

# Chairman's Statement



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## The Year's Results

The performance of the Group's gas business in Hong Kong remained steady in 2008 and related profit recorded a slight increase compared to 2007. In comparison, the Group's city gas businesses in mainland China thrived and continued to record good profit growth.

Profit after taxation attributable to shareholders of the Group for the year amounted to HK\$4,302.5 million, a decrease of HK\$4,967.1 million compared to 2007.

Earnings per share for the year amounted to HK 64.5 cents. In 2007, non-recurrent gain amounted to HK\$6,280.1 million due to a one-off gain resulting from the acquisition of shares in Panva Gas Holdings Limited (“Panva Gas”) by way of asset injection, profit from the sale of properties and a revaluation surplus from the International Finance Centre (“IFC”) complex. In comparison, in 2008, non-recurrent gain amounted to only HK\$1,299.3 million.

Earnings per share relating to the Group's profit after taxation for principal businesses, which was HK\$3,003.2 million for 2008, amounted to HK 45.1 cents, an increase of HK 0.3 cents compared to 2007.

During the year under review, the Group invested HK\$2,895.0 million in gas and water pipelines and facilities in Hong Kong and the mainland.

## Gas Business in Hong Kong

Since air temperature in early 2008 was generally lower than that for the same period in 2007 and the restaurant sector flourished due to a prospering economy during the first half of the year, total volume of gas sales in Hong Kong for 2008 as a whole increased by 2.0 per cent mainly attributable to a rise in residential and restaurant consumption. As at the end of 2008, the number of customers was 1,672,084, an increase of 25,592 compared to 2007. Total appliance sales also grew by 4.6 per cent compared to 2007 due to the introduction of more new products, expansion of sales channels and strengthening of market promotions.

As a result of the implementation of a dual naphtha and natural gas feedstock mix in October 2006, feedstock costs have decreased to the benefit of customers. This has also helped the Company off-set the economic impact resulting from the surge in international oil prices in the past few years. Despite a recent substantial decrease in international oil prices, the price of natural gas imported by the Company is still lower than the market rate. However, as the local gas market is maturing and operational costs have been rising for some time because of inflation, the Company raised the standard gas tariff,

which had been frozen for ten years, by HK 0.3 cents per MJ on 1st October 2008.

## Business Development in Mainland China

The Group's mainland businesses progressed well despite the economic downturn during the second half of 2008. Although current demand throughout the whole energy market is relatively weak compared with past years due to the financial tsunami, demand for natural gas is still substantial on the mainland, thus creating good business prospects. The Group, besides investing in gas projects, is also endeavouring to develop emerging environmentally-friendly energy projects through its wholly-owned subsidiary ECO Environmental Investments Limited and the latter's subsidiaries (together known as "ECO"). In the long run, both gas and emerging environmentally-friendly energy businesses on the mainland have good prospects and investment value.

The development of downstream energy businesses is mainly focused on piped city-gas projects. The acquisition of Panva Gas (now known as Towngas China Company Limited ("Towngas China")) in March 2007 injected an additional 25 piped city-gas

projects into the Group and helped extend the Group's footprint in north-eastern and south-western China. During the year under review, the Group established a joint venture for developing piped city-gas projects in several regions of Hainan province, thus facilitating the Group's expansion within the province. In 2008, the Group also established piped city-gas projects in the Dalian Economic and Technical Development Zone and in Changxingdao, Dalian in Liaoning province, both of which have a high density of industries thus creating great potential for gas market growth. The Group currently has 71 piped city-gas projects, including those of Towngas China, in mainland cities spread across 15 provinces / municipalities. Following construction of the natural gas transmission pipeline from Sichuan province to eastern and southern China, the start of phase two of the West-to-East pipeline project and an increase in the quantity of imported liquefied natural gas, the Group anticipates sufficient gas sources for its mainland projects to 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

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province and Hangzhou, Zhejiang province, and a joint venture that invests in the construction of natural gas pipelines and the exploitation of gas fields in Jilin province. These kinds of midstream investments help develop and strengthen the Group's downstream piped city-gas market interests.

The Group operates water supply projects in Wujiang, Jiangsu province and in Wuhu, Anhui province, and manages an integrated water supply and wastewater joint venture in Suzhou Industrial Park, Jiangsu province. These projects are progressing well.

In overall total, the Group currently has 86 projects spread across 18 provinces / municipalities / autonomous regions, encompassing upstream, midstream and downstream natural gas sectors (including piped city-gas projects of Towngas China), the water supply and wastewater treatment sector, natural gas filling stations and emerging environmentally-friendly energy projects.

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 ventures and the energy sector.

### Environmental Investment Businesses of ECO

The Group has been proactively developing environmentally-friendly energy businesses in Hong Kong through ECO. Profit from ECO's dedicated liquefied petroleum gas filling stations increased significantly in 2008 compared to 2007. Its North East New Territories ("NENT") landfill gas treatment facility is also operating well. Treated landfill gas is transported to Tai Po gas production plant via a dedicated pipeline to partially replace naphtha as a fuel for town gas production. Based on the success of the NENT project, ECO is proactively looking for further opportunities to utilise landfill gas at other sites in Hong Kong. By making use of landfill gases which would otherwise be flared off, such projects also help improve air quality.

ECO has signed a 40-year franchise agreement with the Airport Authority Hong Kong to design, construct and commission a permanent aviation fuel facility for the supply of aviation fuel to Hong Kong International Airport. The facility will consist of a large-scale tank farm for storage of aviation fuel served by tanker jetties. Construction is on schedule and the project is expected to be commissioned by late 2009. The facility will become a major logistics base for supply of

aviation fuel in Hong Kong. ECO has also concluded an agreement with the Airport Authority Hong Kong to develop a second-phase facility comprising another banded area for additional tank storage capacity; commissioning is expected by the end of 2010.

The Group has taken ECO as an investment vehicle to develop clean and emerging environmentally-friendly energy projects on the mainland. The Group's first coalbed methane liquefaction facility on the mainland is located at Shanxi province. Phase one was commissioned during the fourth quarter of 2008. Liquefied coalbed methane is transported by tankers to gas markets, thus providing an additional gas source for piped city-gas projects. ECO is monitoring developments in the coal-based chemical industry and in new technology for the production of clean energies, such as methanol and dimethyl ether, and keeping a close check on related market trends and potential investment opportunities associated with these alternative fuels. ECO is also making plans to run a coal-based chemical project in Erdos, Inner Mongolia. ECO has signed agreements to invest in coal mining and coking plant projects in Fengcheng, Jiangxi province. In Shaanxi province, ECO commissioned a compressed natural gas filling station, the largest of its kind on the mainland,



during the third quarter of 2008. This experimental energy-saving and emission-mitigation project uses natural gas as a substitute for diesel oil for heavy duty trucks. By gradually establishing a filling station network and extending into other mainland regions, ECO anticipates this business venture will prosper.

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

### Towngas China Company Limited (Stock Code: 1083hk)

The Group currently has a 45.63 per cent interest in Towngas China. Through the introduction of the Group's quality assets and excellent management philosophy, Towngas China turned a loss to a profit in 2007. In 2008, Towngas China booked a profit of HK\$202 million, an increase of 40.0 per cent over 2007. Towngas China's credit rating was upgraded by Standard and Poor's Rating Services ("Standard & Poor's") in August 2007 and by Moody's Investors Service ("Moody's") in April 2008, reflecting greater confidence in the management of, and prospects for, the company

thus underpinning any future application for banking facilities regarding business expansion.

Towngas China established new piped city-gas joint ventures during the year both in Huangshan city, Anhui province and in the Jinhai Economic Zone in Shenyang, Liaoning province. Towngas China has also recently signed agreements to acquire piped city-gas projects in Chiping, Shandong province and in Xinjin and Xindu, Sichuan province. The company's businesses are progressing well. Towngas China will continue to strive for rapid expansion through mergers and acquisitions. In addition to scaling up its market share in north-eastern China and Sichuan province, Towngas China is looking to move to other regions so as to accelerate development.

### Pipelaying Projects

In order to cope with the demand arising from urban development in Hong Kong, several pipelaying projects are currently under way. Construction of a 24 km transmission pipeline in the eastern New Territories, to augment the capability and reliability of gas supply, was completed in 2008. 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. 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 South East Kowloon development plan, planning for a pipeline network for this region is in progress.

### Property Developments

An overall total of approximately 1.17 million square feet of the Grand Waterfront property development project, located at the Ma Tau Kok south plant site, had been sold by the end of December 2008, representing over 95 per cent of the total residential floor area of the project. Leasing of the commercial area of the project is also good.

The Group has a 50 per cent interest in the Grand Promenade property development project at Sai Wan Ho. An overall total of approximately 1.67 million square feet had been sold by the end of December 2008, representing over 95 per cent of the total residential floor area of the project.

The Group has an approximately 15.8 per cent interest in the IFC complex. Rental demand for the shopping mall and office towers of IFC continues to be good. The occupancy rate of the project's hotel complex, comprising the Four Seasons Hotel and Four Seasons Place, remains high.

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### Inaugural Offering of US\$1 Billion Guaranteed Notes

HKCG (Finance) Limited, a wholly-owned subsidiary of the Group, issued and sold US\$1 billion (HK\$7.8 billion) Reg S / Rule 144A Guaranteed Notes (the "Notes") in August 2008. Listed on The Stock Exchange of Hong Kong Limited on 8th August 2008 (stock code: 4303hk), the Notes are guaranteed by the Company and were issued at a fixed coupon rate of 6.25 per cent per annum and at an issue price of 99.319 per cent. The Notes have a maturity of 10 years. After swapping into Hong Kong dollar, the effective Hong Kong dollar fixed interest rate is at 5.4 per cent per annum. The net proceeds will be applied towards refinancing part of the existing indebtedness of the Group, funding capital expenditure of the Company or the Group, or for general corporate purposes. The Hongkong and Shanghai Banking Corporation and Morgan Stanley acted as joint book runners and joint lead managers.

The transaction was the largest investment grade corporate debt issue from Asia in 2008. Notwithstanding a challenging bond market environment, the new issue was able to price within a narrow favourable market window, on the back of falling US Treasury yields and was

successfully priced at the tight end of the revised price guidance at 237.5bps over 10-year US Treasury. The issue was very well-received by top quality investors, who viewed the Company as a quality investment opportunity. A credit rating of A1 (stable) was assigned to the Notes by international rating agency Moody's and A+ (stable) by Standard and Poor's.

The financial tsunami has led to a tightening of credit in the global financial markets. The Group's success in completing this transaction before the extent of the financial crisis became apparent has contributed to the provision of long-term financial arrangement for its business developments.

### Donations to Earthquake Victims in Sichuan Province of China

In May 2008, a devastating earthquake took place in Sichuan province, seriously affecting an extensive area of the region. Henderson group and the Company swiftly pledged donations totalling HK\$10 million for relief work. In addition, including Towngas China, the Group's Hong Kong as well as mainland companies, staff, and contractors also made generous contributions, reaching more than HK\$10 million. The Group also set

up a "5. 12 Relief Support Team" and dispatched staff to Sichuan to work alongside local colleagues in support of national relief initiatives. The Group procured emergency relief and reconstruction supplies, which were delivered and distributed directly to the earthquake victims. Staff members of Towngas China's joint ventures in Sichuan formed a volunteer team consisting of 150 persons, paying visits to the stricken areas including Wenchuan, Maoxian, Lixian and Qingchuan and extending a helping hand to the earthquake victims with timely emergency materials and emotional support. The Group's relief work has so far given assistance to over 100,000 victims.

### Company Awards

The success of the Group's US\$1 billion Guaranteed Notes issue has been acknowledged by leading financial publications. The Group has been awarded "Best Investment Grade Bond" by Finance Asia and Asiamoney; "Best Bond", "Best Investment Grade Bond", "Best New Bond" and "Best Corporate Bond" by The Asset; and "Best Asian Bond" and "Best Asian Corporate Bond" by Euroweek. The issue was considered well-executed and well-timed and was the only large-scale bond offering by an Asian corporate investment grade

borrower in 2008 as well as being the first non-government-linked investment grade issue of this size since 2003.

In addition, the Company has been honoured to receive the “Hong Kong Awards for Industries: Productivity and Quality Grand Award 2008” in recognition of its high level of operational productivity and quality of products and services. In early 2008, the Company was also presented with the “Total Caring Award” for the year 2007/2008 acknowledging its unwavering commitment to corporate social responsibility and concern for the betterment of society.

## Employees and Productivity

The number of employees engaged in the town gas business was 1,922 at the end of 2008. During the year under review, the Company’s customers increased by 25,592 with each employee serving 870 customers, slightly up compared to each employee serving 858 customers in 2007. Total remuneration for employees directly involved in the town gas business amounted to HK\$649 million for 2008, an increase of HK\$17 million in comparison with 2007. The Group offers employees rewarding careers based on their capabilities and performance and

arranges a variety of training programmes in order to constantly enhance the quality of 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.

## 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 8th May 2009. Including the interim dividend of HK 12 cents per share paid on 20th October 2008, the total dividend payout for the whole year shall be HK 35 cents per share.

Barring unforeseen circumstances, the forecast dividends per share for 2009 shall not be less than that for 2008.

## Business Outlook for 2009

The local economy is facing challenges due to the global financial tsunami. The economic downturn, increasing unemployment and lower consumption power are impacting many business sectors in Hong Kong, including restaurants which are now facing a difficult business

environment. As a result, the Group expects commercial and industrial gas sales and appliance sales to slow down slightly in 2009 but considers this will not significantly impact the Group’s overall profit.

The Company anticipates an increase of about 25,000 new customers and stable gas sales in Hong Kong during 2009. The Group will endeavour to develop natural gas and emerging environmentally-friendly energy businesses at a faster rate in the coming year. The Group predicts good prospects for its expanding mainland businesses despite the current economic downturn.

### LEE Shau Kee

*Chairman*

Hong Kong, 17th March 2009