

# Report of the Directors

The Directors have pleasure in submitting to shareholders their Report and the Audited Accounts for the year ended 31st December 2008 which are to be presented at the Annual General Meeting to be held in the Four Seasons Grand Ballroom, Four Seasons Hotel, 8 Finance Street, Central, Hong Kong on Thursday, 14th May 2009.

## Principal Activities

The principal activities of the Group continue to be the production, distribution and marketing of gas, water and related activities in Hong Kong and mainland China. Particulars of the principal subsidiaries of the Company are shown on pages 125 to 128 of this Annual Report. Revenue and contribution to operating profit are mainly derived from activities carried out in Hong Kong and mainland China.

## Results and Appropriations

The results of the Group for the year ended 31st December 2008 are set out in the consolidated income statement on page 62 of this Annual Report.

An interim dividend of HK 12 cents per share was paid to shareholders on 20th October 2008 and the Directors recommend a final dividend of HK 23 cents per share payable on 15th May 2009 to shareholders whose names are on the register of members on 8th May 2009.

## Issue of Debt Securities

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 (the "Exchange") on 8th August 2008 (stock code: 4303), the Notes are guaranteed by the Company and were issued at a fixed coupon rate of 6.25 per cent per annum 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 would be applied towards refinancing part of the existing indebtedness of the Group, funding capital expenditure of the Group, and for general corporate purposes. On 20th October 2008, HKCG (Finance) Limited off-market repurchased 50 units of the Notes with principal amount of US\$5 million at the price of 88.37 per cent. The outstanding principal amount of the Notes following the purchase was US\$995 million. The carrying value of the Notes as at 31st December 2008 was HK\$7,613 million.

Save as aforesaid, neither the Company nor its subsidiaries have issued any debt securities.

## Financial Summary

A summary of the results of the Group for the past nine financial years is set out on pages 48 and 49 of this Annual Report.

## Reserves

Movements in reserves of the Group and the Company during the year are set out in Note 38 to the Accounts.

## Property, Plant and Equipment

Movements in property, plant and equipment of the Group and the Company are shown in Note 17 to the Accounts.

## Share Capital

Movements in share capital of the Company are shown in Note 36 to the Accounts.

## Borrowings

Particulars of the borrowings of the Group are provided in Note 32 to the Accounts.

## Charitable Donations

Charitable donations made by the Group in 2008 amounted to HK\$8,000,000 (2007: HK\$3,985,000), of which HK\$5,000,000 was donated for the purpose of Sichuan province earthquake relief.

## Directors

At the Annual General Meeting held on 19th May 2008, Dr. The Hon. Lee Shau Kee, Mr. Liu Lit Man, Mr. Leung Hay Man and Mr. James Kwan Yuk Choi were re-elected as Directors of the Company. Mr. Colin Lam Ko Yin, Dr. The Hon. David Li Kwok Po, Mr. Lee Ka Kit, Mr. Alfred Chan Wing Kin and Mr. Lee Ka Shing held office throughout the year. Mr. Ronald Chan Tat Hung resigned as Executive Director of the Company effective from 11th December 2008 upon his retirement.

According to the Company's Articles of Association, one-third of its non-executive directors and one-third of its executive directors are subject to retirement by rotation at every annual general meeting. Pursuant to Article 97, Mr. Colin Lam Ko Yin, Dr. The Hon. David Li Kwok Po, Mr. Lee Ka Shing, non-executive directors, and Mr. Alfred Chan Wing Kin, an executive director, are due to retire by rotation at the forthcoming Annual General Meeting and, being eligible, offer themselves for reappointment. Details of these directors proposed for re-election are set out in the circular sent together with this Annual Report.

## Biographical Details of Directors

The biographical details of Directors and senior management who are also executive directors are set out on pages 11 and 12 of this Annual Report.

## Disclosure of Interests

### A. Directors

As at 31st December 2008, the interests and short positions of each Director of the Company in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers were as follows:

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## Disclosure of Interests (Continued)

### A. Directors (Continued)

#### Shares and Underlying Shares (Long Positions)

Name of Company	Director	Interest in Shares				Interest in underlying shares pursuant to share options	Aggregate interest	%**
		Personal Interests	Family Interests	Corporate Interests	Other			
The Hong Kong and China Gas Company Limited	Dr. The Hon. Lee Shau Kee	3,903,670		2,705,807,442 (Note 5)			2,709,711,112	40.65
	Mr. Liu Lit Man	2,152,202					2,152,202	0.03
	Dr. The Hon. David Li Kwok Po	18,200,000					18,200,000	0.27
	Mr. Lee Ka Kit				2,705,807,442 (Note 4)		2,705,807,442	40.59
	Mr. Alfred Chan Wing Kin	124,417*					124,417*	0.00
	Mr. James Kwan Yuk Choi	43,923	49,765				93,688	0.00
	Mr. Lee Ka Shing				2,705,807,442 (Note 4)		2,705,807,442	40.59
Lane Success Development Limited	Dr. The Hon. Lee Shau Kee			9,500 (Note 6)			9,500	95
	Mr. Lee Ka Kit				9,500 (Note 6)		9,500	95
	Mr. Lee Ka Shing				9,500 (Note 6)		9,500	95
Yieldway International Limited	Dr. The Hon. Lee Shau Kee			2 (Note 7)			2	100
	Mr. Lee Ka Kit				2 (Note 7)		2	100
	Mr. Lee Ka Shing				2 (Note 7)		2	100
Towngas China Company Limited	Dr. The Hon. Lee Shau Kee			893,172,901 (Note 8)			893,172,901	45.63
	Mr. Lee Ka Kit				893,172,901 (Note 8)		893,172,901	45.63
	Mr. Lee Ka Shing				893,172,901 (Note 8)		893,172,901	45.63
	Mr. Alfred Chan Wing Kin					3,618,000 (Note 9)	3,618,000	0.18
	Mr. James Kwan Yuk Choi					3,015,000 (Note 9)	3,015,000	0.15

\* These shares were jointly held by Mr. Alfred Chan Wing Kin and his spouse.

\*\* Percentage which the aggregate long position in the shares represents to the issued share capital of the Company or any of its associated corporations.

## Disclosure of Interests (Continued)

### A. Directors (Continued)

#### Debentures (Long Positions)

Name of Company	Director	Interest in Debentures				Aggregate interest
		Personal Interests	Family Interests	Corporate Interests	Other	
Towngas China Company Limited	Mr. Alfred Chan Wing Kin	US\$1,000,000 (8.25% guaranteed senior notes due 2011)				US\$1,000,000 (8.25% guaranteed senior notes due 2011)

Save as mentioned above, as at 31st December 2008, there were no other interests or short positions of the Directors in any shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) recorded in the register maintained by the Company pursuant to section 352 of the SFO or as otherwise notified to the Company and the Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers.

### B. Substantial Shareholders and Others (Long Positions)

As at 31st December 2008, the interests and short positions of every person, other than Directors of the Company, in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the SFO were as follows:

	Name of Company	No. of Shares in which interested	%**
<b>Substantial Shareholders</b> (a person who is entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting)	Disralei Investment Limited (Note 1)	1,402,419,759	21.04
	Timpani Investments Limited (Note 1)	1,988,332,010	29.83
	Faxson Investment Limited (Note 1)	2,603,627,504	39.06
	Henderson Land Development Company Limited (Note 1)	2,603,627,504	39.06
	Henderson Development Limited (Note 2)	2,608,426,934	39.13
	Hopkins (Cayman) Limited (Note 3)	2,705,807,442	40.59
	Riddick (Cayman) Limited (Note 4)	2,705,807,442	40.59
	Rimmer (Cayman) Limited (Note 4)	2,705,807,442	40.59
<b>Persons other than Substantial Shareholders</b>	Macrostar Investment Limited (Note 1)	615,295,494	9.23
	Chelco Investment Limited (Note 1)	615,295,494	9.23
	Medley Investment Limited (Note 1)	585,912,251	8.79
	Commonwealth Bank of Australia (Note 10)	399,836,154	6.00

\*\* Percentage which the aggregate long position in the shares represents to the issued share capital of the Company.

Save as mentioned above, as at 31st December 2008, the register maintained by the Company pursuant to section 336 of the SFO recorded no other interests or short positions in shares and underlying shares of the Company.

#### Notes:

- These 2,603,627,504 shares were beneficially owned by Macrostar Investment Limited ("Macrostar"), Medley Investment Limited ("Medley") and Disralei Investment Limited ("Disralei"). Macrostar was a wholly-owned subsidiary of Chelco Investment Limited, which was in turn, a wholly-owned subsidiary of Faxson Investment Limited ("FIL"). Medley and Disralei were wholly-owned subsidiaries of Timpani Investments Limited, which was in turn, a wholly-owned subsidiary of FIL. FIL was a wholly-owned subsidiary of Henderson Land Development Company Limited ("HLD").
- Henderson Development Limited ("HD") beneficially owned 53.01% of the total issued shares of HLD. Of these 2,608,426,934 shares, 2,603,627,504 shares represented the shares described in Note 1 and the other shares were beneficially owned by a wholly-owned subsidiary of HD.

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### Disclosure of Interests (Continued)

3. Of these 2,705,807,442 shares, 2,608,426,934 shares represented the shares described in Notes 1 and 2 and 97,380,508 shares were beneficially owned by Fu Sang Company Limited (“Fu Sang”). Hopkins (Cayman) Limited (“Hopkins”) owned all the issued ordinary shares which carry the voting rights in the share capital of HD and Fu Sang as trustee of a unit trust (“Unit Trust”).
4. These 2,705,807,442 shares are duplicated in the interests described in Note 3. Rimmer (Cayman) Limited (“Rimmer”) and Riddick (Cayman) Limited (“Riddick”), as trustees of the respective discretionary trusts, held units in the Unit Trust. Mr. Lee Ka Kit and Mr. Lee Ka Shing, as discretionary beneficiaries of the discretionary trusts, were taken to have duties of disclosure in relation to these shares by virtue of Part XV of the SFO.
5. These 2,705,807,442 shares included the shares described in Notes 1 to 4. Dr. The Hon. Lee Shau Kee beneficially owned all the issued shares in Rimmer, Riddick and Hopkins and was taken to be interested in these shares by virtue of Part XV of the SFO.
6. These 9,500 shares in Lane Success Development Limited were beneficially owned by a wholly-owned subsidiary of the Company (as to 4,500 shares) and a wholly-owned subsidiary of HLD (as to 5,000 shares). Dr. The Hon. Lee Shau Kee, Mr. Lee Ka Kit and Mr. Lee Ka Shing were taken to be interested in HLD and the Company as set out in Notes 1 to 5 by virtue of Part XV of the SFO.
7. These 2 shares in Yieldway International Limited were beneficially owned by a wholly-owned subsidiary of the Company (as to 1 share) and a wholly-owned subsidiary of HLD (as to 1 share). Dr. The Hon. Lee Shau Kee, Mr. Lee Ka Kit and Mr. Lee Ka Shing were taken to be interested in HLD and the Company as set out in Notes 1 to 5 by virtue of Part XV of the SFO.
8. These 893,172,901 shares in Towngas China Company Limited (“Towngas China”) representing 45.63% of the total issued shares in Towngas China were beneficially owned by Hong Kong & China Gas (China) Limited (as to 850,202,901 shares), Planwise Properties Limited (as to 40,470,000 shares) and Superfun Enterprises Limited (as to 2,500,000 shares), wholly-owned subsidiaries of the Company. Dr. The Hon. Lee Shau Kee, Mr. Lee Ka Kit and Mr. Lee Ka Shing were taken to be interested in the Company as set out in Notes 1 to 5 by virtue of Part XV of the SFO.
9. These options represent personal interests held by the Directors.
10. Commonwealth Bank of Australia (“Commonwealth Bank”) was taken to be interested in these 399,836,154 shares which were held by indirect wholly-owned subsidiaries of Commonwealth Bank.

### Directors' Interests in Competing Business

Pursuant to Rule 8.10 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”), the interests of Directors of the Company in businesses which competed or were likely to compete, either directly or indirectly, with the Group during the year ended 31st December 2008 and as at 31st December 2008 were as follows:

Mr. Alfred Chan Wing Kin and Mr. James Kwan Yuk Choi, Directors of the Company, also acted as the executive directors of Towngas China. The principal activities of Towngas China and its subsidiaries (the “Towngas China Group”) are the sale and distribution of gas fuel in mainland China, including the provision of natural gas, construction of gas pipelines, the operation of city gas pipeline network, the operation of gas fuel automobile refilling stations, and the sale and distribution of liquefied petroleum gas (“LPG”) and the sale of natural gas and LPG household appliances. Although some of the businesses carried out by the Towngas China Group are similar to the businesses carried out by the Group, they are of different scale and/or at different locations. Therefore, the Board is of the view that the businesses of the Towngas China Group did not compete directly with the businesses of the Group.

### Service Contracts

No Director proposed for re-election at the forthcoming Annual General Meeting has entered into any service contract with the Company which is not determinable by the Company within one year without payment of compensation other than statutory compensation.

### Interests in Contracts and Connected Transactions

During the year, the Company had the following connected / continuing connected transactions, each of which, as disclosed by way of announcement, was subject to the reporting and announcement requirements but exempt from independent shareholders' approval requirements under Chapter 14A of the Listing Rules since each of the applicable percentage ratios was less than 2.5%:

## Interests in Contracts and Connected Transactions (Continued)

1. As disclosed in an announcement dated 25th August 2008, ECO Coal Resources Development (Fengcheng) Limited (“ECO”), a wholly-owned subsidiary of the Company, entered into the capital increase agreement (the “Capital Increase Agreement”) on 25th August 2008 with Fengcheng Mining Bureau and Longyan City Hongfu Investment Company Limited (“Longyan Hongfu”), the two existing equity holders of Jiangxi Feng Long Mining Co., Ltd. (“Jiangxi Feng Long JV”), pursuant to which the registered capital of Jiangxi Feng Long JV would be increased from RMB86,734,700 to RMB236,111,600 (the “Capital Increase”). Such increase of RMB149,376,900 would be contributed as to RMB50,209,900 by Fengcheng Mining Bureau, RMB40,139,100 by Longyan Hongfu and RMB59,027,900 by ECO. The Capital Increase would be made by two or more instalments. Immediately after the payment of the first instalment, the registered capital of Jiangxi Feng Long JV would be held as to 40% by Fengcheng Mining Bureau, 35% by Longyan Hongfu and 25% by ECO, which would continue to be held in such proportions after the Capital Increase. In addition to a capital contribution of RMB59,027,900, ECO would also pay an equity subscription premium of RMB63,888,400 to Jiangxi Feng Long JV which would be allocated to its capital reserve. In addition, Fengcheng Mining Bureau, Longyan Hongfu and ECO entered into the joint venture agreement (the “Joint Venture Agreement”) on 25th August 2008 to govern their relationship in Jiangxi Feng Long JV. The Capital Increase Agreement and the Joint Venture Agreement constitute connected transactions of the Company under Chapter 14A of the Listing Rules as Fengcheng Mining Bureau is a connected person by reason of it being a substantial shareholder of an existing subsidiary of the Company. Furthermore, the acquisition of an interest by ECO in Jiangxi Feng Long JV also constitutes a connected transaction since a substantial shareholder of Jiangxi Feng Long JV (Fengcheng Mining Bureau) is a controller of a subsidiary of the Company.
2. As disclosed in an announcement dated 31st December 2008, Shanxi Hong Kong & China Coalbed Gas Co., Ltd. (“Shanxi JV”), a non-wholly owned subsidiary of the Company, as purchaser entered into the Shanxi Jincheng Coalbed Methane Purchase and Sale Contracts (Gas Usage Phase I) and the Shanxi Jincheng Coalbed Methane Purchase and Sale Contracts (Gas Usage Phase II) (collectively, “Coalbed Methane Contracts”) on 31st December 2008 with Qinshui Lanyan Coalbed Methane Co. Ltd. (“Qinshui Lanyan”) as seller and Shanxi Jincheng Anthracite Coal Mining Co. Ltd. (“Shanxi Jincheng”) as warrantor, pursuant to which Qinshui Lanyan agreed to supply coalbed methane to Shanxi JV each for terms of 30 years. The cap of the total amount of consideration for the year ended 31st December 2008 was RMB7,300,000. The annual cap of the aggregate amount of consideration for each of the financial years in the 32-year period ending 31st December 2040 was RMB291,000,000. For the year ended 31st December 2008, the total amount of consideration paid by the Group was RMB4,514,830. Shanxi Jincheng is a substantial shareholder of Shanxi JV and is therefore a connected person of the Company. As Qinshui Lanyan is a non-wholly owned subsidiary of Shanxi Jincheng, it is an associate of Shanxi Jincheng and is therefore also a connected person of the Company. Accordingly, the transactions contemplated under the Coalbed Methane Contracts constitute a continuing connected transaction for the Company under Chapter 14A of the Listing Rules.

The Independent Non-executive Directors of the Company have reviewed the transactions contemplated under the Coalbed Methane Contracts and confirmed that the transactions were entered into (a) in the ordinary and usual course of business of the Group; (b) on normal commercial terms; and (c) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The Auditor of the Company has also confirmed that (a) the transactions have been approved by the Board; (b) the transactions have been entered into in accordance with the relevant agreements governing the transactions; and (c) the amounts of the transactions have not exceeded the aforesaid cap.

Details of the related party transactions undertaken in the normal course of business are provided under Note 41 to the Accounts. None of these related party transactions constitutes a discloseable connected transaction as defined under the Listing Rules.

## Report of the Directors

### Interests in Contracts and Connected Transactions (Continued)

Save as mentioned above, no contract of significance in relation to the Group's business to which any controlling shareholder of the Company or any of its subsidiaries was a party, or in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the year-end or at any time during the year.

### Management Contracts

No contract concerning the management and administration of the whole or any substantial part of the business of the Company was entered into or existed during the year.

### Purchase, Sale or Redemption of the Group's Listed Securities

On 20th October 2008, a subsidiary of the Company off-market repurchased 50 units of the Notes with principal amount of US\$5 million at the price of 88.37 per cent. The outstanding principal amount of the Notes following the purchase was US\$995 million. The carrying value of the Notes as at 31st December 2008 was HK\$7,613 million.

Save as mentioned above, neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of its own listed securities during the year.

### Major Customers and Suppliers

The percentages of the purchases attributable to the Group's largest supplier and the five largest suppliers were 12 per cent and 51 per cent respectively during the year. None of the Directors, their associates, or any shareholder (who to the knowledge of the Directors owned more than 5 per cent of the Company's share capital) had any interest in the Group's five largest suppliers. The percentage of the turnover attributable to the Group's five largest customers is less than 30 per cent during the year.

### Corporate Governance

The Company's corporate governance principles and practices are set out in the Corporate Governance Report on pages 57 to 60 of this Annual Report.

### Public Float

As at the date of this report, being also the latest practicable date prior to the issue of this Annual Report, the Company has maintained the prescribed public float under the Listing Rules, based on the information that is publicly available to the Company and within the knowledge of the Directors.

### Auditor

The Accounts have been audited by PricewaterhouseCoopers who will retire at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-appointment at a fee to be agreed by the Board.

On behalf of the Board

**LEE Chau Kee**

*Chairman*

Hong Kong, 17th March 2009