

Business Review

HONG KONG MARKET PERFORMANCE

The number of residential customers grew by 4.5 per cent during 2002, better than expected, given the slow-down in property developments and the Government's decision to stop selling Home Ownership Scheme flats. The industrial and commercial sector was also weak. As a result, overall gas consumption was trimmed, rising by a modest 0.3 per cent in the wake of a lacklustre economy and unseasonably warm weather throughout the year.

Residential Market

An innovative mix of marketing and policy strategies impacted bottom line profits last year, and continued to help position gas as an energy source of choice rather than just a commodity of necessity. By opening a second Towngas Avenue in the heart of the main shopping district in December 2002, we further expanded our highly successful customer store concept where we showcase quality gas products

in lifestyle settings. We also kept our own TGC brand at the forefront of customers' minds by launching a built-in hotplate with a super-durable surface in lustrous colours, designed to add style and convenience to kitchen layouts. In addition, we successfully promoted our extensive product range and services through Towngas exhibitions at busy shopping malls.

During 2002, we sold 13,750 gas dryers, inclusive of our newly introduced compact 2-in-1 washer/gas dryer, and over 16,000 of our highly convenient built-in rice cooker stoves. These products boost a household's monthly gas consumption by 30 per cent and 10 per cent respectively. A trade-up campaign to encourage installation of larger capacity water heaters also realised a remarkable 6.5 times more sales in this sector than in 2001, whilst teaming up with property developers stimulated bulk purchases of appliances.

“Promoting gas as a lifestyle choice and versatile energy source is enhancing the Company's bottom line”

TGC 2-in-1 washer/gas dryer has maintained the position as one of the most popular washer/dryers used by Hong Kong families.



Commercial and Industrial Market

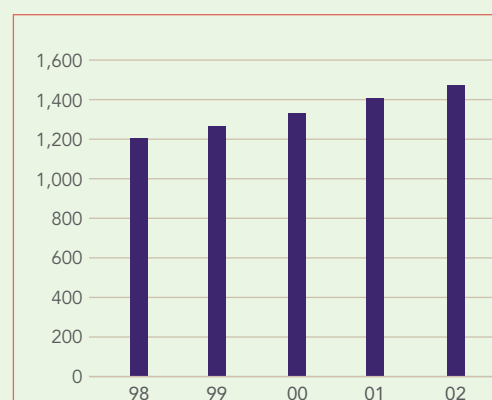
Economic sluggishness had a knock-on effect on Hong Kong's commercial sector over the last year, with both slow take-up of new property developments and mediocre business within the restaurant trade. Nevertheless, our most successful products – steam and hot water boilers, cabinet food steamers, dishwashers and absorption chillers amongst others – continued to be popular bolstered by professional gas cooking competitions, targeted campaigns and aggressive marketing.

We continued to support the Hong Kong Tourism Board's "Best of the Best Culinary Award" for the second year running, as this displays both the skills of the territory's gifted pool of elite chefs cooking with gas and advantages of town gas as a versatile energy source. Our team-up with the Bakery and

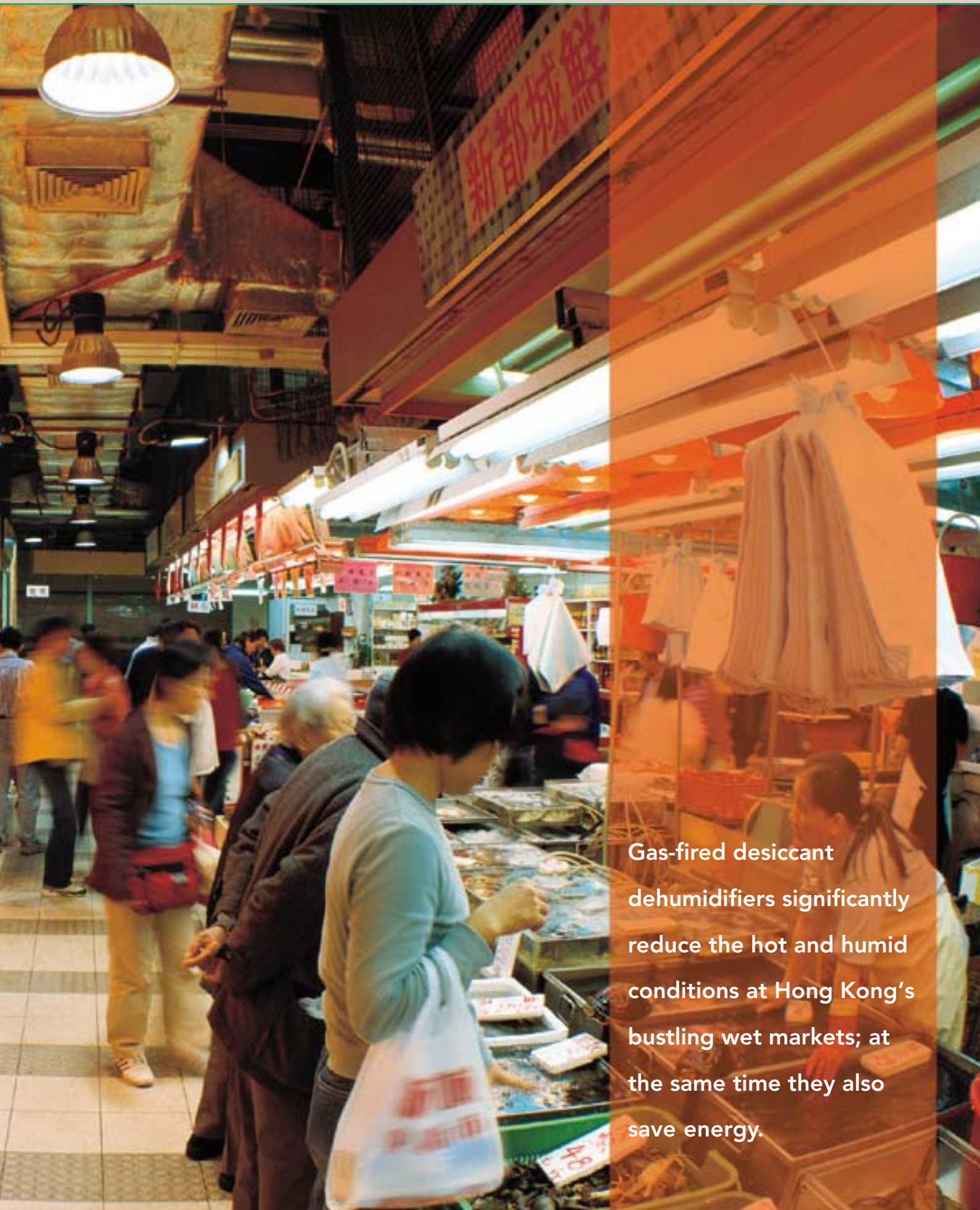
Confectionery Association to hold a Pie and Tart competition in June was similarly successful through promoting the creative gas baking techniques of our young chefs-about-town.

Number of Customers

Company (Thousand)





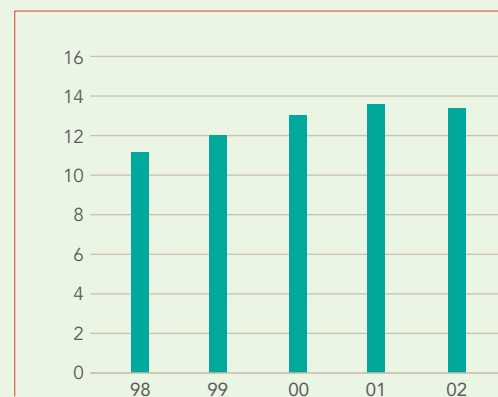


Gas-fired desiccant dehumidifiers significantly reduce the hot and humid conditions at Hong Kong's bustling wet markets; at the same time they also save energy.

Our reputation as a pioneer in the development of sophisticated gas technology products was boosted last year, following a Towngas and Housing Department joint research project which suggested that not only were the hot and humid conditions in one of Hong Kong's wet markets being brought down to a comfortable level by gas-fired desiccant dehumidification, but that energy savings of over 20 per cent were also being achieved. Gas desiccant dehumidifiers are therefore gaining ground as ideal building services equipment for complexes which need to ensure comfortable and reliable indoor air quality such as hospitals, function rooms, swimming pools and supermarkets.

Town Gas Sales per Employee

Company (million MJ)



Our new line of range hoods monitors temperature and smoke levels, and automatically adjusts to ensure proper ventilation.

The Airport Railway Hong Kong Station project, in which Towngas holds a 15 per cent interest, also offers promising demand for future gas utilisation. Targeted for completion in phases from 2003 to the end of 2004, this huge development will eventually provide six-star luxury hotel accommodation, a large shopping and entertainment complex and a grade A 88-storey office block in the heart of Hong Kong's central business and shopping district.

MAINLAND CHINA

China has strong environmental and strategic imperatives to bring clean fuels, and in particular natural gas, to its rapidly expanding city regions. Natural gas is expected to supply about 8 per cent of the mainland's energy needs by 2010, up from around 3 per cent in 2002, with this fast rate of growth anticipated to continue in the following decade. Towngas' well-regarded experience and close mainland connections add significant leverage to our China business ventures.

Strategic Joint Ventures

Towngas looks for major equity shareholding in our joint ventures (JVs) so as to best utilise our management expertise and gas experience to develop city piped gas projects into prosperous businesses. In addition, we seek terms and conditions which will ensure long-term investment returns. In line with this policy, we expanded our portfolio by concluding another seven joint venture deals during 2002. As a result, gas consumption grew by 130 per cent and net profit contribution by more than 180 per cent year-on-year. However, consumption will only really take off once natural gas becomes readily available. We anticipate that our investment will swiftly increase as our projected number of JVs rises from 12 in 2002, to 20 by 2005. Following approval from the Ministry of Foreign Trade and Economic Cooperation of China, Hong Kong & China Gas Investment Limited was established in 2002 to act as the asset management arm of the Company's mainland ventures and spearhead more efficient resource allocation among individual JVs.

The Pearl River Delta, essentially Hong Kong's manufacturing hinterland, is home to our three earliest JVs, all in Guangdong Province and all now profitable. In 2002, we added Guangzhou Jianke and are in the process of establishing a JV in Zhuhai. We will continue to actively seek investment opportunities in this region, which is fast becoming the new workshop of the world. Once the Guangdong Liquefied Natural Gas (LNG) Terminal comes into operation in 2006, gas consumption is expected to rapidly increase through city pipeline networks.

“China's search for energy security and clean fuels heralds the emergence of a vast market to support its fast-growing economy”