





港华紫荆 BAUHINIA



Strong positive growth within the mainland is driving both a surging energy demand and a move to increase the share of natural gas as a primary energy source from the current 2.6 per cent to 10 per cent by 2015. Customer centres are the public face of our city-gas business and an important showcase for promoting Towngas' brand and service image.

By the end of 2005, our joint ventures had safely switched over 1.5 million homes from manufactured gas or other piped gaseous fuel to natural gas. Temporary shortages in electricity supply, soaring fuel prices, intensified prohibition on extensive use of coal, modernisation of state-owned enterprises, together with central government encouragement of foreign funds and expertise, all favour Towngas' increasing investment in natural gas infrastructure.

From Single Utility to Multi-Disciplined Corporation

Mainland China has a grossly different market mix from that of Hong Kong. With natural gas becoming progressively more available in municipal localities, there was an upsurge in demand from commercial, industrial and residential sectors during the year under review. In anticipation of such growth, we both enlarged our investment footprint from southern, eastern and central China in 2005, to embrace northern and

northeastern regions, and fine-tuned our strategy by targeting cities where natural gas consumption is predicted to reach over 100 million m³ within three years following the establishment of a joint venture (JV).

The Group initiated a new thrust during the year under review by expanding into the largely untapped water resources sector (see Diversified Businesses). This strategy signifies our faith in the enormous potential we believe is to be gained by

harnessing synergies between city-water and city-gas ventures. As a result, Towngas is rapidly changing from a single-disciplined utility into a multi-faceted enterprise.

City-Gas Businesses

The Group currently has 31 city-gas projects on the mainland spread across eight provinces and an area of Beijing. Profit contribution from JVs rose by 82 per cent during 2005. We are presently in close talks with some 20 other cities for possible collaboration.

In January 2005, we set up our first JV in the nation's capital, partnering with Beijing Gas Group to supply natural gas to Beijing Economic-Technological Development Area, a strategically-located enterprise zone that gives us a crucial foothold for expanding into northern China. This was followed in March by the

In a joint tri-partnership, Towngas is participating to construct a high-pressure natural gas pipeline system in Hangzhou that will eventually supply household, commercial and industrial business customers.





Bauhinia, Towngas' own made-for-the-mainland appliance brand launched in September, combines our heritage for quality products with our reputation for enhanced safety and reliability.

establishment of our first northeastern territory city-gas business in the city of Jilin, Jilin province. Our largest gas project to date was signed with Xian Natural Gas General Company in January 2006, and the JV is slated to be in operation by mid-2006. Famous as the gateway to the Silk Road and the northwest and an important industrial base for hi-tech products and services, Xian, the capital city of Shaanxi province, is expected to substantially boost the Group's revenues given its immense size and high economic growth rate.

Four strategic mid-stream schemes supplement our mainland city-gas developments, including an agreement signed in August 2005 with Shell Group and Hangzhou Gas Group to develop a high-pressure natural gas pipeline system in Hangzhou, Zhejiang province. With the completion of the West-to-East pipeline during 2005, and once commissioning of the Guangdong Liquefied Natural Gas (LNG) terminal occurs in 2006, natural gas will then be available in all our franchised cities, creating substantially larger market potential and hence improved profitability. Our experience shows that after conversion the majority of our JVs encounter rapid growth in gas demand as communities are incentivised to switch to natural gas once long-term availability is assured and as commercial and industrial sectors start to recognise the economic benefits of application.

Gas Related Businesses

With natural gas supply increasing, our JVs have been encouraged this last year to intensify their exploration of prospects for related businesses through vertical integration and horizontal extensions. Support for harnessing compressed natural gas as a clean and economic vehicular fuel is growing on the mainland, whilst opportunities for natural gas cooling and district energy distribution systems are also beginning to open up.

Towngas' own made-for-the-mainland appliance brand, Bauhinia, was launched in September 2005 and is generating good sales. Carrying the slogan "professional services, enhanced safety and reliability at home" Bauhinia hot plates, built-in hobs and water heaters are distributed through an increasing number of JV customer centres, to which we added 19 new ones during the year, bringing the overall total to 49. Customer centres focus on total-solution services and have welcoming interior designs that encourage hands-on browsing of exhibits. Our contemporary and courteous image, matched by quality products and high safety standards, is attracting favourable attention from the public and municipal officials and positively affecting Towngas' JVs by helping to position them as modern, professional, reliable and caring public utility companies.

Backbone of Investment Strategy

Hong Kong & China Gas Investment Limited (HCIL) is the asset management arm of our mainland initiative, tasked with strategic implementation and deployment of human resources, technology transfer, cost control and corporate and ethical governance. HCIL's successful management depends on effective execution and reflective leadership, coupled with long-term rather than short-term intent. To this end, Towngas brings a strong balance sheet, a solid reputation as a "foreign" investor with good international connections, extensive market intelligence, environmental expertise, risk management experience, and not least, a trustworthy name for high safety and technical standards.

For investments to be profitable however, accurate reading of market conditions is also required. Towngas, with a presence in mainland China since the early 90s, has built up a rich local knowledge, excellent relations with municipal governments and the media and a network of business associates. Through HCIL, we ensure potential ventures have the best chance to blossom and flourish in a diverse geographic, cultural and economic environment.

Professional Competency

During 2005, HCIL particularly concentrated on nurturing second-tier management through Hong Kong/mainland exchange and local graduate trainee programmes, and

on fostering a more flexible mindset amongst staff so they become more willing and able to set strategy and deploy resources whilst holding firm on direction. Priority was also given to engendering a partnership concept with JV colleagues in order to better grasp emerging opportunities in a timely fashion.

Shandong Training Institute, opened in June 2005, together with the training centres in Hong Kong and Guangzhou, helps to build up local talent at an ever-faster pace, narrowing regional diversities and distinct internal ways of working across JVs through skills' courses and promotion of a common corporate culture. These activities run in parallel with our highly

successful Superior Quality Service (SQS) programme. In 2005, SQS teams completed over 200 projects, some of which were presented to over 600 participants at a Quality Day held in Nanjing in October.

Our focus on professionalism, safety and technical competence is earning plaudits at the national and regional level. In April 2005, Guangzhou Training Centre (GTC) gained accreditation from the China Gas Association, quickly followed by its counterpart in Shandong in June. Further recognition came in November, when the Group successfully obtained a permit from Guangdong provincial government to train for, and conduct a number of, technical skill tests and assessments applicable to the gas trade generally. This is a notable tribute to the excellence of GTC, as elevation of a non-municipal unit to a vocational examination centre is extremely rare, and will surely enhance the status of Towngas within the mainland's gas industry.

Guangzhou Training Centre ensures a steady stream of engineers and technical staff are ready and able to meet our business needs on the mainland.



Towngas' Joint Ventures in Mainland China

(City piped gas and water businesses)



	Year of Establishment	Project Investment Rmb million	Registered Capital Rmb million	Equity Share
GAS PROJECTS				
Guangdong Province				
1 Panyu	1994	260	105	80%
2 Zhongshan	1995	240	96	70%
3 Dongyong	1998	132	53	80%
4 Jianke	2002	45	23	70%
5 Shenzhen	2004	1,257	472	30%
6 Shunde	2004	200	100	60%
Central China				
7 Wuhan	2003	1,200	400	50%
Eastern China				
8 Suzhou Industrial Park	2001	245	100	55%
9 Yixing	2001	246	124	80%
10 Taizhou	2002	200	83	65%
11 Changzhou	2003	248	166	50%
12 Nanjing	2003	1,200	600	50%
13 Zhangjiagang	2003	150	60	51%
14 Wujiang	2003	150	60	80%
15 Xuzhou	2004	245	125	80%
16 Danyang	2004	150	60	80%
17 Tongxiang	2003	83	58	76%
18 Huzhou	2004	200	87	95%
19 Maanshan	2003	248	108	50%
20 Anqing	2004	182	73	50%
Shandong Province				
21 Jimo	2001	37	19	90%
22 Laoshan	2002	60	30	60%
23 Zibo	2002	240	106	50%
24 Longkou	2002	84	42	100%
25 Weifang	2003	241	140	50%
26 Jinan	2003	410	390	50%
27 Weihai	2003	245	99	50%
28 Taian	2004	200	80	50%
Northern China				
29 Jilin	2005	247	100	63%
30 Beijing Economic-Technological Development Area	2005	111	44	50%
Northwestern China				
31 Xian	—*	2,034	—*	49%
WATER PROJECTS				
8 Suzhou Industrial Park	2005	3,000	2,123	50%
14 Wujiang	2005	970	300	80%
32 Wuhu	2005	700	300	75%

* JV Company to be established