The Group made significant progress in operations management and project development in 2005. During the year, cost of sales was successfully kept in check through better realignment of resources despite the rising prices of LP Gas. The piped gas business also achieved encouraging results on target, with new development projects secured in seven PRC cities.

CHEN Wei
Managing Director

Review of Operations

For the year ended 31 December 2005, the Group recorded a turnover of approximately HK$2,324,100,000, an increase of 29.1% over the previous year. Gross profit increased by 54.3% to approximately HK$689,560,000. Due to impact of the changes in fair value of derivative financial instruments, profit attributable to equity holders of the Company decreased by 45.4% to approximately HK$155,777,000.

Sale of LP Gas in Bulk

Sale of LP Gas in bulk comprises the direct sale of LP Gas to wholesale customers in large quantities which are delivered by tank lorries and tank vessels. It remained a principal activity of the Group in 2005, benefiting from the Group's strong efforts to further realign its resources. Such efforts included the strengthening of communications and co-operations with up-stream enterprises on the one hand and the standardization of purchasing on the other hand. By centralising purchases, maintaining inventory at reasonable levels, expanding sourcing and reducing transportation costs, the Group has successfully contained its cost of sales. As a result, the wholesale business maintained solid development despite the rising costs of LP Gas in the PRC. For the year ended 31 December 2005, the business recorded a turnover of HK$854,189,000 which was approximately the same as last year, accounting for approximately 36.8% of the Group's total turnover.

Retail of LP Gas

This business comprises the direct sale of LP Gas in cylinders to end-user customers. During the year, rising prices of LP Gas coupled with strained supply in some of the PRC cities presented severe challenges to gas fuel operators. Small and medium sized LP Gas firms with low efficiencies were driven out of the market. As a result, the Group was able to secure a solid growth in sales as well as a higher market share in the retail of LP Gas. Turnover derived from the business grew by 39.3% to approximately HK$574,474,000 in 2005, accounting for approximately 24.7% of the Group's total turnover.

As at 31 December 2005, the Group had approximately 2,300,000 households of end-user customers covering 8,740,000 people for its retail sale of LP Gas in cylinders, an increase of approximately 200,000 households over the corresponding figure at 31 December 2004.

Sale of Piped Gas

This business comprises the direct sale of piped natural gas, piped LP Gas and piped coal gas to end-user households. Turnover of the business increased by 130.3% to approximately HK$153,102,000, accounting for approximately 6.6% of the Group's aggregate turnover derived from the gas fuel businesses in 2005.

As at 31 December 2005, the Group had approximately 753,000 households of end-user customers for its sale of piped gas, an increase of approximately 297,000 households over the corresponding figure at 31 December 2004. The increase in end-user customers was due to new piped gas connections as well as new city piped gas projects acquired during the year.

Gas Pipeline Construction

The Group's gas pipeline construction business mainly includes the development and maintenance of piped gas stations and networks through which the Group provides direct connection of piped gas to end-user households and receives a connection fee. For the year ended 31 December 2005, the Group received approximately HK$712,068,000 in connection fee, an increase of approximately 65% over last year. The amount accounted for approximately 30.6% of the Group's total turnover in 2005, compared to approximately 24.0% last year.

The Group has made gas pipeline construction a long-term core business, which not only brings revenue at a higher gross profit margin but also facilitates the expansion of piped gas distribution. While making solid efforts to increase its penetration in the existing piped gas market, the Group is also striving to obtain more piped gas projects by leveraging on the gas pipeline development business.

Administrative Expenses

The Group's administrative expenses increased significantly from HK$85,441,000 in 2004 to HK$165,487,000 in 2005, representing an increase of approximately 93.7%. This is because of the amortisation of share option expenses increased from HK$2,733,000 in 2004 to HK$16,129,000 in 2005 in connection with the share options granted in November 2004. Legal and professional increased from HK$1,675,000 in 2004 to HK$21,510,000 in 2005 due to professional fees incurred for the switch from the growth entreprise market ("GEM") to the Main Board of the Stock Exchange in 2005. Staff costs also increased from HK$27,424,000 in 2004 to HK$40,257,000 in 2005, mainly due to an increase in the number of operating subsidiaries in 2005.

Acquisition of New Projects

The Group continued to accelerate its new project development in 2005 and gained major breakthroughs and achievements. On the piped gas front, the Group further strengthened its strategic position in Sichuan and the northeastern PRC region while increased its market penetration in Guangdong, the number one PRC province in terms of economic development. A total of seven projects were secured during the year concerning piped gas distribution and gas pipeline construction in cities that included Jianyang in Sichuan province, Tieling, Chaoyang and Benxi in Liaoning province, and Shaoguan and Qingyuan in Guangdong province. Moreover, discussions on several major LP Gas projects have reached final stages and are expected to be concluded in 2006.

Sichuan Jianyang Project

The Group through its wholly-owned subsidiary Panriver Investments Company Limited ("Panriver Investments") entered into an acquisition agreement with Jianyang Development Bureau to acquire 100% equity interest in Jianyang Natural Gas Company for a consideration of RMB28,500,000. Lezhi Panva Gas Co., Ltd., another wholly-owned subsidiary of the Group, has taken up a 10% interest in Jianyang Natural Gas Company which was renamed as Jianyang Panva Gas Company Limited ("Jianyang Panva Gas"). As part of the acquisition, Jianyang Panva Gas was granted an exclusive right to operate natural gas business in Jianyang city for 30 years.

Jianyang occupies an area of approximately 2,215 square kilometres, with a population of approximately 1,430,000 and connectable natural gas households of approximately 376,000. Located in the western part of Sichuan Basin, Jianyang is 55 kilometres from Chengdu, the provincial capital of Sichuan, and adjacent to the state-endorsed Chengdu Economic and Technological Development Zone. As such, Jianyang is well positioned to benefit from the eastern and southern developments of Chengdu. Armed with provincial-class tourism, economic and technological development zones, Jianyang is a city with highly promising prospects in the Chengdu Plain Economic Circle. Its prime location, outstanding competitive advantages, strong economic infrastructure and well-integrated strengths provide a favourable market for natural gas development.

Jianyang Panva Gas is principally engaged in the provision of natural gas, with ancillary businesses that include the design and installation of natural gas facilities, the repair and maintenance of natural gas utensils, the retail of natural gas equipment and parts, and the retail of building materials.

Shandong Jinan Project

Panriver Investments has entered into a joint venture agreement with Jinan City Gas Company ("Jinan Gas") and an independent third party in relation to the establishment of Shandong Panva Gas Co. Ltd. ("Shandong Panva") to operate the piped natural gas businesses in the Jiancheng District, the western part of Jinan city, Shandong province, with an exclusive operating right for 30 years. According to the agreement, Shandong Panva will have a registered capital of RMB400,000,000, of which Jinan Gas will contribute 50% or RMB200,000,000, Panriver Investments will contribute 48% or RMB192,000,000, and the independent third party will contribute 2% or RMB8,000,000.

As major province of the PRC, Shandong has a well-developed economy and is one of the eminent coastal provinces open to foreign investment. Being the capital city of Shandong province, Jinan is the political, economic and cultural centre of the province. It ranks among the "Top 50" PRC cities in terms of economic strength and the "Best 40" PRC cities in terms of investment environment. It enjoys a sub-provincial city status granted by the State, with five districts, four municipalities and one city under its jurisdiction. Jinan occupies an area of 8,227 kilometres with a total population of approximately 5,820,000, of whom 2,700,000 reside in the city district. The operational area of Shandong Panva will cover a population of 1,150,000 accounting for approximately 50% of the population in the Jiancheng District. It is expected that the population in the Jiancheng District will grow to 2,000,000 by 2020 with connectable natural gas households of 525,000. The Group has obtained the necessary approvals for the project subsequent to 31 December 2005.

Liaoning Benxi Project

Panriver Investments has entered into an asset transfer agreement with the Benxi People's Government State Assets Supervision & Management Committee (the "Benxi People's Government') to acquire 80% of the state-owned equity right of Benxi Town Gas Company ("Benxi Town Gas") at a consideration of RMB78,200,000, which holds a 30-year concession to operate the piped coal gas business in Benxi, Liaoning province. Panriver Investments and the Benxi People's Government have established a new joint venture company named Panva Benxi Gas Company Ltd. ("Panva Benxi") which has a registered capital of RMB97,800,000.

Benxi is well-known for its steel, coal, medical, chemical and mechanical industries. Located near the city of Shenyang, the capital city of Liaoning province, Benxi occupies an area of approximately 8,420 square kilometres with a population of over 1,560,000, of whom 790,000 reside in the city district. Benxi recorded a GDP of RMB29,360 million in 2004. With economic revitalisation and urbanisation gaining pace in the northeastern PRC, Benxi is expected to record a steady increase in piped coal gas users providing strong profit growth potential for Panva Benxi.

Panva Benxi is principally engaged in the provision of piped coal gas and the installation of related facilities in Pingshan district, Mingshan district and part of Xihu district in Benxi. The Group has obtained the necessary approvals for the project subsequent to 31 December 2005.

Liaoning Tieling Project

Panriver Investments has entered into an asset transfer agreement with the Tieling Rural Construction Committee ("Tieling Rural Construction") to acquire 80% of the state-owned equity right of Tieling Town Gas Company ("Tieling Town Gas") for a consideration of RMB39,368,000, which holds a 30-year concession to operate the piped gas business in Tieling, Liaoning province. Panriver Investments and Tieling Rural Construction will establish a new joint venture company named Tieling Panva Gas Co. Ltd. ("Tieling Panva") which will have a registered capital of RMB49,210,000.

Located in the northern area of Liaoning province, Tieling is part of the hinterland to Liaodong Peninsula and a major producing area of grain and livestock in the province. Tieling has 29 kinds of mineral resources and accounts for 30% of the coal reserve in Liaoning province. Tieling occupies an area of approximately 13,000 square kilometres with a population of over 3,000,000, of whom 435,000 reside in the city district. Tieling recorded a GDP of RMB216,100,000 in 2004. There are large reserves of coal mine and coal bed methane in the vicinity of Tieling which provide a reliable supply of coal gas to Tieling Panva.

Tieling Panva will be principally engaged in the provision and sale of piped gas, the planning, construction, design and installation of gas pipelines, the provision of gas fuel to automobile, the construction of gas fuel refilling stations, and the sale of gas fuel household appliances. The Group has obtained the necessary approvals for the project subsequent to 31 December 2005.

Liaoning Chaoyang Project

Panriver Investments has entered into an asset transfer agreement with the Chaoyang People's Government State Assets Supervision & Management Committee (the "Chaoyang People's Government") to acquire 90% of the state-owned equity right of Chaoyang Town Gas Company ("Chaoyang Town Gas") for a consideration of RMB80,324,000, which holds a 30-year concession to operate the piped gas and LP Gas businesses in Chaoyang, Liaoning province. Panriver Investments and Chaoyang People's Government will establish a new joint venture company named Chaoyang Panva Gas Co. Ltd. ("Chaoyang Panva") which will have a registered capital of RMB89,249,000.

Located in the western part of Liaoning province, Chaoyang is rich in mineral resources and has the largest iron reserve in western Liaoning. Chaoyang occupies an area of approximately 20,000 square kilometres with a population of over 3,360,000, and ranks the top city of Liaoning province in terms of labour resources. It is also one of the ten major gold producing areas in the PRC.

Chaoyang Panva will be principally engaged in the desulphurization, purification, storage, pressure regulating and transportation of coal gas, the engineering, installation, maintenance and sale of gas fuel household appliances, and the provision of LP Gas. The Group has obtained the necessary approvals for the project subsequent to 31 December 2005.

Guangdong Qingyuan and Shaoguan Projects

In December 2005, Panriver Investments entered into an asset transfer agreement with three companies in the PRC to acquire 100% of Shaoguan Keguang Piped Gas Co Ltd ("Shaoguan Keguang") and 80% of Qingyuan Beike Languang Piped Gas Co. Ltd ("Qingyuan Beike") for a total consideration of RMB124,800,000, which hold a 30-year concession to operate the piped gas business in Shaoguan and Qingyuan, Guangdong province.

Located in northern Guangdong province, Shaoguan is the hub of heavy industry in Guangdong. It occupies an area of 18,385 square kilometres with a population of approximately 3,130,000 in 2002. Shaoguan Keguang is principally engaged in the development, construction and operation of piped gas, gas fuel facilities and technology development, the sale, operation and refilling of gas cylinders, the sale of electronic appliances, the sale, installation, testing and maintenance of gas fuel household appliances, and piped gas engineering and installation.

Qingyuan is located in the mid-north region of Guangdong province. Being part of the midstream and downstream area of Beijiang, Qingyuan is served by an extensive transportation network. It occupies an area of 19,500 square kilometres with a population of approximately 3,899,700 in 2003. In 2004, Qingyuan recorded a GDP growth of 19.6% over 2003, ranking it the strongest city in Guangdong province in terms of economic growth. Qingyuan Beike is principally engaged in the development, construction and operation of city piped gas, and the sale of gas fuel household appliances, kitchenware, electronic appliances and etc. As of the date of this report, the Group is still awaiting regulatory approvals for the companies.

Available for Sale Investments

Available for sale investments is mainly made up of the Group's investment in Chengdu City Gas Co., Ltd.

Corporate Culture

During the year, the Panva Professional Managers Club has been formally established. This organisation aims to foster stronger ties among the Group's professional managers and provide them with a venue to share their life experience and management expertise. The Panva Professional Managers Club has successfully organised the first competition on painting, calligraphy and photography and the 2005 Panva Forum. During the year, the Company also launched e-Bulletin, an electronic interactive platform designed for the enhancement of internal communications between the Company and its staff.

New mileage was gained in the Group's staff training programmes, marked by the wider variety of subjects and more in-depth contents. The extensive subjects ranged from management (for instance the course on "Earnings Models of LP Gas Enterprises") and technology to professional know-how such as gas safety, financial analysis, legal matters such as the "New Company Law", and personal quality enhancement such as the course on "Corporate Manners". Classes were held in multiple manners, such as intensive workshops on business and administration learning, overseas inspection trips, panel discussions, and internal and external talks and seminars.

Enhancement of Safety in Operations

Safety is the paramount concern of the Group in carrying out its gas fuel operations. During the year, apart from organising several training courses and fire drills to enhance safety management, the Group also launched various programmes to educate customers and promote gas safety in the communities, families and schools.

The Group also achieved new breakthroughs in operations management. The headquarters was positioned as the centre of strategic planning and decision as well as cultural and service development for the Group's overall operations. Apart from exercising hands-on management of all regional operations and targeting their specific needs, the Group also strengthened its realignment of resources and adopted centralised purchases to capitalise on the Group's economies-of-scale advantages.

More stringent control was adopted in the Group's piped gas operations to reduce production costs and increase the accountability of the management teams. On the external front, "one-stop" service was introduced to the communities emphasizing continued improvement and innovation to enhance the Group's brand name prestige.

While capitalising on its economies-of-scale advantages, the Group also adopted various means to distinguish itself in the bulk LP Gas market. This was achieved through the introduction of new high-end products and the provision of strong technological support, which significantly increased the value of the Group's product range. Presently, the Group's wide variety of products include clean LP Gas, high clean LP automobile gas, industrial LP Gas, high power mixed gas and propane.

In the retail market, the Group launched unique promotional drives for its LP Gas leveraging on the Group's strong brand name, effective operational system and sophisticated management. In the wholesale market, the Group continued to keep abreast of market development and make improvements to its sales operations by paying attention to the feedback of major customers.

Listing of the Company on the Main Board of the Stock Exchange

As announced on 3 May 2005, the Company had applied to the Stock Exchange for the listing of the Shares on the Main Board by way of introduction (the "Listing"), with Merrill Lynch (Asia Pacific) Limited acting as the Company's sponsor. The Stock Exchange subsequently approved the Listing. Following the passing of an ordinary resolution by shareholders at the Company's extraordinary general meeting to approve the Listing, the last day of dealings in the Shares on the GEM was 7 December 2005 and dealings in the Shares on the Main Board commenced at 9:30 a.m. on 8 December 2005. The stock code of the Company is 1083.

Contingent Liabilities

The Group has no material contingent liabilities as at the balance sheet date.

Financial Position

As at 31 December 2005, the Group's cash and cash equivalents amounted to approximately HK$986,411,000 which were mostly denominated in Renminbi, Hong Kong dollars and United States dollars.

As at 31 December 2005, the Group's bank loans and other borrowings amounted to approximately HK$2,015,305,000, of which approximately HK$1,916,042,000 arose from the issue of guaranteed senior notes in September 2004 and the Group's issue of 5-year convertible bonds in April 2003. The Group ended the year under review with a current ratio of approximately 2.3 times and a gearing ratio (net debt to equity attributable to the holders to the parent) of approximately 50.3%. The strong financial position enables the Group to undertake new development projects.

Total assets pledged in securing these bank loans had a net book value of approximately HK$40,432,000 as at 31 December 2005.

In September 2004, the Company issued guaranteed senior notes, which carry a fixed interest rate of 8.25%. With a substantial amount raised from the guaranteed senior notes, there is a cost of carry for amounts that have not been invested by the Company and in order to reduce such a carrying cost, the Company entered into an interest rate swap agreement with Morgan Stanley Capital Services Inc. ("Morgan Stanley Swap") in September 2004 and a subsequent swap agreement with Credit Suisse First Boston ("CSFB Swap") in March 2005. Pursuant to the terms of the swaps, the Company's effective interest rate liability for the guaranteed senior notes is subject to changes in LIBOR (in the case of the Morgan Stanley Swap) and in the USD 30-year CMS and USD 2-year CMS constant maturity swap rate, or CMS rate (in the case of the CSFB Swap).

Although the Company implemented certain mechanism into the structure of the two swaps to mitigate the rising interest rates, the magnitude and pace of short term interest rate hikes were out of our expectation and to certain extent market expectation. A poor judgment by the management has resulted in higher interest expenditure in 2006; however the impact of the higher interest rate for 2006 was offset by the interest savings enjoyed by the Company in 2004 and 2005.

In addition, the Company has adopted HKAS 39, governing the recognition and measurement of financial instruments, with effect from 1 January 2005. Under HKAS 39, from 1 January 2005 onwards, all derivatives that are within the scope of HKAS 39 are required to be carried at fair value at each balance sheet date regardless of whether they are deemed as held for trading or designated as effective hedging instruments. Under HKAS 39, derivatives are deemed as held-for-trading financial assets or financial liabilities, unless they qualify and are designated as effective hedging instruments. For derivatives that are deemed as held for trading, which include the Morgan Stanley Swap and the CSFB Swap, changes in fair value must be recognized in the Company's profit and loss account for the period in which they arise.

The fair value of these swaps as at 31 December 2005 was estimated to be approximately negative HK$328 million, which was based on market prices quoted from financial institutions for equivalent instruments on 31 December 2005. This amount includes derivatives recognized at fair value of approximately negative HK$101 million as at 1 January 2005, and changes in the fair value of interest rate swaps of approximately HK$208 million, which was recognized as a loss in the Company's consolidated income statement for the year ended 31 December 2005.

The management of the Company will continue to evaluate and monitor the impact of the interest rate swaps and will reduce the exposures caused by the interest rate swaps to their minimal.

Employees and Remuneration Policies

As at 31 December 2005, the Group had 3,818 employees, an increase of 16.72% from a year ago. Approximately 99% of the Group's employees are located in the PRC. The Group remunerates its employees based on their individual performance, job nature and responsibility. Moreover, the Group provides training and various benefits for its employees including medical welfare, provident funds, bonuses and other incentives. The Group also encourages its employees to pursue a balanced life and provides a good working environment for its employees to maximise their potential and contribution to the Group.

PROSPECTS

Looking ahead, the Group will further enhance its corporate culture and social contribution in 2006 while focusing on the following development works:

- further expanding the Group's economies-of-scale through mergers and acquisitions and new project development;
- prudently seeking for new projects of higher investment returns while adhering to the Group's well-tested selection criteria;
- focusing on the development of piped gas projects while expanding the Group's LP Gas business in selective PRC cities;
- further standardising the Group's operations and enhancing the returns of existing projects through effective cost reduction measures and realignment of resources; and
- strengthening the Group's co-operations with up-stream enterprises to ensure a reliable gas fuel supply.

Appreciation

On behalf of the Board, I would like to take this opportunity to express our gratitude to all staff for their devoted efforts in 2005. I would also like to thank the family members of our staff for their support and understanding during the year.

By Order of the Board

CHEN Wei
Managing Director

Hong Kong, 24 April 2006