

The continuous growth of Xi'an's economy and the local government's promotion of cleaner energy are boosting demand for natural gas to the advantage of our piped city-gas joint venture.



# Strengthening our position in mainland China



# Mainland China Gas Business

Demand for natural gas is expected to account for 7 per cent of the nation's total primary energy consumption by 2010, driven by rising urban and industrial requirements and government policies seeking to reduce polluting emissions caused by burning of coal. Towngas substantially extended its reach within mainland China in 2006 through a strategic partnership agreement with a leading piped city-gas operator.

## Accelerators for Strong Growth

The Group continued its coherent growth strategy during the year and focused on nurturing piped city-gas and water supply and wastewater<sup>1</sup> joint venture (JV) partnerships and developing on-shore liquefied natural gas (LNG) projects as an alternative form of energy supply.

Profit contribution to the Group increased by 46 per cent and turnover rose 65 per cent in 2006, inclusive of water projects.

A major leap forward in sustainable value creation occurred in December 2006 when we agreed to acquire an approximately 45 per cent equity stake in Panva Gas Holdings Limited (Panva Gas), a well-established mainland piped city-gas business, in exchange for ten Towngas piped city-gas projects in Shandong and Anhui provinces. The Group has subsequently appointed four executive directors, including the Chairman, to the board of directors of Panva Gas.

Beautiful Jilin, platform for gas growth in northeast China





The transaction will substantially boost the scale of Towngas' downstream piped gas distribution business by bringing another 25 piped city-gas projects to the Group's JV portfolio. In return, Panva Gas will improve its operational and acquisition competitiveness through injection of Towngas' management expertise, considerable financial resources and technical skills. With the ability to advance much more rapidly in locations where Panva Gas' network is firmly entrenched, such as the southwest and northeast of the country, the Group has gained a flagship vehicle to help leapfrog its previous piped city-gas expansion strategy.

A unified approach towards capital expenditure authorisation, management, audits, vendors, suppliers and service providers will benefit both companies in areas where current and future projects overlap. In addition, Towngas and

Panva Gas have become trustworthy partners in the restructuring of state-owned gas enterprises and are renowned for reliability, safety and excellent customer service. All these aspects will help underpin faster development of the Group's mainland business through its newly-acquired capability to leverage synergies of expansion and management.

### Piped City-Gas Businesses

Natural gas consumption in downstream domestic piped city-gas markets and from industrial applications is forecast to rise substantially in future years. In line with this prediction, turnover increased by 45 per cent and sales volume rose 51 per cent in 2006. This strengthening position is on track to intensify as the Group's network expands and new JVs are established.

Four further JVs were added to the Group's portfolio during the year. Yuhang, Tongling, and Jintan JVs increased our franchised area in eastern China where gas demand is expected to grow rapidly, especially from the industrial sector. Yingkou JV, our first in Liaoning province, and located within the Yingkou Economic and Technological Development Zone which houses a cluster of energy-thirsty industries, is projected to speed up the Group's development in the northeast of the country.

<sup>1</sup> See Diversified Businesses for water business in mainland China

## Mainland China Gas Business

Our largest piped city-gas project to date in Xi'an, Shaanxi province, started operating in November 2006, and now serves approximately 600,000 customers. It is already fulfilling expectations as an important stepping stone for business expansion into western China gas markets.

The addition of a further 25 piped city-gas projects following the strategic partnership with Panva Gas brought the Group's total number of piped city-gas projects to 60, spread across 11 provinces and an area of

Beijing, at close of deal in March 2007. We are currently in talks with a number of other cities regarding possible collaborative ventures.

### New Energy Businesses

Rapid urbanisation in mainland China, temporary shortages in peak-load power capacity, and a growing impetus to reduce atmospheric pollution are all influencing the push for cleaner burning fuels, particularly natural gas.

Towngas' expansion into two small upstream natural gas projects in 2006, in partnership with companies experienced in this kind of regional gas exploration and production, is well-aligned with the central government's commitment to become more energy-efficient and improve environmental protection. The JV in Shanxi province will make LNG from coalbed methane (CBM); the Yan'an JV in Shaanxi province will supply LNG from natural gas feedstock. Both projects are slated to start production by mid-2008. Each will contribute to reducing pollution and conserving natural resources such as fossil fuels, harness new forms of energy sources to supplement peak demand which existing piped gas supply will be unable to meet for some time to come, and develop an economical fuel for heavy-load vehicles, such as coal and oil transportation and container trucks.

Extraction of coalbed methane – producing cleaner-burning energy resource leading to reduction of greenhouse gas emissions



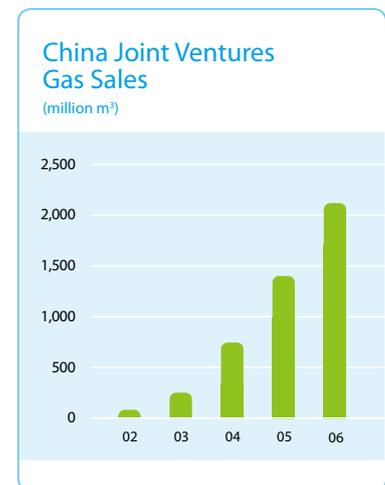
With the full support of provincial authorities and local officials, the JV agreement with Shanxi Jincheng Anthracite Coal Mining Group Co Ltd, signed in October 2006, gives Towngas a 70 per cent stake with a 30 year tenure in a methane liquefaction operation capable of processing up to 250,000 cubic metres per day. Shanxi province has the largest reserves of CBM resources on the mainland, particularly in its Qinshui basin where the project is based.

In the coal mining business, methane gas, pumped from underground seams, is normally flared off on site to the atmosphere to avoid dangerous build-up in the pits. However, this process is both a waste of energy and a creator of greenhouse gas, thus adding to air pollution. In contrast, the liquefaction, storage, sale and distribution of liquefied CBM is environmentally-friendly; tapping methane before coal is excavated will also help lower the number of mine accidents. Towngas will sell coalbed-produced LNG to energy-thirsty, affluent eastern coastal regions. Development of a piped network for transmission of CBM over long distances, as opposed to tanker transport, depending on scale, is also being explored as this is a potential under-exploited business opportunity.

The northern part of Shaanxi province is a rich source of natural gas. Towngas has signed a long-term contract with Shaanxi Zijing Energy Company Limited for a 70 per cent stake in a joint venture which will invest into a natural gas liquefaction facility. Following anticipated completion of the initial stage of the project by mid-2008, annual production is expected to be about 60,000 tonnes. Shaanxi JV will supplement supply to our downstream piped city-gas businesses and will have the capacity to replace diesel, currently used by some 2,000 coal-fleet vehicles in the locality, with more cost-effective and much less-polluting LNG. Potential demand for such fuel in the region is estimated to be around 88,000 tonnes per year.

### Other Gas-related Businesses

A further 13 new customer centres opened across mainland cities during the year, bringing our current total of one-stop-shop outlets to 59. These centres continue to set the benchmark for value-added services to gas customers and act as the main showcase for the Group's Bauhinia gas appliance brand.



## Mainland China Gas Business



Bauhinia appliances – safe, reliable, good-value, quality products

Several new Bauhinia products were unveiled at GASEX 2006 held in Beijing in September, all combining stylish elements with user-friendly features. Given the Group's large and rising customer base, substantial growth in sales is projected to continue and ultimately become a successful bottom-line contributor to the Group.

### Hong Kong & China Gas Investment Limited (HCIL)

HCIL is the strategic asset management arm of our mainland businesses and helps the Group leverage the huge market potential of the country across highly diversified geographic, cultural and economic environments. Established in 2002, HCIL has an excellent standing with our JVs and the gas industry generally due to its successful management style and supportive approach.

In future, HCIL will work closely with the management of Panva Gas whose mainland headquarters is, like HCIL, located in Shenzhen. Together, the Group will have an even stronger management team which will bring synergies of operation to our combined piped city-gas businesses.

### Enhancing and Expanding Professional Competency

HCIL advanced its development strategies for second tier management staff in 2006, particularly through a variety of training schemes. The objective is to ensure the Group has a deep-enough pool of talented and knowledgeable employees ready to seize opportunities and overcome challenges in the years ahead. High priority is given to nurturing the leadership potential of mainland young executives by exposing them to different work environments and

culture, especially through an exchange scheme that brings JV employees to Towngas' Hong Kong headquarters for six-monthly attachments.

A further way in which we seek to encourage creative ideas and interactive teamwork of mainland colleagues is through our Superior Quality Services (SQS) scheme, an in-house continuing improvement programme. In 2006, 26 JVs completed over 300 SQS projects. Our technical training programmes also continue to be a role model for the mainland gas industry and help to underpin the Group's growing reputation and influence within the gas profession. Currently, HCIL has two technical training facilities, one located in Guangdong province and the other in Shandong province. Both run courses to enhance professional skills in gas engineering and services.

## Towngas' Joint Ventures in Mainland China

(Piped city-gas and water businesses)



	Year of Establishment	Project Investment Rmb million	Registered Capital Rmb million	Equity Share		Year of Establishment	Project Investment Rmb million	Registered Capital Rmb million	Equity Share
<b>GAS PROJECTS</b>					<b>GAS PROJECTS</b>				
<b>Guangdong Province</b>					<b>Shandong Province</b>				
1 Panyu	1994	260	105	80%	24 Jimo	2001	37	19	90%
2 Zhongshan	1995	240	96	70%	25 Laoshan	2002	60	30	60%
3 Dongyong	1998	132	53	80%	26 Zibo	2002	240	106	50%
4 Jianke	2002	45	23	100%	27 Longkou	2002	84	42	100%
5 Shenzhen	2004	2,316	772	30%	28 Weifang	2003	241	140	50%
6 Shunde	2004	200	100	60%	29 Jinan	2003	410	390	50%
<b>Central China</b>					<b>Northern China</b>				
7 Wuhan	2003	1,200	420	50%	30 Weihai	2003	245	99	50%
<b>Eastern China</b>					<b>Northern China</b>				
8 Suzhou Industrial Park	2001	245	100	55%	31 Taian	2004	200	80	50%
9 Yixing	2001	246	124	80%	<b>Northern China</b>				
10 Taizhou	2002	200	83	65%	32 Jilin	2005	247	100	63%
11 Changzhou	2003	248	166	50%	33 Beijing Economic-Technological Development Area	2005	111	44	50%
12 Nanjing	2003	1,200	600	50%	34 Yingkou	2006	80	40	100%
13 Zhangjiagang	2003	150	60	51%	<b>Northwestern China</b>				
14 Wujiang	2003	150	60	80%	35 Xi'an	2006	1,668	1,000	49%
15 Xuzhou	2004	245	125	80%	<b>WATER PROJECTS</b>				
16 Danyang	2004	150	60	80%	8 Suzhou Industrial Park	2005	3,500	2,123	50%
17 Tongxiang	2003	83	58	76%	14 Wujiang	2005	1,500	300	80%
18 Huzhou	2004	200	87	95%	36 Wuhu	2005	700	300	75%
19 Maanshan	2003	248	108	50%					
20 Anqing	2004	182	73	50%					
21 Jintan	2006	150	60	60%					
22 Tongling	2006	240	100	70%					
23 Yuhang	2006	240	160	50%					