

CHAIRMAN'S STATEMENT



“The Group's businesses developed steadily in 2003... The Board of Directors looks forward to yet another year of steady growth in 2004.”

The Year's Results

The Group's businesses developed steadily in 2003. Total gas sales volume in Hong Kong rose by 1.4 per cent over the previous year. Profit attributable to shareholders for the year was HK\$3,051 million, an increase of HK\$3 million as compared with 2002. As there were share repurchases during 2003, earnings per share increased from HK 53.6 cents for 2002 to HK 53.9 cents for 2003.

During the year under review, the Group further invested HK\$677 million in pipelines and facilities. As at the end of 2003, the number of customers reached 1,520,166, an increase of 49,428 over 2002.

Business Development in China

The Group continues to expand its foothold on the mainland and invest in natural gas projects as a long-term strategic priority for its core business development.

China's entry into the World Trade Organization is boosting prosperity of the national economy leading to an increasing need for energy, in particular a surge in the demand for clean fuel. As the laying of natural gas trunklines is in progress, a national policy to improve the energy mix has been gradually implemented in cities nationwide. By encouraging the construction of natural gas infrastructure, the government strives to promote the use of natural gas to replace polluting fuels such as coal and heavy oil to enhance urban air quality. This national policy favours expansion of the Group's core business on the mainland.

Since the fourth quarter of 2003, the West-to-East gas pipeline has gradually started supplying natural gas to East China and this will soon extend to the

Group's city piped gas projects in Jiangsu, Anhui, etc., helping to drive rapid growth in commercial, industrial and residential gas consumption. Other areas will also be supplied with natural gas from 2005 onwards.

In 2003, the Group particularly focused on developing its mainland business within the economically prosperous regions of Guangdong, East China, Shandong and Central China where natural gas supply is imminent and achieved good progress. The Group has thus far concluded 24 city piped gas joint venture projects on the mainland, including those in large-scale cities such as Shenzhen, Nanjing, Wuhan and Jinan.

The Group's mainland joint ventures have been operating well and are gaining a reputation for safe operation and provision of quality services which is enhancing the Group's standing with municipal governments and local citizens and creating substantial positive media publicity.

In line with the Group's development strategy, our investment holding company, Hong Kong & China Gas Investment Limited, established in Shenzhen, Guangdong Province in early 2002, manages the Group's mainland businesses and is playing an important role in ensuring the effective development of our joint ventures.

Following the arrival of natural gas in various mainland regions, the Group will continue to negotiate with more cities for prime piped gas joint ventures taking into consideration of the economic development of the cities.

Impact of SARS Outbreak on Towngas' Business

The spread of Severe Acute Respiratory Syndrome (SARS) in Hong Kong, starting in mid-March 2003 and lasting for over three months, had a devastating impact on different business sectors due to the drastic fall in the number of inbound visitors and fragile local consumer sentiment. Although there was a rise in residential gas sales, the impact of the SARS outbreak on the restaurant and hotel sector led to a fall in commercial and industrial gas sales. As a result, overall gas sales volume for the year was lower than expected.

To bring relief to the restaurant and hotel sector in Hong Kong, the Group allowed this sector to apply for an extension of the credit payment period for two months for the period from May through July 2003. The response to this was favourable with about 3,000 customers benefiting from this measure, involving a combined bill amount totalling about HK\$200 million. In partnership with the Hong Kong Catering Industry Association, the Group also sponsored HK\$2 million for a four-month programme to promote hygiene in restaurants so as to revive consumer confidence in dining out.

Business for the restaurant and hotel sector has since improved following the containment of the SARS outbreak and removal of Hong Kong from the list of infected areas by the World Health Organization in late June 2003. During the second half of 2003, revival was further boosted due to the positive impact on Hong Kong's economy following the signing of the Closer Economic Partnership Arrangement between the mainland and Hong Kong and the implementation of a new mainland

policy which allows residents from Guangdong, Beijing and Shanghai to visit Hong Kong in an individual capacity.

Pipelaying Projects

Paralleling Hong Kong's development, several substantial pipelaying projects are at the planning stage or are currently underway. Construction of a 3,500 kPa 750 mm-diameter transmission pipeline in the eastern New Territories is progressing smoothly.

Pipelaying work for the extension of gas supply to an international theme park at Penny's Bay on Lantau Island commenced in March 2002 and is scheduled for completion in April 2004. Gas sales in Hong Kong are expected to increase once this theme park opens.

International and Local Recognition

The Group gives high priority to quality management, customer services and enhancement of shareholder value, all of which have consistently won us public recognition, both abroad and locally. In 2003, the Group continued to be rated as one of Hong Kong's top ten leading companies in the Far Eastern Economic Review's survey of Asian businesses. The Group was also rated as one of the top ten companies in Yazhou Zhoukan's 2003 Chinese Business 500 listing and retained fifth ranking for Hong Kong.

The Group has always promoted an innovative culture and provided our customers with creative products and services. In 2003, Towngas Avenue won the Innovation Grand Award in the 2003 Hong

Kong Awards for Services organised by the Hong Kong General Chamber of Commerce. The Group also won the Gold Award for "Most Effective Use of Corporate Identity, Product Design and Packaging" in the Asian Brand Marketing Effectiveness Awards organised by MEDIA magazine in 2003.

Property Developments

The Group has a 15 per cent interest in the Airport Railway Hong Kong Station project. Phase One office tower and shopping mall have been leased out. Phase Two comprises the 88-storey Two International Finance Centre office tower, which was completed in the second quarter of 2003; fourteen floors have been sold to the Hong Kong Monetary Authority for HK\$3,699 million and the leasing of the remaining floors is progressing well. Phase Two shopping mall was launched commercially in October 2003. IFC Mall has attracted a variety of international brand names and is the largest shopping and entertainment hub in Hong Kong's downtown, Central District. The project's six-star hotel tower and service apartment tower, both to be managed by Four Seasons Hotels and Resorts, are scheduled for completion by the end of 2004.

The Group has a 50 per cent interest in the Sai Wan Ho Ferry Concourse Development project. Construction of the superstructure, now in progress, is expected to be completed in 2005. Residential buildings with a total gross floor area of approximately 1.4 million square feet are being developed.

The Ma Tau Kok South Plant site is being developed into five residential apartment buildings, providing approximately 2,000 units, with a residential floor area of approximately 980,000 square feet and a total floor area exceeding 1.1 million square feet. Foundation work has already been completed; construction of the superstructure is now in progress. The project is due for completion in 2006.

Employees and Productivity

The number of employees engaged in the town gas business was 1,986 as at the end of 2003; the number of customers increased by about 49,000 compared with 2002. Overall productivity rose by 3.5 per cent. Total remuneration for employees involved directly in the town gas business amounted to HK\$654 million for 2003 compared to HK\$656 million for 2002. The Group offers our 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 of 23rd April 2004. Including the interim dividend of HK 12 cents per share paid on

20th October 2003, the total dividend payout for the whole year shall be HK 35 cents per share.

Barring unforeseen circumstances, the forecast dividends per share for 2004 shall not be less than that for 2003.

Future Outlook

Hong Kong's economy has been relatively sluggish in recent years. To ease financial burden on our customers, the Group has kept its gas tariff and monthly maintenance charge at 1998 levels throughout this period. The Group's success in cost control and productivity enhancement has helped alleviate the impact of this price freeze on business results. The Group will continue to expand and diversify into new markets to enhance business growth. The gradual improvement of Hong Kong's economy and a revival of local consumer sentiment are expected to benefit the Group's business development.

The Company expects an increase of about 3 per cent in gas sales volume and an addition of about 48,000 new customers in 2004. The Board of Directors looks forward to yet another year of steady growth in 2004.

Lee Shau Kee

Chairman

Hong Kong, 11th March 2004