

Chairman's Statement



The Year's Results

The Group's town gas business in Hong Kong maintained stable development in 2018. Concurrently, the Group's city-gas businesses in mainland China and emerging environmentally-friendly energy businesses progressed well, thus bringing good growth to the Group's overall recurrent businesses during the year.

Profit after taxation attributable to shareholders of the Group for the year amounted to HK\$9,313 million, an increase of HK\$1,088 million, up by 13.2 per cent, compared to 2017. Earnings per share for the year amounted to HK60.5 cents. Exclusive of the Group's share of a revaluation surplus from the International Finance Centre complex, the Group's profit after taxation for the year was

HK\$7,283 million, an increase of HK\$275 million, up by approximately 4 per cent compared to 2017 mainly attributable to the growth of the Group's local and mainland businesses.

During the year under review, the Group invested HK\$6,746 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 maintained moderate growth in 2018. Favourable overall employment conditions and growth in the number of inbound visitors, driven by the commissioning of cross-boundary infrastructure, helped gas business

development in the restaurant and hotel sectors. Benefiting from a rise in residential, commercial and industrial gas sales, total volume of gas sales in Hong Kong for 2018 reached 29,550 million MJ, an increase of 1.7 per cent compared to 2017, whilst total number of appliances sold in 2018 was over 283,000 units, an increase of 3 per cent compared to 2017.

As at the end of 2018, the number of customers was 1,908,511, an increase of 25,104 compared to 2017, up slightly by 1.3 per cent.

Business Development in Mainland China

The Group's mainland businesses continued to progress steadily during 2018. Overall, inclusive of projects of the Group's subsidiary, Towngas China Company Limited

(“Towngas China”; stock code: 1083.HK), the Group had 254 projects on the mainland, as at the end of 2018, nine more than at the end of 2017, spread across 26 provinces, autonomous regions and municipalities. These projects encompass upstream, midstream and downstream natural gas sectors, water sectors, efficient energy applications and exploration and utilisation of emerging environmentally-friendly energy, as well as telecommunications.

The Group’s development of emerging environmentally-friendly energy businesses in mainland China, including coalbed methane liquefaction, coal chemicals, conversion and utilisation of biomass, utilisation of industrial and agricultural waste as well as natural gas refilling stations, through its wholly-owned subsidiary ECO Environmental Investments Limited and the latter’s subsidiaries (collectively known as “ECO”), is progressing steadily. Benefiting from international oil prices maintained at a relatively good level during the first three quarters of 2018, ECO recorded stable profit growth during the year. ECO’s in-house research and development of innovative technologies is also progressing well with a number of achieved results gradually being applied commercially. Gradual commissioning and development of related projects are expected to contribute to the long-term business growth of the Group.

Diversification and an increase in the number of projects have gradually transformed the Group from a locally-based company in Hong Kong centred on a single town gas business a number of years ago into a sizable, nationwide, multi-business corporation focused on environmentally-friendly energy ventures and utility sectors.

Utility Businesses in Mainland China

The Group’s city-gas businesses are progressing well. As at the end of 2018, 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 2018 was approximately 23,000 million cubic metres, an increase of 18 per cent over 2017. As at the end of 2018, the Group’s mainland gas customers stood at approximately 27.54 million, an increase of 9 per cent over 2017. The Group continues to have a good reputation as a large-scale city-gas enterprise with outstanding overall performance on the mainland.

The mainland’s economic growth slowed in 2018 compared to 2017 under the impact of international trade tensions. In addition, the exchange rate risk arising from devaluation of the renminbi during the second half of 2018 also created challenges for the Group’s mainland businesses. Nevertheless, despite this

adverse international business environment, the mainland’s volume of exports increased in 2018 compared to 2017. Rising per capita income of urban and rural residents also drove domestic consumer spending during the year, helping to sustain a stable industrial manufacturing base thus boosting the country’s demand for energy, including electricity, petroleum and natural gas. In the medium to long term, the Chinese government advocates the use of natural gas to reduce air pollution and improve smoggy atmospheric conditions. To this end, a natural gas utilisation policy has been formulated to strengthen preventative measures to combat air pollution and speed up the use of natural gas to replace coal (“coal-to-gas”) across the country so as to minimise buildup of smog. Using piped natural gas instead of bottled petroleum gas is also being encouraged nationwide, thus enhancing sales of the former, whilst greater use of household heating in the Yangtze River Basin is raising residential gas sales there. The government is also promoting distributed energy systems by advocating partial replacement of coal-fired power with natural gas. This favourable momentum will continue to benefit the Group’s city-gas and natural gas businesses in the future.

As natural gas is a major clean energy being promoted on the mainland, long-term and steady growth in market demand is anticipated. In view of this, the

country is striving to maintain an ample supply of natural gas. With a gradual increase in imported piped natural gas from Central Asia and Myanmar, together with a scheduled supply of piped natural gas from Russia and a rise in the sources of imported liquefied natural gas (“LNG”), supply of natural gas will gradually become sufficient, which will benefit market development. In addition, a number of mainland provinces and cities are laying plans to develop gas storage facilities to boost natural gas storage capacity over winter alongside the development of LNG receiving stations. All these projects will help maintain a stable supply of natural gas, helping the Group’s mainland city-gas businesses to continue to thrive in the future.

In line with the Chinese government’s policy of advocating faster development of gas storage capacity, the Group is actively enhancing gas storage capacity on the mainland. Construction of the Group’s natural gas storage facility in underground salt caverns in Jintan district, Changzhou city, Jiangsu province, is progressing in phases. This project is the first of its kind built by a city-gas enterprise on the mainland. Phase one involves the construction of 10 wells, with storage capacity of approximately 460 million standard cubic metres; the first three wells were commissioned at the end of October 2018. Phase two, wholly-owned by the Group, involves the construction

of 12 wells with storage capacity of 560 million standard cubic metres. Upon completion, total storage capacity of the whole facility will be over 1 billion standard cubic metres, helping the Group supplement and regulate gas supply during the peak winter period for a number of its city-gas projects in eastern China. In the longer term, there are also plans to supply gas from this facility to the Group’s city-gas projects in other regions through interconnected upstream pipeline networks, facilitating the Group’s business development in downstream city-gas markets.

The Group has been in the mainland water market, under the brand name “Hua Yan Water”, for over 13 years and currently invests in, and operates, seven water projects. These include 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; 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; and a new water services joint venture project in Foshan city, Guangdong province added in the fourth quarter of 2018 through investment in Foshan Water Environmental Protection Co., Ltd. The major businesses of

this company encompass tap water supply, wastewater treatment and municipal engineering. This is the Group’s first water services project located in the Guangdong-Hong Kong-Macao Greater Bay Area. In tandem with the country’s promotion of the development of the Greater Bay Area, investment in this project is expected to provide opportunities for the Group to develop water services and environmental protection businesses within the region. In addition, given food waste processing and utilisation is also a sizable environmentally-friendly industry, the Group has constructed a plant in Suzhou Industrial Park to handle 500 tonnes daily of food waste, green waste and landfill leachate for conversion into natural gas, oil products, solid fuel and fertilizers under the “Hua Yan Water” brand; trial production formally commenced in mid-February 2019 and is the Group’s first project converting waste into valuable products. Projects of this kind will gradually be extended to other affluent mainland regions.

Operation and management of businesses encompassing city-gas, midstream natural gas, city-water and environmental waste processing and utilisation projects create ever-greater synergy and mutual advantages. Furthermore, these businesses generate stable incomes, provide good environmental benefits and exhibit high growth potential. 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 well, contributing to ECO's steady profit growth. With a total turnover of approximately 6.76 million tonnes of aviation fuel in 2018, ECO's aviation fuel facility provided a safe and reliable fuel supply to Hong Kong International Airport. ECO's five dedicated LPG vehicular refilling stations also operated smoothly in 2018, providing a quality and reliable fuel supply to the territory's taxi and minibus sectors. ECO's landfill gas utilisation projects are generating noticeable environmental benefits. In addition to the facility in the North East New Territories, which has been operating for several years, a second landfill gas utilisation project in the South East New Territories has now been in operation for one year and is further helping to raise the proportion of landfill gas used by the Group, thus increasing its contribution to energy conservation and emission reduction in Hong Kong.

With the mainland's growing concern for greater environmental protection, "coal-to-gas" conversion is still prevailing thus generating a significant demand for LNG as a gas supplement during winter. In relation to this, ECO's coalbed methane liquefaction facility, located in

Jincheng city, Shanxi province, is operating smoothly. However, due to tight upstream gas sources in 2018, output from the project decreased during the year compared to 2017.

Conversion of biomass into clean energy and chemical products is one of ECO's major business strategies, which is also in line with the policy direction of mainland China. To this end, ECO has successfully put into trial operation for one year, using its self-developed technology, an integrated processing project located in Zhangjiagang city, Jiangsu province, to process inedible bio-grease feedstock into hydro-treated vegetable oil (HVO). A total of approximately 7,000 tonnes of HVO, which has gained "International Sustainability and Carbon Certification" (ISCC), was produced and exported to European markets last year. On this basis, ECO has commenced phase two of this project to enhance production capacity to 180,000 tonnes per annum. HVO, as an advanced biofuel, can be added to diesel directly in order to reduce emissions, thus contributing to the mitigation of climate change.

Mainland China is a sizeable agricultural production country generating a large quantity of agricultural waste every year. Apart from using a small portion of this in fields or for power generation, there are currently no effective measures to make good use of the rest of this waste. ECO has commenced construction of a pilot project in Tangshan city, Hebei province, to apply self-

developed hydrolysis technology to break down agricultural straw into hemicellulose, cellulose and lignin to yield furfural and paper pulp, both used for chemical feedstock and basic materials with noticeable economic and environmental benefits. This pilot project is expected to be commissioned in late 2019 and, if successful, will drive ECO to cultivate a broad green and low-carbon eco-system business.

The operating environment of ECO's clean coal chemical project in Ordos city, Inner Mongolia Autonomous Region, remained positive during 2018. Additionally, trial production of a facility to convert a portion of the project's syngas into 120,000 tonnes of ethylene glycol annually was started in 2018, and has successfully produced high-quality ethylene glycol, representing a key step to further expanding ECO's syngas upgrading businesses.

ECO's scientific research, focusing on the extraction of high-quality carbon materials from the pitch portion of high-temperature coal tar oil, has achieved promising results, successfully producing high-quality activated carbon and hydrogenated pitch. High-quality activated carbon can be used for making super capacitors, whereas hydrogenated pitch can be used as a raw material for carbon fibre or as an anode material for batteries. Given the prevailing trend for promoting new energy electric vehicles and rail transport electrification in mainland China, prospects for

these new carbon materials are promising. ECO's first pilot project of this kind in Ordos city, Inner Mongolia Autonomous Region, is now at the preparatory stage; construction work is expected to commence within 2019.

ECO continues to march along its well-defined new energy business development strategy by strengthening its capabilities in developing innovative technologies, and, with that, building up its key businesses relating to low-carbon and clean-coal chemicals, efficient conversion and utilisation of agricultural straw, preparation of high-quality carbon materials, hydrogenation and upgrading of bio-grease, and utilisation of unconventional gas resources, etc. In so doing, ECO is gradually migrating from its original business strategy focusing on fuel substitutes to one encompassing higher value-added chemical and advanced materials. Related key technologies have already achieved a number of breakthroughs and some have already been granted the intellectual property rights. As these projects begin to show significant economic and environmental benefits, they are expected to become the basis of ECO's core business in the future.

Telecommunications Businesses

The Group's development of telecommunications businesses in Hong Kong and mainland China, including provision of connectivity, data centres and cloud computing

services for international and local internet service providers, telecommunications operators as well as large corporations, through its wholly-owned subsidiary Towngas Telecommunications Company Limited and the latter's subsidiaries, is progressing steadily. The company is strengthening its foundations to cater for data transmission, processing and storage needs as well as swifter market development in the future.

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

Towngas China, a subsidiary of the Group, maintained stable business growth in 2018. Profit after taxation attributable to its shareholders for the year amounted to HK\$1,224 million, a decrease of approximately 10 per cent compared to 2017. Exclusive of the one-off profit of HK\$209 million for Towngas China resulting from the listing of Foshan Gas Group Co., Ltd. in 2017, profit after taxation attributable to shareholders increased by approximately 6 per cent compared to 2017. As at the end of December 2018, the Group held approximately 1,895 million shares in Towngas China, representing approximately 67.45 per cent of Towngas China's total issued shares.

In respect of project development, 11 new projects were added to Towngas China's portfolio in 2018, including a city-gas project in Liujiang district, Liuzhou city,

Guangxi Zhuang Autonomous Region; a midstream natural gas pipeline network and city gate station project in Chiping county, Liaocheng city, Shandong province; Towngas Natural Gas Sales Co., Ltd.; and eight distributed energy projects located in Jiawang district, Xuzhou city, Jiangsu province; in Xuzhou Biomedical Industrial Park, Jiangsu province; in Jimo Chuangzhi new district, Qingdao city, Shandong province; in Yangxin Economic and Technological Development Zone and Boxing Economic Development Zone, both in Binzhou city, Shandong province; in Changchun city, Jilin province; in Chengnan Economic Development Zone, Tangshan city, Hebei province; and in Guilin city, Guangxi Zhuang Autonomous Region respectively.

Besides developing existing markets and proactively investing in commercial and industrial distributed energy and "coal-to-gas" conversion projects in tandem with the country's policy of advocating environmental protection, Towngas China will also continue to research and develop high-quality gas accessory products and explore extended businesses so as to provide customers with one-stop household products and services for purchase. Towngas China will also continue to seize opportunities to explore more environmental protection projects, striving for the best interest and returns for its investors and shareholders.

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. Medium term notes totalling HK\$1,027 million, with a maturity ranging from 3 to 30 years, were issued during 2018. In line with the Group's long-term business investments, as at 31st December 2018, the amount of medium term notes issued had reached HK\$14.4 billion with tenors ranging from 3 to 40 years, mainly at fixed interest rate with an average of 3.5 per cent per annum and with an average tenor of 15 years.

In January 2014, the Group issued its first perpetual subordinated guaranteed capital securities (the "Perpetual Securities"), amounting to US\$300 million, through Towngas (Finance) Limited, a wholly-owned subsidiary of the Group. These Perpetual Securities were redeemed in January 2019. Since Perpetual Securities have no fixed maturity date, they are accounted for as equity instead of borrowings in financial statements. This helps to strengthen the Group to maintain its high investment grade credit ratings. Therefore, the Group issued new Perpetual Securities again in February 2019 and the proceeds are mainly used to refinance the redeemed US\$300 million Perpetual Securities. The newly issued US\$300 million Perpetual

Securities will keep a coupon interest rate of 4.75 per cent per annum for the first five years. The Perpetual Securities are redeemable, at the option of the Group, in February 2024 or thereafter every six months on the coupon payment date. This issuance of the Perpetual Securities, rated A3 and A- by international rating agencies Moody's Investors Service and Standard and Poor's Rating Services respectively, received an overwhelming response from investors and were more than 14 times oversubscribed. The Perpetual Securities, guaranteed by the Company, were listed on The Stock Exchange of Hong Kong Limited on 13th February 2019 (stock code: 5749.HK).

Employees and Productivity

As at the end of 2018, the number of employees engaged in the town gas business in Hong Kong was 2,052 (2017 year end: 2,022), the number of customers was 1,908,511, and each employee served the equivalent of 930 customers, a similar level to 2017. 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 2,418 as at the end of 2018 compared to 2,388 as at the end of 2017. Related manpower costs amounted to HK\$1,139 million for 2018. In 2018, there was an approximately 4 per cent

average increase in remuneration over 2017. 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 approximately 49,700 as at the end of 2018, an increase of approximately 2,700 compared to 2017.

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 as at 5th June 2019. The necessary resolution will be proposed at the forthcoming Annual General Meeting on 28th May 2019, and if passed, share certificates will be posted on 13th June 2019.

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

5th June 2019. Including the interim dividend of HK12 cents per share paid on 2nd October 2018, the total dividend payout for the whole year shall be HK35 cents per share.

Barring unforeseen circumstances, the forecast dividends per share for 2019 after bonus share issue shall not be less than the interim and final dividends for 2018.

Business Outlook for 2019

The Company predicts steady growth in its number of customers in Hong Kong during 2019. Favourable employment conditions and thriving inbound tourism are helping to stimulate domestic demand and consumer spending. The Group's gas business in Hong Kong is also benefiting from the efforts of the Government of the Hong Kong Special Administrative Region to increase land and housing supply which should help maintain stable and good growth in the number of gas customers in the next few years. Additionally, town gas as an energy resource, combining both environmental and economic advantages, is creating a competitive edge fostering development of the Company's commercial and industrial energy markets. Nevertheless, the external environment is complex and fast-changing. Coupled with increasing local manpower costs and operating expenses leading to rising costs for businesses in Hong Kong generally, the local business environment is full of

challenges. The Company will, however, continue to encourage smart innovation to enhance operational efficiency so as to maintain stable development of its gas business in the territory.

Given the international political environment and the world economy face a number of uncertainties, this will continue to impact economic development on the mainland, particularly that associated with export manufacturing industries. Under these circumstances, the Group's mainland businesses inevitably also face challenges with respect to growth in the near term. Despite this, as domestic consumer spending is making an ever-increasing contribution to the mainland's economic growth, aided by the Chinese government continually striving to expand domestic demand in order to offset some of the impact resulting from the uncertain prospects of export manufacturing industries. Additionally, export of mainland products to countries and regions along the "Belt and Road Initiative" routes shows growth potential and will help to facilitate the development of manufacturing industries. In the long term, the Chinese government's move to improve smoggy atmospheric conditions by tightening supervision and administration of related measures will be progressive. On 1st January 2018, the Implementing Regulations for the Environmental Protection Tax Law became effective alongside the Environmental Protection Tax

Law, aiming to further promote corporate initiatives to enhance environmental protection levels by charging taxes in accordance with the quantity of pollutants discharged; this is helping the development of natural gas markets. The Chinese government is also increasing its efforts to reduce carbon emissions by encouraging the use of clean energy, creating good opportunities for natural gas to replace coal in industrial production, as well as in boilers, power generation, distributed energy, household heating, etc. In addition, increasing upstream gas supplies, expanding and improving pipeline networks and rapid urbanisation, leading to a continuous rise in demand for utility facilities and energy, are all favourable to the downstream gas market and the healthy development of the natural gas business sector in general. As a result, the Group's gas sales volumes are expected to show promising growth in the future.

In respect of emerging environmentally-friendly energy businesses, following the Chinese government's move towards greater energy diversification, environmental protection and recycling of materials, 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 as fuels for vehicles and vessels to reduce atmospheric pollution.

ECO is additionally moving towards production of high-quality chemical products which are less sensitive to international oil prices, taking this as a guide for future business development; some associated projects will be commissioned within this year. As ECO's in-house research and development of a number of technologies is gradually achieving results, which are being put into commercial production, emerging environmentally-friendly energy businesses will ignite a new light for the Group, illuminating the way for long-term development and medium-to-long term business growth strategies.

With the Group's solid foundation in Hong Kong and its diverse business sectors spread across extensive areas on the mainland, together with its established operational base, successful technical experience, corporate brand names and sales channels built there over 20 years alongside society's growing concern over air quality, it is anticipated that there will be ever-rising demand for clean energy and the Group's mainland businesses will have further prosperous development. According to mainland China's Thirteenth Five-Year Plan, the share of natural gas in the country's total energy mix is set to increase from approximately 8 per cent currently to 10 per cent by year 2020, thus creating huge market potential for clean energy. In addition, given that the number of piped-gas customers in Hong Kong and mainland China is rising, the Group foresees

that this sizeable customer base will create a promising platform for expansion of various new businesses. Furthermore, in line with the country's development plan for the Guangdong-Hong Kong-Macao Greater Bay Area, the Group is seizing investment opportunities to explore environmental protection projects in the Pearl River Delta region.

Despite a number of projected global economic uncertainties in 2019, the continuing optimisation of mainland China's economic structure, which the government has been implementing for a number of years, together with a rising middle-class population, will also help maintain stable economic growth and sustain keen demand for clean energy. The Group will continue to formulate, and is gradually implementing, plans in accordance with the country's energy and environmental protection policies. Overall, with society's growing aspiration for more environmental protection, demand for natural gas, as well as environmentally-friendly and renewable energy, will increase. Furthermore, the Group is actively promoting technological research and new product development, and related work is being effectively and gradually implemented, thus continuously injecting new impetus to foster business growth. In addition, with sizeable customer base resources built up after years of operating urban utilities, the Group anticipates an ever broader and brighter development for its various businesses in the future.

Consideration to Step Down as Chairman

I, being advanced in age, am considering to step down from the position of Chairman of the Company after the conclusion of the forthcoming annual general meeting and to propose to the Board to appoint Dr. Lee Ka-kit and Mr. Lee Ka-shing as Joint Chairmen. Details of my decision and future arrangements will be announced on the date of the annual general meeting, 28th May 2019.

I would like to express my heartfelt gratitude to our shareholders for their confidence and unfailing support to me as Chairman over the past decades.

Lee Shau-kee

Chairman

Hong Kong, 20th March 2019