioned, and new projects under development, the foundation for long-term growth of the Group's businesses is being continually reinforced. However, the drastic fall in international oil prices in 2015 led to a decline in prices of associated products, and profit was affected.

### **Utility Businesses in Mainland China**

The Group's city-gas businesses are progressing well with a total of four new projects added to its portfolio in 2015. As at the end of 2015, inclusive of Towngas China, the Group had a total of 131 city-gas projects in

mainland cities spread across 23 provinces, autonomous regions and municipalities. The total volume of gas sales for these projects in 2015 was approximately 15.5 billion cubic metres, a slight increase of 2 per cent over 2014. As at the end of 2015, the Group's mainland gas customers stood at approximately 20.9 million, an increase of 10 per cent over 2014. The Group continues to have a good reputation as a large-scale city-gas enterprise with outstanding performance on the mainland.

Despite the impact of a slowdown in global economic growth leading to continuous weak demand for commodities worldwide, the mainland economy continued to grow steadily in 2015 compared to 2014, though the pace was slower. The growth in demand for energy, including electricity, petroleum and natural gas, was noticeably lower across the whole country. However, long-term and steady growth in the demand for natural gas, a major clean energy resource on the mainland, is still anticipated. The mainland government has also formulated a natural gas utilisation policy to strengthen preventative measures to combat air pollution and to minimise the formation of smog. This momentum will benefit the Group's city-gas and natural gas businesses helping to create continuous growth.

The sluggish global economy during 2015 had an adverse impact on industrial gas market demand and,

with low international oil prices, other petroleum fuels gradually became more competitive than piped natural gas. In April 2015, the mainland government aligned its two-tiered natural gas ceiling city-gate prices of "existing" and "incremental" volumes by reducing the ceiling price for "incremental volume" but slightly raising that for "existing volume", both applicable to non-residential users. This was then followed by a further reduction in non-residential natural gas city-gate prices in November 2015. These measures have further promoted market-oriented reform of natural gas prices and enhanced the competitiveness of natural gas relative to other energy. In the medium to long term, natural gas is still projected to be the clean energy of choice for reducing air pollution and improving smoggy atmospheric conditions on the mainland. With gradual commissioning of the country's large-scale natural gas projects, including transmission pipelines from Sichuan province to eastern and southern China and the West-to-East pipeline, and pipeline projects for importing natural gas from Central Asia and Myanmar, together with the signing of piped natural gas supply contracts with Russia, as well as a rise in the quantity of imported liquefied natural gas ("LNG"), supply of natural gas on the mainland is becoming ample, which is beneficial to market development. Thus, with increasing

sources of gas supply, expanding pipeline networks and the public's aspiration for greater environmental protection, the Group anticipates its mainland city-gas businesses will continue to thrive in future.

The Group's midstream natural gas projects are operating smoothly. These include natural gas pipeline projects in Anhui and Hebei provinces; natural gas extension projects in Jilin and Henan provinces; and the Guangdong LNG Receiving Terminal project. In addition, Towngas China added two midstream natural gas projects to its portfolio in 2015 – the Xuancheng-Huangshan natural gas sub-stream and downstream city-gas project in Anhui province, and the Taigang Gas midstream long-haul pipeline project in Taian city, Shandong province. Construction of the Group's gas storage facility in underground salt caverns in Jintan district, Changzhou city, Jiangsu province is in progress. Upon completion, this facility will be the first of its kind developed by any city-gas enterprise on the mainland. The total storage capacity of this facility will be approximately 400 million standard cubic metres. Construction of phase one of this project, with a storage capacity of 130 million standard cubic metres, is expected to be completed during the third quarter of 2016. This facility, which will help the Group supplement and regulate gas supplies during the peak winter

period in eastern China, is in line with the Chinese government's policy of advocating faster development of gas storage capacity. These kinds of midstream projects generate good returns and support the Group's development of its downstream city-gas markets.

The upstream natural gas supply market is also facing reform. The Shanghai Petroleum and Natural Gas Exchange (the "Exchange") launched a pilot operation on 1st July 2015 to further promote a market-oriented pricing mechanism for natural gas. Currently, major products for spot trading in the Exchange are piped natural gas and LNG. With increasing sources of upstream gas supply, the Exchange is able to provide more choices for downstream customers. A number of natural gas pipeline network companies at provincial level are participating in trading on the Exchange. The Exchange comprises ten shareholder companies, including the Group.

The Group's development of natural gas vehicular refilling stations under the brand name "Towngas" is progressing well with a total of approximately 100 stations constructed so far spread across different provinces in mainland China. The Group will continue to develop this type of new energy vehicular refilling station business and actively develop refilling projects for marine vessels in mainland China.

2015 was the 10th anniversary of the Group's entering into the mainland water market under the brand name "Hua Yan Water". The Group has so far invested in, and operates, six water projects, including water supply joint venture projects in Wujiang district, Suzhou city, Jiangsu province and in Wuhu city, Anhui province; wholly-owned water supply projects in Zhengpugang Xin Qu, Maanshan city and in Jiangbei Xin Qu, Wuhu city, both in Anhui province; and an integrated water supply and wastewater treatment joint venture project, together with an integrated wastewater treatment joint venture project for a special industry, both in Suzhou Industrial Park, Suzhou city, Jiangsu province. In 2015, the Group also initiated an interest in the drinking water market on the mainland by launching "AquaJoy", a high-end bottled purified water product, through its project in Wujiang district, Suzhou city, Jiangsu province. With increasing demand for clean water resources across the country, the Group's water projects, supplying water of good quality, are progressing well, maintaining steady growth in volume of water sales. To achieve a healthier development in the water sector, the Group's project companies are now striving for a reasonable increase in the selling price of water.

Operation and management of businesses encompassing city-gas, midstream natural gas and city-water

projects create greater synergy and mutual advantages. Furthermore, these businesses generate stable income and provide good environmental benefits, with room for expansion. The Group will therefore keep on looking for opportunities to invest in high-quality utility projects on the mainland.

### Emerging Environmentally-Friendly Energy Businesses

ECO's major businesses in Hong Kong – an aviation fuel facility, dedicated liquefied petroleum gas ("LPG") vehicular refilling stations and landfill gas utilisation projects – are all operating smoothly. Total turnover for ECO's aviation fuel facility for 2015 was 6.07 million tonnes. The facility provides a safe and reliable fuel supply to Hong Kong International Airport and contributes to ECO's steady profit growth. The LPG refilling station business is progressing steadily, providing a quality and reliable fuel supply to the local taxi and minibus sectors. ECO's landfill gas project in the North East New Territories, after operating for several years, is generating noticeable environmental benefits. On this basis, ECO commenced the development of a South East New Territories landfill gas utilisation project in 2015, with commissioning expected to start in mid-2016, which will further increase the proportion of landfill gas used by the Group and make a further

contribution to energy conservation and emission reduction in Hong Kong.

ECO's oilfield project in Thailand, despite the adverse impact of the continuous fall in international oil prices and a slowdown in the mainland economy, is operating smoothly. With several high-yield wells drilled in 2015, this project recorded an output of 1.86 million barrels of oil during the year, an increase of 36 per cent compared to 2014, though falling international oil prices adversely affected profit growth.

ECO's coalbed methane liquefaction facility, located in Jincheng city, Shanxi province, is operating smoothly. Construction of a project in Xuzhou city, Jiangsu province to produce LNG by methanation of coke oven gas has been largely completed; trial operation is expected in the second quarter of 2016. By then, ECO's capability to produce LNG will be enhanced. In addition, ECO is planning to develop a natural gas liquefaction project in Hohhot city, Inner Mongolia Autonomous Region, to supply LNG for local heavy-duty trucks; commissioning is expected by the end of 2017.

As smog and air pollution on the mainland are now a growing concern, the Chinese government is increasing its efforts to promote the development of refilling station networks supplying LNG as a fuel for

vehicles and vessels. The use of LNG as a gradual replacement for diesel for heavy-duty trucks is an especially important and effective anti-pollution measure. A network of ECO natural gas refilling stations is gradually taking shape in, amongst others, Shaanxi, Shandong, Shanxi, Henan and Liaoning provinces. All in all, ECO currently has 60 refilling stations in operation, under construction or at the planning stage, and as expansion into more provinces progresses, the ECO brand name and its network will gradually become more well-known in the market.

Conversion of biomass into clean energy and chemical products is an important part of ECO's business development trend which is in line with the direction of the country. To this end, ECO is constructing a plant to upgrade low-quality inedible bio-oil. Located in Zhangjiagang city, Jiangsu province, the facility will handle approximately 220,000 tonnes of palm acid oil annually for conversion into high-quality chemical products and low-sulphur fuels; construction is expected to be completed early next year for trial production.

Mainland China, a sizeable agricultural country, generates a large quantity of agricultural waste every year. Apart from a small portion of this used in fields or for power generation, the rest is not fully utilised as effective measures are yet to be put in place, thus creating

a huge source of raw material for potential biomass conversion. ECO has successfully developed new technologies to convert agricultural and forestry waste into natural gas through thermal gasification and methanation, and also to produce levulinic acid, through hydrolysis, which can be used as a raw material for producing clean fuel additives. ECO is planning to start a pilot project in Hebei province using these technologies expecting to produce natural gas early next year, which will then open a further chapter in ECO's new energy businesses.

ECO's coal-based methanol production plant in Inner Mongolia Autonomous Region operated smoothly in 2015. Following the completion of the construction work in mid-2015 to enhance methanol production capacity to over 1,100 tonnes per day, the yield for the whole year rose to over 300,000 tonnes, an increase of 26 per cent compared to 2014. An additional facility to upgrade methanol into natural gasoline (a gasoline substitute chemical product) using self-developed technology is now at the pilot production stage, thus laying a solid foundation for ECO's methanol upgrading business.

ECO is also developing innovative resource conversion technologies for the production of high value-added environmentally-friendly energy. Related research and development has achieved a breakthrough in results, with noticeable economic

and environmental benefits, especially in the areas of conversion of coal tar oil into carbon materials, upgrading and utilisation of oil-rich powder coal and conversion of agricultural waste into natural gas and fuel additives, all of which should also help strengthen ECO's competitive edge in this new energy sector in future.

### **Towngas China Company Limited (Stock Code: 1083.HK)**

The business of Towngas China, a subsidiary of the Group, developed steadily in 2015. Exclusive of unrealised exchange losses on the renminbi and the provision for the disposal of the coke plant of Changchun Gas Company Limited ("Changchun Gas"), Towngas China's profit after taxation attributable to its shareholders for the year amounted to HK\$1,202 million, an increase of approximately 1 per cent compared to 2014. Due to the depreciation of the renminbi during the year, inclusive of the unrealised exchange losses and Changchun Gas' provision for the disposal, Towngas China's profit after taxation attributable to its shareholders for 2015 was HK\$807 million, a decrease of approximately 23 per cent compared to 2014. As at the end of 2015, the Group held approximately 1,666 million shares in Towngas China, representing approximately 62.53 per cent of Towngas China's total issued shares.

Project development is progressing with Towngas China acquiring three new piped-gas projects in 2015, namely in Wulian county, Rizhao city, Shandong province; in Anxin county, Baoding city, Hebei province; and in Jiangbei New District, Wuhu city, Anhui province. In 2015, Towngas China also acquired two midstream pipeline projects and one vehicular refilling station project, namely Xuancheng-Huangshan natural gas sub-stream and downstream city-gas project in Anhui province, Taigang Gas midstream long-haul pipeline project in Taian city, Shandong province, and Xingqixiang vehicular gas refilling station project in Qiqihar city, Heilongjiang province.

In June 2015, Standard & Poor's Ratings Services, an international rating agency, raised its long-term corporate credit rating on Towngas China to "BBB+" from "BBB", and maintained its "cnA+" long-term Greater China regional scale credit rating with a "stable" outlook. In July 2015, Moody's Investors Service, another international rating agency, also raised its issuer credit rating on Towngas China to "Baa1" from "Baa2" with a "stable" outlook. Such ratings demonstrate the rating agencies' recognition of Towngas China's stable financial status and reflect the company's increasing credit strength.

### Financing Programmes

In order to tap funding in a timely and flexible manner, the Group established a medium term note

programme in 2009 under HKCG (Finance) Limited, a wholly-owned subsidiary of the Group. Taking advantage of low interest rates, medium term notes totalling HK\$1,457 million, with maturity ranging from 10 to 15 years, were issued during 2015. In line with the Group's long-term business investments, the Group had issued, as at 31st December 2015, medium term notes of an aggregate amount equivalent to HK\$11.8 billion with tenors ranging from 5 to 40 years, with an average interest rate at fixed rate of 3.47 per cent and an average tenors of 15 years, under this programme.

### Employees and Productivity

As at the end of 2015, the number of employees engaged in the town gas business in Hong Kong was 1,999 (2014 year end: 1,972), the number of customers was 1,839,261, and each employee served the equivalent of 920 customers, a similar level to 2014. Inclusive of employees engaged in local businesses such as telecommunications, LPG vehicular refilling stations and engineering contractual works, the total number of the Group's employees engaged in businesses in Hong Kong was 2,380 as at the end of 2015 compared to 2,331 as at the end of 2014. Related manpower costs amounted to HK\$979 million for 2015. In 2015, there was an approximately 5 per cent average increase in

remuneration over 2014. The Group will continue to offer employees rewarding careers based on their capabilities and performance and arrange a variety of training programmes in order to constantly enhance the quality of the Group's customer services.

Exclusive of businesses in Hong Kong, the total number of the Group's employees in mainland China and other places outside Hong Kong was 45,600 as at the end of 2015, an increase of approximately 1,000 compared to 2014.

On behalf of the Board of Directors, I would like to thank all our employees for their dedication and hard work in creating value for shareholders and customers.

### Bonus Issue of Shares

The Directors propose to make a bonus issue of one new share for every ten existing shares held by shareholders whose names are on the Register of Members of the Company on 16th June 2016. The necessary resolution will be proposed at the forthcoming Annual General Meeting on 7th June 2016, and if passed, share certificates will be posted on 24th June 2016.

### Final Dividend

The Directors are pleased to recommend a final dividend of HK23 cents per share payable to shareholders whose names are on the Register of Members of the

Company as at 16th June 2016. Including the interim dividend of HK12 cents per share paid on 2nd October 2015, the total dividend payout for the whole year shall be HK35 cents per share.

Barring unforeseen circumstances, the forecast dividends per share for 2016 after bonus share issue shall not be less than the interim and final dividends for 2015.

### Business Outlook for 2016

The Company predicts steady growth in the number of customers in Hong Kong during 2016. With a weak global economy and slowdown of inbound tourism, the local economy is facing downward pressures. However, favourable local employment conditions are helping to stimulate internal demand and consumer spending. As the Government of the Hong Kong Special Administrative Region is also striving to increase land and housing supply, the Company anticipates stable and good growth in the number of gas customers in the next few years. Expansion in the commercial and industrial energy market is also benefiting from the competitiveness of town gas, an energy resource combining both environmental and economic benefits. As international oil prices have been decreasing substantially for over a year, fuel cost adjustment charges of the gas tariff in Hong Kong have been reduced which is beneficial to customers and to further

enhancement of the competitiveness of town gas, relative to electricity in particular, in the energy market. However, increasing local manpower costs and operating expenses are leading to rising operating costs for businesses generally in Hong Kong. The Company's increase in its standard gas tariff on 1st August 2015 has helped offset some of this pressure on its own rising operating costs. The Company will, however, continue to enhance operational efficiency so as to maintain stable development of its gas business in the territory.

Mainland China's Thirteenth Five-Year Plan commenced in 2016. Currently, given weak global economic growth, continuously low international oil prices, the mainland's marked slowdown in economic growth and decline in the growth of production for export and the domestic market, the volume of gas sales of the Group's city-gas businesses in mainland China is thus slowing. The market is also facing the risk of renminbi depreciation. All these factors are creating challenges for the overall profit growth of the Group's mainland businesses in the near term. Nevertheless, in the long term, promotion of the use of natural gas is benefiting from the mainland government's drive to reduce carbon emissions, to encourage the use of clean energy, and to enforce the Law on the Prevention and Control of Atmospheric Pollution which was revised on 1st January 2016, further

tightening supervision and administration of related measures. All these factors, coupled with rapid urbanisation, will lead to a continuing rise in demand for utility facilities and energy. Natural gas price adjustments in late 2015 have also lowered upstream gas prices substantially, thus enhancing the competitiveness of natural gas. Increasing upstream gas supply and the government's move to reduce carbon emissions and minimise the formation of smog are creating opportunities for natural gas to replace coal in boilers and elsewhere including for power generation, distributed energy projects, household heating, gas hot water heaters and gas dryers. This is favourable to the development of the downstream gas market and the healthy development of the natural gas business sector in general.

In respect of emerging environmentally-friendly energy businesses, following the Chinese government's move towards greater energy diversification, environmental protection and the creation of a more circular economy, the Group is continuing to develop and apply new technologies for conserving energy and reducing pollutant emissions. There is also a growing trend for greater use of low-sulfur, high-quality oil, electricity and natural gas, etc. as fuels for vehicles and vessels to reduce atmospheric pollution. Despite international oil prices hitting record lows recently, which will impact profit growth and slow down

the pace of investment of the Group's emerging environmentally-friendly energy businesses in the short term, ECO will now increasingly move towards production of high-quality chemical products which are less sensitive to international oil prices, taking this as a guide for future project investments. Furthermore, as self-developed research and developments achieve ever more sophisticated results, emerging environmentally-friendly energy businesses will ignite a new light for the Group, illuminating the way for long-term development and business growth strategy.

With the Group's solid foundation in Hong Kong and its diverse business sectors spread across extensive areas on the mainland, together with its successful technical experience, corporate brand names and sales channels built there over 20 years, and mainland society's growing concern over air quality, it is anticipated that there will be ever-rising demand for clean energy. According to the Thirteenth Five-Year Plan, the share of natural gas in the country's total energy mix is set to increase from 6 per cent currently to 10 per cent by the year 2020, thus creating huge market potential. In addition, given that the number of piped-gas customers in Hong Kong and mainland China is increasing, the Group, with its sizeable customer base, foresees better benefits from its expanding new businesses.

Despite the various challenges resulting from the slowdown in economic growth on the mainland, the Group has formulated, and is gradually implementing, development plans for different businesses in accordance with the energy and environmental policy of mainland China. Overall, with increasing demand for natural gas and renewable energy, and the society's growing concern for more environmental protection, the Group anticipates its development in the years to come will be even broader and better.

#### **LEE Shau Kee**

*Chairman*

Hong Kong, 18th March 2016