Chairman's Statement

The Year's Results

The performance of the Group's gas business in Hong Kong remained steady in 2011. In comparison, the Group's city-gas businesses in mainland China thrived, continuing to record good profit growth; concurrently emerging environmentally-friendly energy businesses are being developed at a fast pace with some projects already commissioned and now operating smoothly.

Profit after taxation attributable to shareholders of the Group for the year amounted to HK$6,149.6 million, an increase of HK$564.8 million compared to 2010. Earnings per share for the year amounted to HK 77.8 cents, an increase of 10.1 per cent over 2010. Profit growth in 2011 was mainly due to growth in profit of mainland businesses.

During the year under review, the Group invested HK$4,725.1 million in production facilities, pipelines, plants and other fixed and intangible assets for the sustainable development of its various businesses in Hong Kong and mainland China.

Gas Business in Hong Kong

Local economic growth slowed down in 2011 under the shadow of uncertain prospects for the global economy. Despite this, a continuous increase in the number of inbound tourists and high domestic demand, boosted by certain policies implemented by the Government of the Hong Kong Special Administrative Region, helped maintain prosperity in tourism, restaurant and hotel sectors. During the year under review, the Company successfully gained several new commercial and industrial customers who started to convert to the use of town gas. The average temperature of 2011 was also slightly lower than 2010. As a result, there was an increase in overall residential, commercial and industrial gas sales, with the total volume of gas sales in Hong Kong for the year 2011 rising by 2.1 per cent compared to 2010. Appliance sales for the year 2011 also increased by about 8 per cent compared to 2010.

As at the end of 2011, the number of customers was 1,750,553, an increase of 26,237, as anticipated, compared to 2010.

Business Development in Mainland China

The Group's mainland businesses progressed well in 2011 in respect of growth in the number of projects and profit.

Mainland China's Twelfth Five-Year Plan commenced in 2011. Despite the adverse impact of factors such as a weak external economy and high domestic inflation, the mainland economy continued to grow relatively rapidly during 2011 though the pace was slower than in 2010. The Group's city-gas and natural gas businesses benefited from this economic progress and recorded continuous growth during the year. The Group's development of emerging environmentally-friendly energy projects, through its wholly-owned subsidiary ECO Environmental Investments Limited and the latter's subsidiaries (together known as "ECO"), is progressing well with ECO now at various stages of project investment, construction and gradual commissioning. As a result of rising internal demand for consumer goods and progressive urbanisation on the mainland, demand for clean energy is increasing. Upstream natural gas supply is also improving. Therefore in the long run, both city-gas and emerging environmentally-friendly energy businesses on the mainland have good prospects and investment value.

Overall, as at the end of 2011, inclusive of projects of the Group's subsidiary, Towngas China Company Limited ("Towngas China"; stock code: 1083.HK), the Group had 138 projects on the mainland, 18 more than 2010 spread across 21 provinces/municipalities/autonomous regions and encompassing upstream, midstream and downstream natural gas sectors, water supply and wastewater treatment sectors, natural gas vehicular filling stations, environmentally-friendly energy applications, energy resources, logistics businesses and telecommunications.

Diversification and an increase in the number of projects are rapidly transforming the Group from a locally-based company centred on a single business into a sizable, nation-wide, multi-business corporation with a focus on environmentally-friendly and energy ventures and utilities sectors.

Utility Businesses in Mainland China

The Group's city-gas businesses progressed well in 2011, with two new projects successfully established in Chaozhou, Guangdong province and Jingxian county, Hengshui, Hebei province. Inclusive of five new projects established by Towngas China in 2011, the Group had 100 city-gas projects in mainland cities spread across 19 provinces/municipalities/autonomous regions as at the end of 2011. During the year under review, the number of gas customers on the mainland reached approximately 13.2 million and total volume of gas sales also exceeded ten billion for the first time, attaining 10,300 million cubic metres. The Group is now the largest city-gas enterprise on the mainland.

With gradual completion of large-scale natural gas projects, including transmission pipelines from Sichuan province to eastern and southern China and phase two of the West-to-East pipeline, and an increase in the quantity of imported liquefied natural gas, together with domestic sources, the shortfall in natural gas supply in the past few years is now gradually being mitigated. Thus, with access to sufficient gas sources, the Group anticipates its mainland projects will continue to thrive in the future.

The Group's midstream natural gas projects are making good progress. These include high-pressure natural gas pipeline joint ventures in Anhui province, Hebei province, Hangzhou, Zhejiang province and Jilin province; the Guangdong Liquefied Natural Gas Receiving Terminal project; and a natural gas valve station project in Suzhou Industrial Park, Suzhou, Jiangsu province. These kinds of high-pressure, natural gas pipeline projects generate good returns and help the Group develop and strengthen its downstream city-gas markets.

During the third quarter of 2011, the Group added a second integrated wastewater treatment project, for a special industry, to its existing integrated water supply and wastewater joint venture in Suzhou Industrial Park, Suzhou, Jiangsu province. Together with water supply projects in Wujiang, Jiangsu province and in Wuhu, Anhui province, the Group has so far invested in and operates four water projects, all of which are progressing well.

Operation and management of businesses encompassing city-gas, city-water and midstream natural gas projects create positive synergy and bring increasing benefits to the Group. The Group will therefore keep on looking for opportunities to invest in high-quality utility projects on the mainland.

Emerging Environmentally-friendly Energy Businesses

Coalbed Methane and Non-conventional Methane Utilisation Businesses

ECO's coalbed methane and non-conventional methane utilisation businesses have been developed based on the technology and operational experience gained from its landfill gas utilisation project which has been successfully operating in Hong Kong for several years. The North East New Territories landfill gas treatment facility contributes to improving air quality in Hong Kong, minimising the use of fossil fuels and reducing greenhouse gas emissions. Since 2008, ECO has been developing similar clean and environmentally-friendly energy projects on the mainland with an extended scope of application. A coalbed methane liquefaction facility located in Jincheng, Shanxi province was fully commissioned during the first quarter of 2011.

The annual production capacity of the whole facility is 250 million standard cubic metres of liquefied coalbed methane supported by a secure upstream coalbed methane supply. The facility, which is operating well, has now become the largest liquefaction and utilisation project of its kind on the mainland.

ECO's coal-mine methane liquefaction project in Yangquan mining district, Shanxi province, is progressing as scheduled; construction is expected to commence in 2012 for commissioning in the first quarter of 2014. Coal-mine gas, which typically contains about 40 per cent methane, will be used to produce liquefied methane by deploying coal-mine gas deoxidisation and coalbed methane cryogenic liquefaction technologies. With an estimated annual production capacity of about 80 million standard cubic metres for eventual transportation by road tankers to downstream markets, this project will provide the Group's city-gas businesses with a more environmentally-friendly gas source to help conserve energy and reduce gas emissions.

Coal Resources and Coal Chemical Processing

ECO started to develop coal resources and coal chemical processing businesses in 2009, focusing mainly on more environmentally-friendly and cleaner technologies for coal resources conversion and utilisation. To this end, ECO has constructed a methanol production plant, with an annual capacity of 200,000 tonnes, in Junger, Erdos, Inner Mongolia. The plant is now at the pilot production stage and is expected to be fully commissioned in mid-2012. Construction of ECO's Xiaoyugou coal mine, which is associated with the methanol production plant, is also complete and pilot production started in early 2012. ECO acquired an operative open-pit coal mine in Inner Mongolia in September 2011 and this is now starting to contribute additional profits and coal resources reserves to the Group. ECO's coking coal mine and coking plant project in Fengcheng, Jiangxi province, is also on schedule; commissioning is expected in 2012. The main product, coke, will be used for refining steel, and its by-product, coke oven gas, will provide an additional gas source for the Group's Fengcheng city-gas project. ECO will continue to expand its coal resources reserves and develop more far-sighted clean coal utilisation technologies so as to produce more clean fuels for use as substitutes for oil products.

Energy-related Logistics and Facilities Businesses

ECO's energy-related logistics and facilities businesses originated from its five dedicated liquefied petroleum gas ("LPG") vehicular filling stations in Hong Kong, which have been operating steadily for several years servicing taxis and minibuses. ECO started its gas filling station business on the mainland in 2008. Since then, ECO has gradually established a network of compressed and liquefied natural gas filling stations servicing heavy-duty trucks in Shaanxi, Shandong, Liaoning, Henan and Anhui provinces.

ECO's aviation fuel facility in Area 38, Tuen Mun, servicing Hong Kong International Airport, is operating smoothly. The facility supplied over 5 million tonnes of aviation fuel to the airport in 2011. Jetties are available for berthing large-scale tankers and for unloading these tankers' aviation fuel. ECO's facility, with a total storage capacity of 264,000 cubic metres, is now a major logistics base for supply of aviation fuel in Hong Kong.

In tandem with the development of its coal resources business, ECO has also started a coal logistics business and to this end has set up logistics platforms in important coal distribution areas such as Qinhuangdao, Hebei province and Dandong, Liaoning province from which to launch its operations. ECO is also investing in the construction of an inland coal and bulk cargo logistic port in Jining, Shandong province to connect an upstream dedicated coal transportation railway with a downstream canal running to eastern China. The logistic port, with an annual throughput of 10 million tonnes, is expected to be commissioned in 2012.

Development of New Energy Technologies

To capture a competitive edge, ECO set up a new-energy research and development centre in 2010 focusing on related application technologies. The centre has achieved good progress in developing innovative technologies for converting materials of low value, such as non-edible oil and coal tar oil, into clean fuel and substances of high value. ECO is proactively transforming these technologies into ones applicable for industrial use, and is also directly investing in related production projects. These kinds of investments are expected to play an increasingly important part in ECO's new energy businesses.

The energy market on the mainland has great potential to expand. ECO's development of different emerging environmentally-friendly energy businesses and its conclusion of related agreements are expected to bring good economic benefits and business prospects to the Group.

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

Towngas China, a subsidiary of the Group, continued to record good growth in profit after taxation attributable to its shareholders, amounting to HK$709 million in 2011, an increase of approximately 62.6 per cent over 2010. As at the end of December 2011, the Group had an approximately 66.18 per cent interest in Towngas China.

In April 2011, Moody's Investors Service, an international rating agency, upgraded both Towngas China's issuer and senior unsecured bond ratings from Baa3 to Baa2 with a stable outlook in view of the company's favourable industry trend for offering growth potential. These new ratings demonstrate the increasing credit strength of Towngas China which is helping to lower the company's funding costs and widen its channels of financing.

In 2011, Towngas China acquired five new projects located in Xiushui county and Wuning Industrial Park, both in Jiujiang, Jiangxi province; in Miluo, the Group's first in Hunan province; in Bowang New District, Maanshan, Anhui province; and in Beipiao, Liaoning province. Towngas China is focused on developing city-gas businesses in small to medium-sized cities and will continue to strive for rapid expansion through mergers and acquisitions.

Development of Town Gas Network and Facilities in Hong Kong

The network supply capability of the Company is expanding at a good pace in line with market growth. Several network development projects are in progress to meet long-term demand.

Laying of a 15 km pipeline to bring natural gas from Tai Po to Ma Tau Kok gas production plant, to partially replace naphtha as feedstock for the production of town gas, is progressing well and is expected to be substantially completed within 2012. Construction of a 9 km pipeline in the western New Territories to strengthen supply reliability is also in progress. In tandem with the government's development of West Kowloon, South East Kowloon and a cruise terminal, network planning, design and construction in these locations are underway. Construction of a new submarine pipeline from Ma Tau Kok to North Point will commence in 2012. Meanwhile, new gas mains have been laid to Lei Yue Mun, located along the South East Kowloon seashore, where a number of restaurants are situated, some of which have already converted to the use of town gas.

The Group will constantly allocate more resources towards renovating Hong Kong's town gas network to ensure safety of operation and supply.

Property Developments

The entire residential floor area of the Grand Waterfront property development project located at Ma Tau Kok south plant site had been sold by the end of December 2010. Leasing of the commercial area of the project is good. All residential units of Grand Promenade had also been sold by the end of the first quarter of 2011.

The Group has an approximately 15.8 per cent interest in the International Finance Centre ("IFC") complex. Rental demand for the shopping mall and office towers of IFC continues to be robust. The occupancy rate of the project's hotel complex, comprising the Four Seasons Hotel and rental serviced apartments, remains high.

Financing Programmes

In February 2011, the Group concluded a HK$3.8 billion 5-year syndicated term loan and revolving credit facility, mainly for refinancing a HK$3.0 billion inaugural syndicated facility, taken up in 2006, and for the Group's business development. This syndicated facility was backed by 11 international and regional financial institutions including Japanese, American, Taiwanese, Spanish and Hong Kong banks. The facility carries an interest margin of 0.49 per cent per annum over HIBOR. The success of this syndicated facility demonstrates the banking community's strong confidence in the Group's business prospects.

The Group issued its first renminbi-denominated notes in Hong Kong in late March 2011 with a total amount of RMB1 billion for a term of five years at a coupon interest rate of 1.4 per cent (the "RMB Notes"). The Group is the first company among Hang Seng Index Constituent Stocks in Hong Kong to raise funds through the offshore renminbi debt capital market. Inclusive of the RMB Notes, the Group has issued medium term notes with, up to now, an aggregate amount equivalent to HK$6.07 billion under its medium term note programme.

In response to growing demand from investors operating in the Greater China capital markets, Standard & Poor's Ratings Services ("Standard & Poor's), an international rating agency, launched the first credit rating benchmark developed especially for the region in 2011 to assign credit ratings to borrowers active in mainland China, Hong Kong, and Taiwan (including the fast-growing offshore renminbi debt market). The Company was assigned the highest rating of cnAAA, whilst Towngas China was assigned cnA under this Greater China long-term credit rating scale, demonstrating Standard & Poor's high recognition of the Group's stable financial status and strong credit standing.

Company Awards

The Company has achieved good business results in both Hong Kong and mainland China, and endeavours to fulfil its corporate social responsibilities, advocate sustainable development, take initiatives to serve the community and protect the environment. During the year under review, the Company gained the "The Excellence of Listed Enterprise Awards 2011" from Capital Weekly, in recognition of the Company's excellent corporate governance and successful business strategy.

In 2011, the Company once again gained the "Global Chinese Business 1000 – Outstanding Performance Award" from Yazhou Zhoukan, which ranks companies in Chinese-concentrated Asian regions such as mainland China, Hong Kong, Taiwan, Malaysia and Singapore. The Company's ranking in Hong Kong was eighth in 2011.

In addition, the Company and Towngas China respectively won "The Best Listed Company Award" and "The Most Valuable Listed Company during the Twelfth Five-Year Plan Award" in the "2011 Golden Bauhinia Awards" organised by Ta Kung Pao and several authoritative professional organisations in Hong Kong and mainland China, including the securities industry. From about 300 short-listed companies in Hong Kong and mainland China, the success of the Company and Towngas China in winning these awards demonstrates investors' recognition of their good business results and management experience.

Towngas China also once again gained the "Hong Kong Outstanding Enterprises Award 2011" from a locally-renowned financial magazine, Economic Digest, in recognition of its rapid project development, continuous business growth and overall good corporate strength.

Hong Kong Employees and Productivity

As at the end of 2011, the number of employees engaged in the town gas business in Hong Kong was 1,938, the number of customers had increased by 26,237 since 2010, and each employee served the equivalent of 903 customers, slightly up compared to each employee serving 897 customers as at the end of 2010. Total manpower costs for employees directly involved in the town gas business amounted to HK$689 million for 2011. In 2011, there was an approximately 4 per cent average increase in remuneration over 2010. Inclusive of employees engaged in local businesses such as telecommunications, LPG vehicular filling stations and engineering contractual works, the total number of employees of the Group in Hong Kong was 2,255 as at the end of 2011. 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.

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 credited as fully paid for every ten shares held on the Register of Members on 13th June 2012. The necessary resolution will be proposed at the forthcoming Annual General Meeting on 5th June 2012, and if passed, share certificates will be posted on 21st June 2012.

Final Dividend and Special Dividend

The Directors are pleased to recommend a final dividend of HK 23 cents per share payable to shareholders whose names are on the Register of Members as at 13th June 2012.

The Company will celebrate its 150th Anniversary in 2012. To reward our shareholders, the Directors are pleased to recommend a 150th Anniversary one-off special dividend of HK 17.5 cents per share payable to shareholders whose names are on the Register of Members as at 13th June 2012. Including the interim dividend of HK 12 cents per share paid on 3rd October 2011 and the final dividend of HK 23 cents per share recommended, the total dividend payout for the whole year shall be HK 52.5 cents per share, representing 150 per cent of that originally recommended for the whole year.

The above proposed bonus shares are not entitled to the recommended final dividend for 2011 and 150th Anniversary special dividend.

Barring unforeseen circumstances, the forecast dividends per share for 2012 after bonus share issue shall not be less than the interim and final dividends for 2011.

Business Outlook for 2012

The Company predicts steady growth and an increase of about 25,000 new customers in Hong Kong during 2012. Restaurant, hotel and retail sectors are benefiting from a prospering tourism industry in Hong Kong. The Group expects commercial and industrial gas sales and appliance sales in Hong Kong to increase overall in 2012 compared to 2011. However, Hong Kong is still affected by global economic instabilities and all business sectors are being impacted by a surge in operating costs due to high inflation. In order to ease the financial burden on domestic town gas customers, the Company will not adjust its basic gas tariff in 2012. The Company will continue to enhance its operational efficiency and endeavour to uphold stable revenue from its gas business in Hong Kong.

In line with the gradual implementation of the Twelfth Five-Year Plan, the central government advocates increasing urbanisation, expanding domestic demand, more energy conservation and a reduction of gas emissions. As the mainland economy is sustaining good growth, it is anticipated that there will be rising demand for utility services and clean energy. The Group's city-gas and natural gas businesses on the mainland are therefore expected to continue to achieve good growth. Furthermore, following the mainland government's move towards a policy of energy diversification and environmental protection, the Group predicts good prospects for its emerging environmentally-friendly energy businesses, which will ignite a new light illuminating the way for the Group's long-term development and business growth.

It is projected that the Group's businesses will maintain good growth during 2012. The combined results of the Group's emerging environmentally-friendly energy businesses and mainland utility businesses will overtake the results of its Hong Kong gas business in 2012, and will have faster growth momentum than its Hong Kong gas business thereafter given their good prospects.

Established in 1862, The Hong Kong and China Gas Company Limited was the first utility corporation in Hong Kong. Since incorporation, the Company has made unremitting efforts to achieve continuous growth and contribute to the prosperous development of the territory; its top priority has always been to serve the local community. In 2012, the Company will celebrate its 150th Anniversary with a series of commemorative activities and the above proposed distribution of special dividend.

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 corporate brand names built up there over the last 20 years and an anticipated rising demand for clean energy, the Group predicts good prospects and an even better future for its businesses in the years to come.

LEE Shau Kee
Chairman
Hong Kong, 19th March 2012