

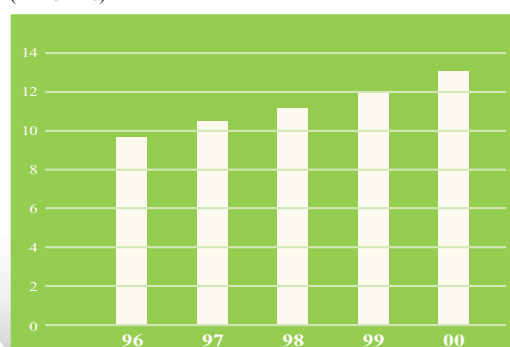
REVIEW OF OPERATIONS

MARKETING HIGHLIGHTS

During the period under review, overall gas sales increased as a result of our innovative marketing efforts and our customised applications and products, as well as conducive cool weather conditions. We also recorded growth in new meter installations and the sale of appliances.

We increased total gas sales by 5.5 per cent, gained 63,807 new customers and sold 289,788 appliances, an increase of 6.7 per cent over the previous year. Gas consumption rose to 26,057 million megajoules. Residential gas sales increased by 6.1 per cent while commercial and industrial gas sales rose by 4.9 per cent.

Gas Sales per Employee (Company)
(million MJ)

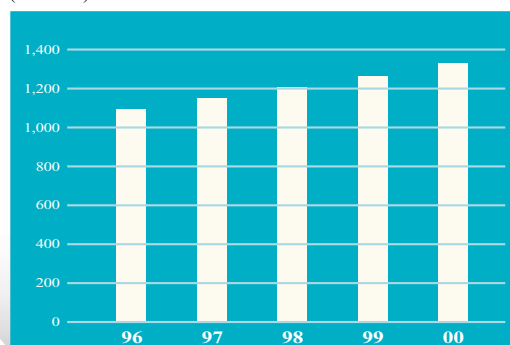


We had a good year. And the more confident consumer sentiment at year-end bodes well for the future.

RESIDENTIAL MARKET

There were several growth catalysts for the residential market. The completion of more than 130,000 new flats, a robust replacement market, our sharpened competitive edge and the introduction of new products and applications were all key factors.

Number of Customers (Company)
(thousand)



Underscoring our growth has been our primary goal of increasing gas sales and maintaining our competitive edge against other fuels and other brands of products. We have been consistently developing new gas applications and new products to meet different customer needs. Our emphasis is totally driven by quality, ease of operation and unstinting service support. We listen to our customers through regular customer surveys and focus groups, ensure product quality through infant care programmes and customise all new appliances with value-added features and a high level of safety and environmentally-friendly performance.

LAUNCH OF TGC BRAND

A pivotal development last year was the creation and launch of Towngas's own in-house "TGC" brand. This move opened up a new area of growth for the Group, as it will help Towngas capture bulk installations for new housing developments. "TGC" capitalises on Towngas brand qualities such as peace-of-mind reliability, a solid reputation, innovation, good value and excellent service.



In developing our branded line of appliances, we also worked closely with selected product manufacturers on product development, aiming for customer-friendly features, appearance and reliable performance. The first two "TGC" products launched were the Intelligent Timer Superbowl, which offered innovative features, and a line of stylish, temperature-modulated water heaters.

In the year ahead, more products targeted at the upscale market segment will be launched under the "TGC" brand, including range-hoods, dishwashers and built-in hobs. In addition, a world-first, 2-in-1 washer/gas dryer will be launched in the spring of 2001. These initiatives aim at giving our customers more choice, higher quality and better service.



The timer-activated Intelligent Superbowl is the first product launched with the new in-house brand — TGC.

CUSTOMER-ORIENTED SOLUTIONS FOR THE HOME

Our constant focus on what customers really need has worked well. Our customers have responded enthusiastically to a considered approach to their home needs, and our products continue to help enhance their lifestyles.

To date, we have introduced a floor heating system, a desiccant dehumidification system, a bathroom warmer/dryer and a towel warmer for Hong Kong's special home environment. We have also begun installing a substantial number of water heaters under kitchen sinks so that these domestic appliances are hidden from view. This flexible method of installation allows gas water heaters to blend in well with modern home interiors.

For the high-end market, we have established a full range of modern gas appliances — along with luxury kitchen cabinets that can be installed in new developments. Our aim is to provide developers, architects and consultants with a total kitchen solution. This also opens up more opportunities for marketing gas appliances such as built-in hobs, dishwashers and the new 2-in-1 washer/gas dryer.

We continued to promote our “Towngas Four Home Treasures” package — featuring a Superbowl (a two-burner hotplate with a built-in rice cooker), water heater, gas clothes dryer and hot-filled dishwasher. We also introduced a new counter-top dishwasher that is compact in size and particularly suitable for the typical Hong Kong home. Our gas clothes dryer has been ranked Hong Kong's best selling brand for the fourth year in a row, with a record over 17,000 units sold during the year.

NEW POTENTIAL

Towngas entered into the LPG appliance business during the year, utilising the Group's existing service infrastructure and expertise in the town gas appliance business. In the fourth quarter, Towngas started marketing LPG appliances that carry four Rinnai LPG hotplates, which offer a more powerful flame when compared with other LPG appliances. A more comprehensive product range will be introduced in the coming year. With our established brand name, customised products and excellent customer service, we stand ready to capture a substantial share of the market.

COMMERCIAL AND INDUSTRIAL MARKET

Commercial and industrial gas sales grew by an impressive 4.9 per cent during the period under review. Increased gas consumption at hospitals, due to the conversion of diesel to gas for steam and hot water boilers, together with higher consumption in the food and beverage industry, contributed to this growth. Our effective and aggressive marketing efforts helped as well. The year also saw an increase in the sale of condensing boilers, desiccant dehumidifiers and a range of baking and roasting ovens.

As Hong Kong's economy continues to improve and the tourism business recovers further, the commercial and industrial market should offer greater growth potential. But growth is never a given unless gas applications and the appliances and equipment we offer are competitive, which is why we are constantly developing new commercial strategies and creative approaches to doing business.

DEALING EFFECTIVELY WITH INDUSTRY COMPETITION

We face strong competition from electricity suppliers who provide incentives for restaurants to convert to so-called flameless cooking. To deal with this competition head-on, we made further improvements to all of our traditional applications last year, making our appliances less noisy and more compact in size, and enhancing energy efficiency. In doing so, we made our appliances more environmentally-friendly while at the same time helping those in the catering industry to lower their running costs.

In addition to the development of new appliances and equipment that precisely meet customer needs, we supported such initiatives with creative marketing campaigns. Our Perfect Ten campaign for commercial catering equipment, for instance, offered 10 cooking applications that cater to the individual needs of different restaurants.

We also increased the number of dealers and agents last year, while at the same time instituting better account servicing and developing more sales channels.

EMERGING MARKET FOR DESICCANT DEHUMIDIFIERS

The Government's environmental policy of improving indoor air quality deserves our support. We responded proactively and, in the process, developed an emerging market for gas-fired desiccant dehumidifiers.

Several such dehumidifiers have been installed for indoor swimming pools, hospitals, exhibition halls and warehouses. Sales increased by 28 per cent, to 23 units.

SERVICE INITIATIVES

Quality service at Towngas has gone beyond the stage of simply providing our customers with competent, efficient and friendly service. We have extended our service frontier to providing innovative services specially developed for households. We offer customers greater convenience and a wider scope of services through new programmes such as automatic meter reading and bimonthly billing. Other non-gas products include the Towngas Card and household protection packages. At the same time, customer communication has remained a key focus, and this has led to the creation of a new platform for communication: District Council Focus Teams.

BREAKTHROUGH SYSTEMS FOR GREATER CUSTOMER CONVENIENCE

Last year, we broke new ground by developing an automatic meter reading (AMR) system that enables our gas meters to be read electronically and at regular intervals. The system utilises our gas piping system as a trunk link to transmit radio frequency signals back to the Towngas office. Since gas meters are installed within our customers' premises, eliminating the need for manual reading of these meters will mean greater customer convenience as well as improvements in staff productivity. Installation of the AMR system will begin in 2001 in new residential developments, and the system is expected to become an integral part of the "Intelligent Home" of the 21st century.

Customer convenience was further enhanced by the introduction of a bimonthly billing system in September 2000. Customers now only need to settle their gas bills once every two months. Apart from the environmental benefit of saving over 12 million pieces of paper and envelopes a year — reducing waste and saving trees — the new scheme also generates manpower and cost savings.



Bimonthly billing system aims to bring convenience to customers and environmental benefits to the city.

Another successful initiative was the Towngas Card, a co-branded credit card with Bank of East Asia, for which we signed up more than 84,000 subscribers within the first year after launch. Card members can choose to settle their gas bills together with their regular Towngas Card statements, thereby avoiding the need for a separate gas bill with a separate payment process.

Within a relatively short period of time, the Towngas Card has become a convenient payment option for customers, another channel for Towngas branding and a new opportunity for revenue generation.

We also introduced a range of household protection packages for our customers. More than 8,000 customers signed up for the packages in the first year, bearing testimony again to the strength of the Towngas brand name.

CUSTOMER SATISFACTION — THE ULTIMATE TEST

Customers have the final say and we always listen. We also try to anticipate and pre-empt rather than react.

Our Millennium Six-Star Services, which offer greater convenience with shorter lead times for service and extended hours with regard to enquiries, installation and maintenance, have been used extensively by customers.

Our pledge of emergency response time has been shortened from 60 to 45 minutes, while our achieved average rate is 20 minutes, reinforcing the Company's emphasis on public safety.

We also generated further efficiency in the handling of residential on-demand maintenance orders. Last year, there were a total of 617,412 service visits to customer premises, a decrease of 4.3 per cent per customer when compared with 1999. The average booking time was reduced to only 1.5 days.

Last year our Regular Safety Inspection programme covered 860,847 households. The success of this programme can best be measured by the reduction of on-demand requests by 30.6 per cent compared to the 1996 level. Calls to our Customer Service Hotline also dropped by 21.3 per cent since 1996.

Our service achievements have been well recognised locally and internationally. We won the Company of the Year Award and the HKMA Quality Award in 1999, and the UK-based Management Today/ Unisys Service Excellence Award (Overseas Category) in 2000. We were assessed in terms of our customer service, as well as the efficiency and effectiveness of our procedures to implement, monitor and evaluate services, and initiatives that are supported by state-of-the-art infrastructure and systems.

TOWNGAS SERVICE PLEDGE

		May 1999 to April 2000
WE PLEDGE		WE ACHIEVED
Reliability	Uninterrupted gas supply	99.997%
	Restoration of gas supply within 24 hours	99.87%
Safety	Emergency Teams arrived on site within an hour ¹	99.95%
Appointments	Availability within 3 working days	1.23 working days on average
	Keeping appointments ²	95.10%
Speed and Convenience	Customer Service Hotline	
	– Calls answered within 5 rings	94.63%
	– Less than 1 minute to get access to our staff	93.36%
Service Attitude	Courteous and friendly ³	8.25 (maximum score:10)
Handling Suggestions	Handled written comments or suggestions within 3 working days	100%

1 Average 20.92 minutes

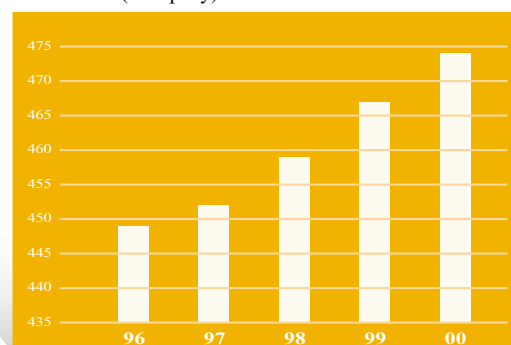
2 The percentage was based on results of monthly surveys conducted between May 1999 and April 2000

3 The result was based on monthly surveys conducted between May 1999 and April 2000 by an independent research company

GAS SUPPLY AND PIPELAYING PROJECTS

Planning and design work are in progress for the extension of gas supply to new areas of development. One of the strategic projects on hand is the Hong Kong International Theme Park that is being planned for Lantau Island. To prepare for the supply of gas to the area in 2005, new pipelines have been planned along the proposed road infrastructure. Pipelaying work for the Science Park at Pak Shek Kok started last year and the first phase will be completed in 2001, and work for the Cyberport in Telegraph Bay will commence in the same year. These large projects are forecast to bring substantial growth in gas sales.

**Number of Customers per km
of Mains (Company)**



We have extended our transmission and distribution network to a total of 2,925 kilometres. The largest project currently underway is the 24-kilometre Eastern Transmission Pipeline (ETP) in eastern New Territories. Work on this 3,500 kPa 750mm-diameter pipeline will be completed in phases, in tandem with urban developments in Hong Kong. The supply of gas to the urban areas will be reinforced when the ETP is completed. The network system will also add to our gas storage capacity.

Another project, the Western Harbour Submarine Pipeline (WHSP), linking the West Kowloon Reclamation Area to Sai Ying Pun over a total length of 1.9 kilometres, is scheduled to start. This 700 kPa 600mm-diameter submarine pipeline will further augment gas supply, as well as assure reliability of supply for Hong Kong Island.

Together with the Government and other public utilities, we are actively pursuing the adoption of advanced information technology. An Electronic Mark Plant Circulation System, connecting different utilities with the Government, is being developed to improve coordination and to minimise the impact of road works.

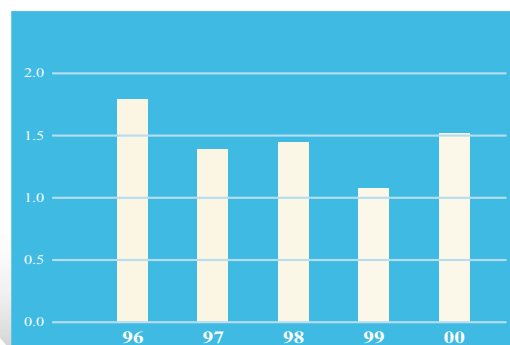
SAFETY

Safety and reliability in the delivery of gas to the territory's densely populated areas is critical to the success of Hong Kong because of its role as a major financial and business centre for Asia. At Towngas, this responsibility is clearly understood and accepted with appropriate seriousness.

In this regard, we are pleased to report a 53 per cent reduction in the number of third-party damage incidents to our gas pipes since 1997. The reduction was achieved through external safety education programmes for road contractors and an increase in inspection visits to work sites.

Several public safety improvements were also made last year, including the elimination of flueless water heaters for shower purposes, which was completed in August 2000; the introduction of newly developed cooking appliances with temperature control functions that automatically cut off gas supply when over-heating happens; and the increased use of stainless steel braided hoses in place of rubber hoses for connecting gas points to appliances, with more than 50 per cent of rubber hoses having been replaced to date.

Accident Frequency Rate (Company)
(Number of accidents per 100 thousand man hours)



Emphasis has always been placed on the continuous improvement of safety records. Stringent occupational safety standards are imposed, together with the implementation of safety programmes. The goal is to achieve zero accidents.

A safety management system allows us to closely monitor our safety performance and to ensure that our employees work in a safer, healthier and more pleasant environment.

We also initiated the formation of a Joint Utilities Safety and Occupational Health Policy Group to allow for effective communication with the Government. The intention is also to enable the major utilities to influence government policies and laws on safety and occupational health.

Our gas safety record has been excellent, and casualties or injuries resulting from gas incidents have been rare.

ENVIRONMENTAL PROTECTION

REDUCING EMISSIONS

Our utilisation of landfill gas from the Shuen Wan Landfill site for municipal gas production has proven to be successful. Last year, 10 million cubic metres of landfill gas were used, reducing carbon dioxide emission by 9,800 tonnes. The Group is actively considering the use of landfill gas from other landfill sites. Such use not only provides us with a new supply source, but also reduces our use of naphtha as feedstock. This in turn contributes to the conservation of energy resources and prevents emissions stemming from the burning of unutilised landfill gas.

We concluded two separate sales contracts for carbon dioxide — for dry ice and for liquid carbon dioxide. This helps make further use of the dry ice equipment that has been installed at our Tai Po Plant, which started operation last autumn, and converts the possible emission into products of economic value.