

新奥燃气控股有限公司*

XINAO GAS HOLDINGS LIMITED

(incorporated in the Cayman Islands with limited liability)

北京新奥
燃气有限公司

annual report 2001

* For identification only



C O N T E N T S

1	Characteristics of GEM
2	Corporate Information
4	Operational and Financial Summary
7	Chairman's Statement
11	Areas of Operations
13	Business Review
28	Directors, Senior Management and Staff
31	Directors' Report
38	Auditors' Report
39	Consolidated Income Statement
40	Consolidated Balance Sheet
41	Balance Sheet
42	Consolidated Statement of Recognised Gains and Losses
43	Consolidated Cash Flow Statement
44	Notes to The Financial Statements
81	Financial Summary
82	Notice of Annual General Meeting

Characteristics of the Growth Enterprise Market (“GEM”) of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”)

▶▶ GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which these companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the Main Board and no assurance is given that there will be a liquid market in the securities traded on GEM.

The principal means of information dissemination on GEM is publication on the Internet website operated by the Stock Exchange. GEM-listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website at “www.hkgem.com” in order to obtain up-to-date information on GEM-listed issuers.

BOARD OF DIRECTORS

Wang Yusuo
Yang Yu
Zhao Jinfeng
Qiao Limin
Jin Yongsheng
Yu Jianchao
Zhao Baoju (*Non-executive Director*)
Wang Guangtian
(*Independent non-executive Director*)
Xu Liang (*Independent non-executive Director*)

COMPLIANCE OFFICER

Yang Yu

QUALIFIED ACCOUNTANT AND COMPANY SECRETARY

Cheng Chak Ngok, AHKSA, ACCA, ACS, ACIS

AUTHORISED REPRESENTATIVES

Yang Yu
Cheng Chak Ngok

MEMBERS OF THE AUDIT COMMITTEE

Wang Guangtian
Xu Liang
Yu Jianchao

REGISTERED OFFICE

Ugland House
P O Box 309
South Church Street
George Town
Grand Cayman
Cayman Islands
British West Indies

PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Room 4202
Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong

HEAD OFFICE IN THE PRC

Huaxiang Road
Langfang Economic and Technical Development Zone
Langfang City
Hebei Province
The PRC

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE IN THE CAYMAN ISLANDS

Bank of Butterfield International (Cayman) Ltd
Butterfield House
Fort Street
P O Box 705
George Town
Grand Cayman
Cayman Islands
British West Indies

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Central Registration Hong Kong Limited
Rooms 1901-5, 19th Floor, Hopewell Centre
185 Queen's Road East
Wanchai
Hong Kong



STOCK EXCHANGE LISTING

The Growth Enterprise Market of
The Stock Exchange of Hong Kong Limited

STOCK CODE

8149

SPONSOR

N M Rothschild & Sons (Hong Kong) Limited
16th Floor, Alexandra House
16-20 Chater Road
Central
Hong Kong

AUDITORS

Deloitte Touche Tohmatsu
Certified Public Accountants
26th Floor, Wing On Centre
111 Connaught Road Central
Hong Kong

LEGAL ADVISER

Woo, Kwan, Lee & Lo
27th Floor, Jardine House
1 Connaught Place
Central
Hong Kong

PRINCIPAL BANKERS

Agricultural Bank of China

Langfang Development Zone Branch
Huaxiang Road
Langfang Economic and Technical Development Zone
Langfang City
Hebei Province
The PRC

China Construction Bank

Langfang Anci District Branch
25 Yinhe Main Road
Langfang City
Hebei Province
The PRC

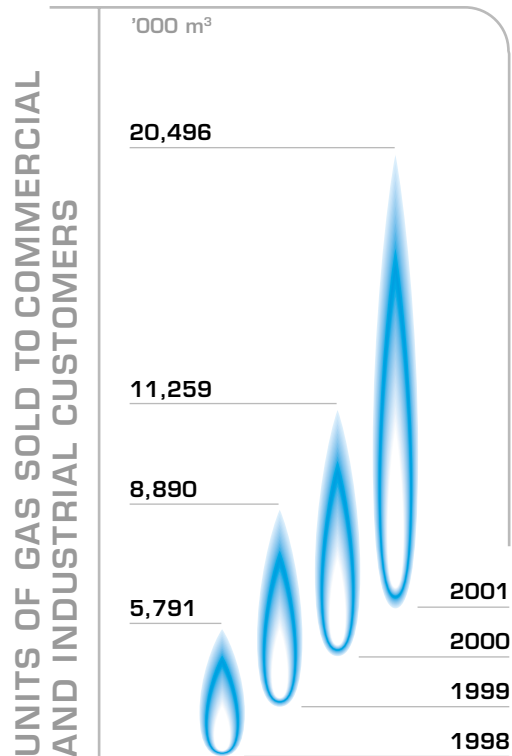
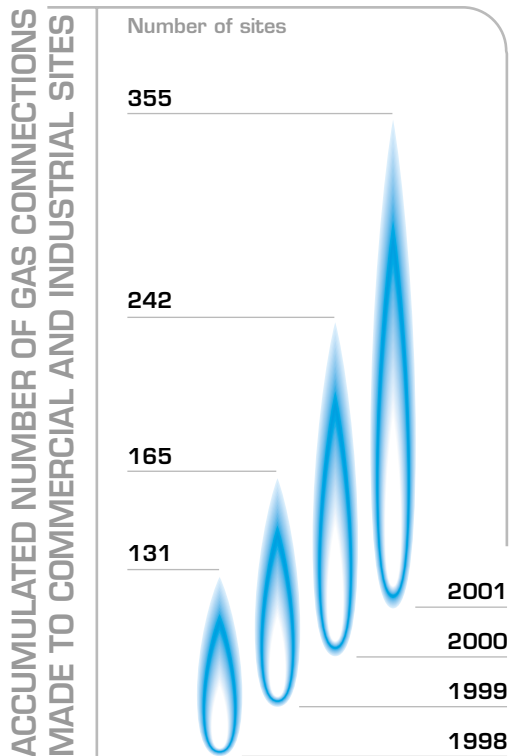
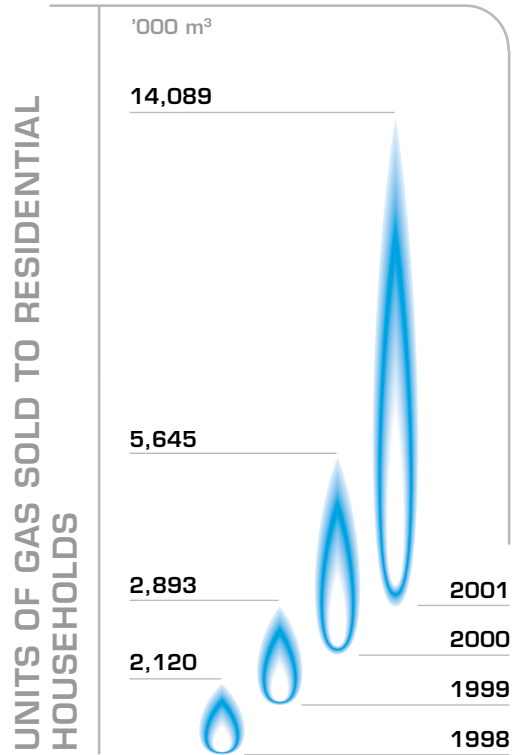
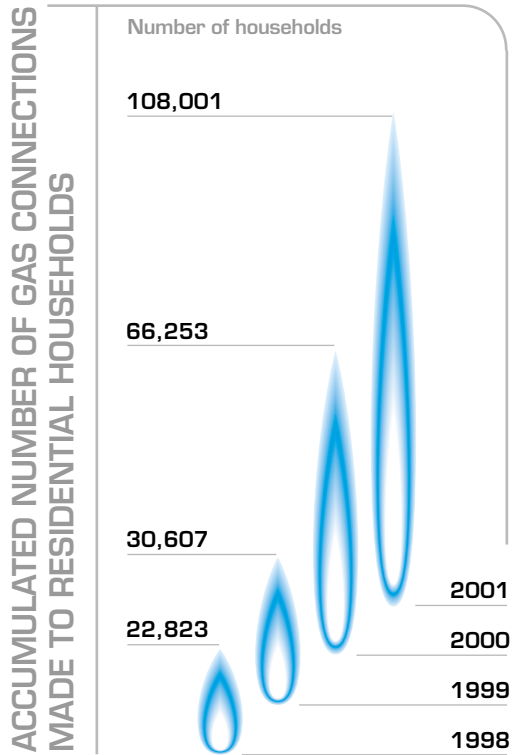
Bank of China (Hong Kong)

Ground Floor
131-133 King's Road
North Point
Hong Kong

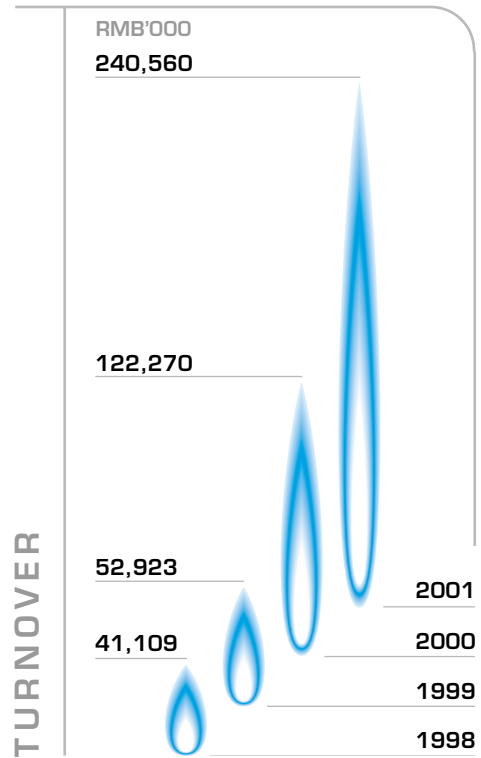
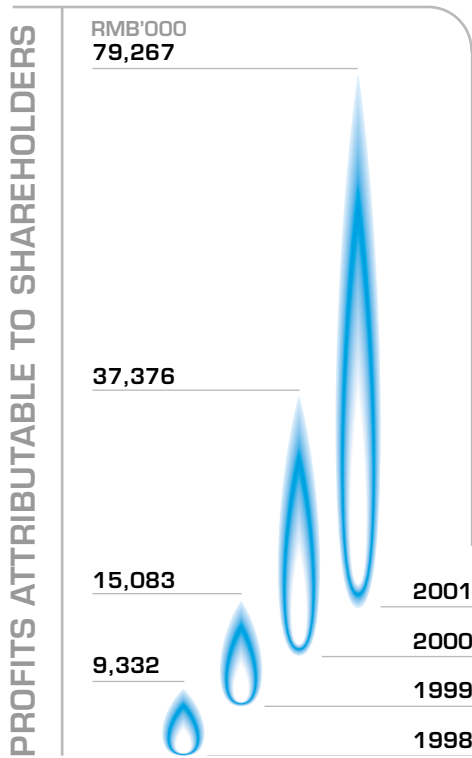
Fleet National Bank

33rd Floor, Jardine House
1 Connaught Place
Central
Hong Kong

OPERATIONS

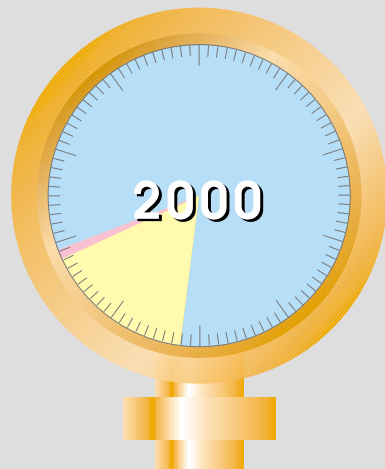


FINANCIALS



TURNOVER BREAKDOWN

- 82.8% ● Connection fees
- 16.8% ● Gas usage charges
- 0.4% ● Sale of gas appliances

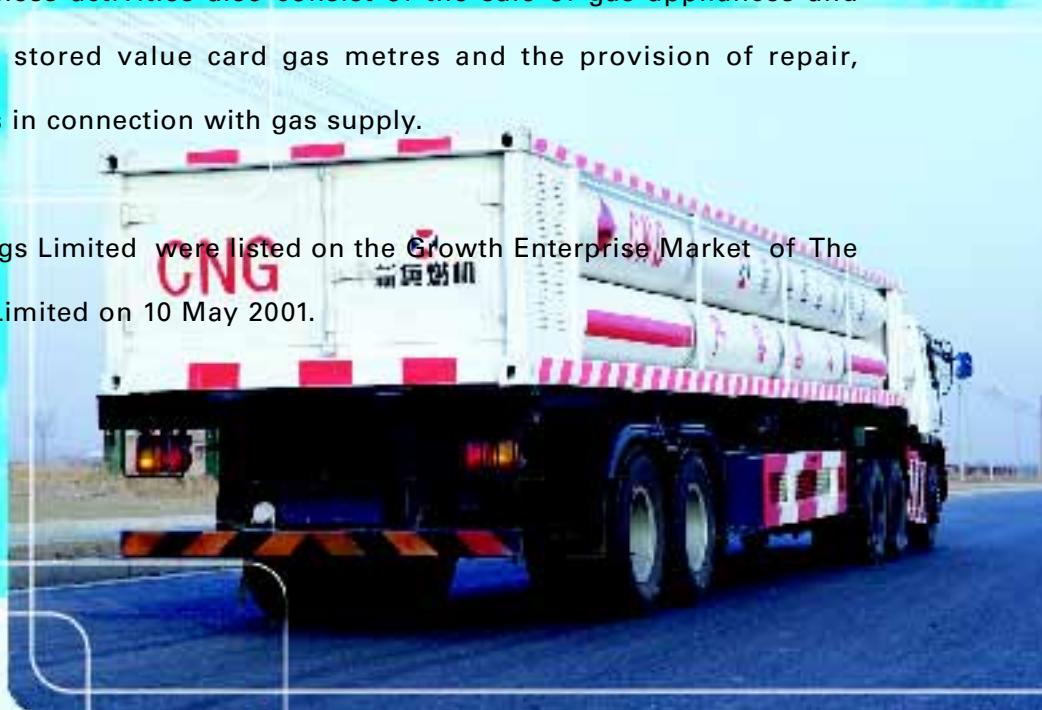


- 76.8% ● Connection fees
- 21.0% ● Gas usage charges
- 2.2% ● Sale of gas appliances

XINAO GAS HOLDINGS LIMITED

Xiniao Gas Holdings Limited is one of the first non state-owned piped gas distributors in the People's Republic of China. The principal business of the Group is the investment in, and the operation and management of, gas pipeline infrastructure and the sale and distribution of piped gas in the PRC. Its business activities also consist of the sale of gas appliances and equipment, the production of stored value card gas metres and the provision of repair, maintenance and other services in connection with gas supply.

The shares of Xiniao Gas Holdings Limited were listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited on 10 May 2001.



Dear Shareholders

Xinao Gas Holdings Limited ("Xinao Gas" or the "Company" and together with its subsidiaries, the "Group") was successfully listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited on 10 May 2001. On behalf of the Board of Directors of the Company, I am pleased to announce the annual results of the Group for the year ended 31 December 2001.



The Company achieved encouraging results in meeting its various operational benchmarks and enhancing management quality in 2001. The Company has further increased its market share and brand recognition in the PRC city gas distribution market. I would like to take this opportunity to express my gratitude to all our friends who have cared and supported Xinao Gas over the years.

FINANCIAL HIGHLIGHTS

The Group's turnover was RMB240.6 million for the year ended 31 December 2001, representing an increase of 96.7% from RMB122.3 million last year. Connection fees accounted for 76.8% of the Group's turnover or RMB184.8 million. Gas usage charges was RMB50.6 million, representing 21.0% of the Group's turnover. The Group's net profit increased by 1.1 times to RMB79.3 million when compared to last year.

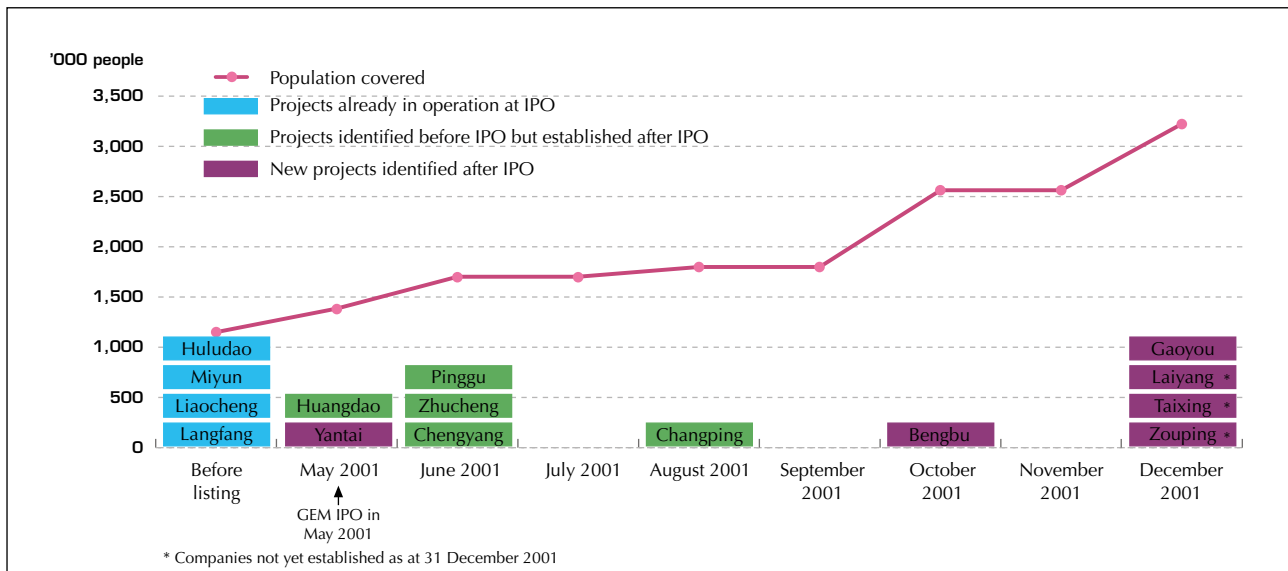
As at 31 December 2001, the Group's cash in hand was ample and amounted to RMB182.5 million while bank borrowings was RMB123.1 million. This strong financial position allows the Group to take advantage of any attractive investment and development opportunities in the future. As the Group expects to incur a considerable amount of capital expenditure in 2002, we may consider increasing our gearing to an appropriate level or raising funds through equity issue in the future.

MARKET EXPANSION AND NEW PROJECTS

In the past, the city gas distribution in the PRC was basically monopolised by State-owned enterprises and was managed by local governments as a social welfare business. Xinao Gas is one of the first non state-owned enterprises that has entered into the PRC city gas distribution business using market principle. With nine years of solid experience in this industry, the Group has laid a sound foundation for securing new projects consistently.

At the time of listing in May 2001, the Group had a total of four projects in the PRC, namely Langfang Xinao, Liaocheng Xinao, Beijing Xinao and Huludao Xinao. Following its listing, the Company has completed the acquisition of three project companies and have established five new project companies.

Timeline for obtaining new projects and total population coverage



The Group has, in 2001, established Xinao (China) Gas Development Company Limited and Langfang Xinao Gas Equipment Company Limited, both are wholly owned by the Group. The former mainly engages in the distribution of compressed natural gas, while the latter mainly engages in the production of stored value card gas metres. At present, the Group has a capacity to manufacture 100,000 units of stored value card gas metres per year and is one of the largest producers of stored value card gas metre in the PRC.

As at the year end, the Group has secured exclusive rights to supply piped gas to 15 project cities with a total population coverage of about 3.4 million people. Since the Company's listing in May 2001, it has secured six new projects and the Group's business has expanded from Hebei, Shandong, Beijing and Liaoning into Anhui and Jiangsu. The project in Bengbu, Anhui Province is the Group's first project secured in the downstream markets of the West to East Pipelines. Bengbu is the first city along the West to East Pipelines that foreign investors have invested in and the population in this city is the highest among all of the Group's project cities. This demonstrates the Group's ability in market expansion and can serve as a role model for other new project cities to be developed by the Group in the future.

OVERALL BUSINESS PERFORMANCE

In 2001, the Group had provided natural gas connections for a total of 41,748 residential households and 113 commercial and industrial sites (connected to a total installed designed daily capacity of gas appliance of 130,445 cubic metres). As at 31 December 2001, the Group had made gas connections to a total of 108,001 residential households and 355 commercial and industrial sites (connected to a total installed designed daily capacity of gas appliance of 269,747 cubic metres). Last year, the Group sold a total of 34.6 million cubic metres of piped gas and received gas usage charges amounted to RMB50.6 million.

As at 31 December, 2001, the Group owned and operated a total of 464 kilometres of intermediate pipelines and main pipelines and 12 gas processing stations.

CORPORATE MANAGEMENT AND HUMAN RESOURCES

We are committed to high standard of corporate management and will continue to strengthen our trading and human resources capability. In 2001, we further perfected and consummated our framework in quality assurance and implemented a systematic corporate procedures for procurement, construction design and construction procedures and formulated an effective quality control system. Langfang Xinao obtained its ISO9001 certification in 2001. Liaocheng Xinao and Huludao Xinao are also in the process of applying for their ISO9001 certifications. Although the other project companies have not yet applied for such certification, these project companies have adopted the management procedures in accordance with the standards set out under ISO9001. The service framework with Xinao characteristics was further perfected with "users service supervisory network", "users satisfaction assessment" and "staff satisfaction assessment" being introduced to most project companies and a 24-hour call centre was set up in Langfang Xinao on 6 August 2001. Such call centre can provide further assurance to our customers in terms of effective and safe use of gas. A gas distribution company management model with Xinao characteristics had been formulated and was put on trial. Currently, the Group is in the process of developing a management information system for most of its project companies while the stock control system have been computerised.

At the time of listing, the Group employed 501 employees and as at 31 December 2001, there were altogether 1,142 employees within the Group. Such increase in employees numbers is to put in place an adequate number of staff for future projects. The Group continues to strengthen communication and ideas exchange with international counterparts with a view to bringing advanced technology and management philosophy into the daily operation of the Company.

AWARDS

In 2001, Xinao Gas has received numerous awards from renowned financial publishers including "The 200 Best Small Companies" by Forbes Global, "2001 Top 500 Chinese Enterprises in the World" by Yazhou Zhoukan and "The Best Small Cap IPO" by FinanceAsia. Asiamoney had ranked Xinao Gas as one of the "Best Small Company" in the PRC and one of the "Overall Best Managed Company 2001" in the PRC. In addition, the Chinese State of the Nation Research Association has approved Xinao Gas to be a national grade research base for city gas utility industry. All these awards demonstrated that Xinao Gas is highly regarded by the professional investment community as well as by the PRC government.

PROSPECTS

Looking ahead, the Board of Directors is confident with the future prospects of the Group. Natural gas, being a clean and efficient source of energy, is attracting increasing public attention and is being heavily promoted by both the Central and local governments in supporting for its usage. Consumers acceptance of natural gas is growing and its application is getting wider. The West to East Pipelines project is progressing smoothly and relevant gas transmission networks are also being commissioned progressively. All these initiatives can greatly increase the number of cities which have access to gas supply thus providing immense opportunities to the Group. In addition, the winning of the right to host the 2008 Olympic Games by Beijing is expected to cause an urgency to improve the air quality and there will be an increase in the demand for real estates in Beijing and the surrounding areas. Xinao Gas will benefit greatly from these. Under such favourable environment, Xinao Gas will march ahead in full swing to secure new project cities in the downstream market of the West to East Pipelines and in cities like Shandong and Liaoning which are economically well developed and rich in natural gas resources. At the same time, the Group will endeavour to increase the gas penetration rate of existing project cities, expand our customer base and maximise our income in order to create greater values and returns for our shareholders and investors. Through the relentless pursuit of excellence and supports from our member of staffs as well as people from different spectrum of the society, we are determined to become the leader in the city gas distribution industry.

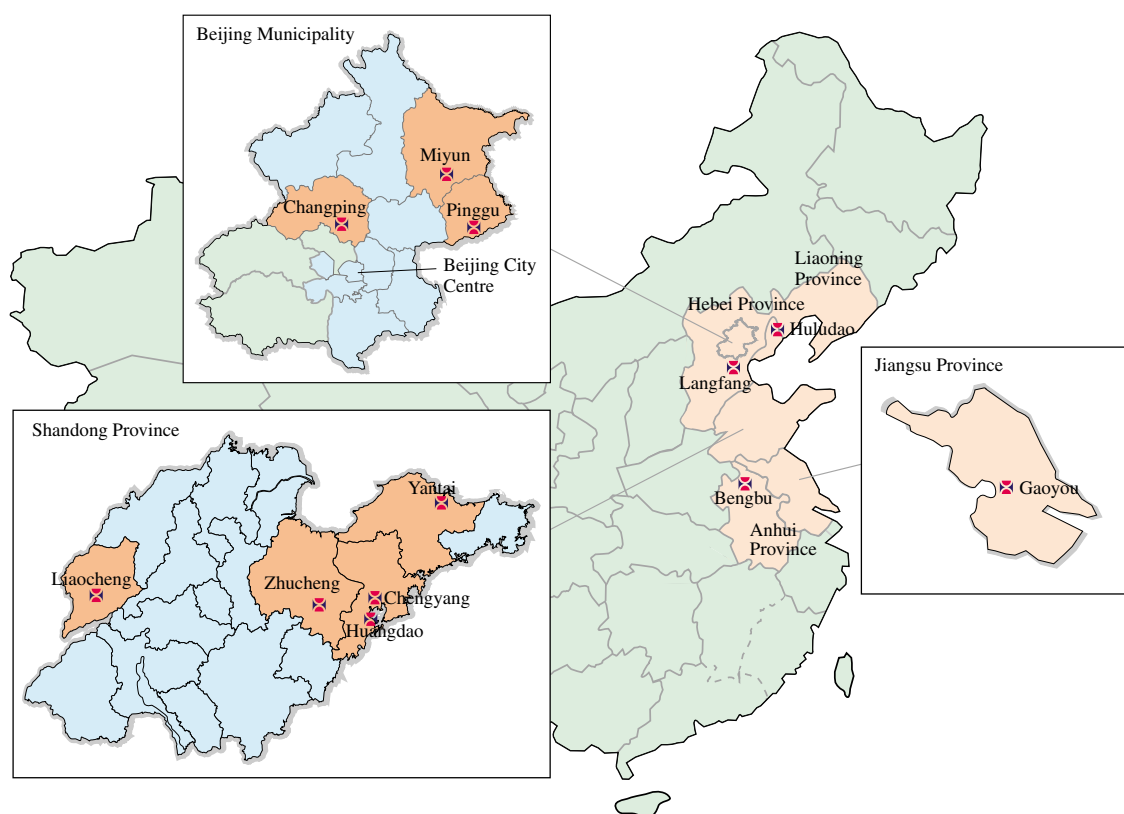
WANG Yusuo

Chairman

March 2002

AREAS OF OPERATIONS

ANNUAL REPORT 2001



Incorporated

Project companies

Operational locations

Population as of 2000

1	Langfang Xinao	Langfang, Hebei Province	270,000
2	Liaocheng Xinao	Liaocheng, Shandong Province	314,000
3	Beijing Xinao	Miyun, Beijing Municipality	97,000
4	Huludao Xinao	Huludao, Liaoning Province	469,000
5	Jingchang Xinao	Changping, Beijing Municipality	97,000
6	Jinggu Xinao	Pinggu, Beijing Municipality	97,000
7	Qingdao Xinao	Huangdao, Qingdao City, Shandong Province	194,000
8	Xincheng Xinao	Chengyang, Qingdao City Shandong Province	52,000
9	Zhucheng Xinao	Zhucheng, Shandong Province	168,000
10	Yantai Xinao	Yantai, Shandong Province	41,000
11	Bengbu Xinao	Bengbu, Anhui Province	764,000
12	Yangzhou Xinao	Gaoyou, Jiangsu Province	149,000
			2,712,000

Operational data as at 31 December 2001

Project companies	Year of first establishment	Group's interest	Length of existing pipelines ⁽¹⁾ (km)	Number of existing processing stations	Combined designed daily capacity of existing processing stations (m ³)	Contracted number of gas supply locations ⁽²⁾	Number of gas connections made ⁽²⁾	Estimated daily gas consumption for residential households ⁽³⁾ (m ³)	Installed designed daily capacity for commercial and industrial customers ⁽⁴⁾ (m ³)
Langfang Xinao	1993	100%	191	4	409,800	60,730 households and 251 sites	58,518 households and 240 sites	23,407	164,240
Liaocheng Xinao	1999	90%	69	1	50,000	16,201 households and 36 sites	10,347 households and 31 sites	4,139	14,315
Beijing Xinao	1999	95%	28	1	72,000	8,215 households and 21 sites	4,551 households and 17 sites	1,820	62,828
Huludao Xinao	1999	90%	54	1	30,000	26,970 households and 56 sites	22,537 households and 48 sites	9,015	21,700
Jingchang Xinao	2000	80%	33	1	72,000	8,494 households and 9 sites	4,049 households and 8 sites	1,620	1,828
Jinggu Xinao	2000	70%	32	1	72,000	5,750 households and 8 sites	2,314 households and 6 sites	926	2,464
Qingdao Xinao	2000	90%	37	1	72,000	7,080 households and 5 sites	3,548 households and 4 sites	1,419	2,272
Xincheng Xinao	2001	90%	10	1	30,000	3,578 households and 1 site	1,511 households	604	-
Zhucheng Xinao	2001	80%	10	1	30,000	2,124 households and 1 site	626 households and 1 site	250	100
Yantai Xinao	2001	100%	Expected to commence gas supply to customers from June 2002 onwards.						
Bengbu Xinao	2001	70%	Expected to commence gas supply to customers from August 2002 onwards.						
Yangzhou Xinao	2001	100%	Expected to commence gas supply to customers from October 2002 onwards.						
Total			464	12	837,800	139,142 households and 388 sites	108,001 households and 355 sites	43,200	269,747

Notes:

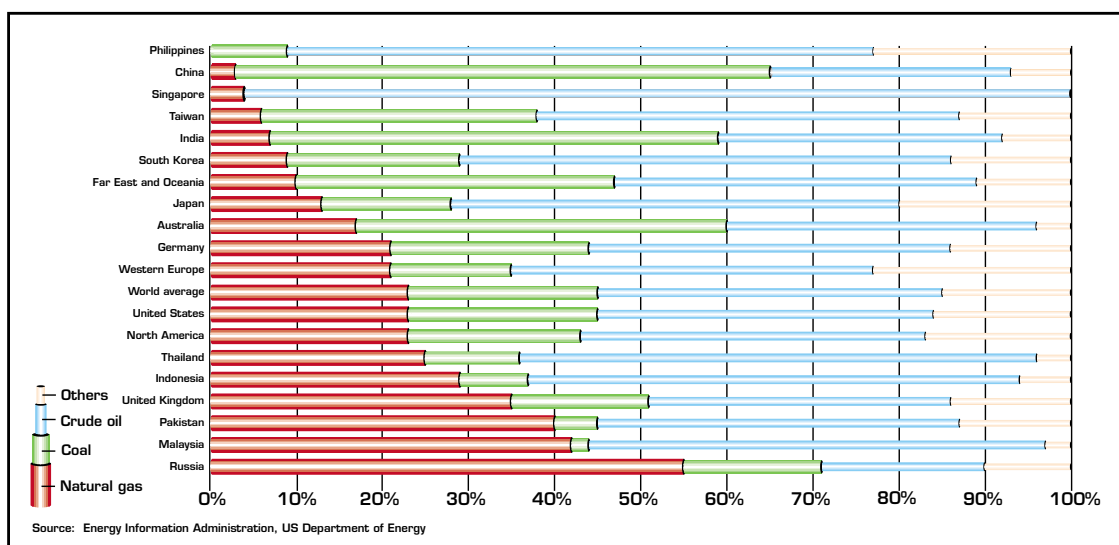
- (1) Existing pipelines represent intermediate pipelines and main pipelines.
- (2) The difference between contracted number of gas supply locations and number of gas connections made represents connections to be made.
- (3) Estimated daily gas consumption for households is calculated based on an average daily gas consumption of 0.4 cubic metre per household for those residential customers with gas connections made.
- (4) Estimated gas consumption for commercial and industrial customers is based on 50% of the installed designed daily capacity of their gas appliance (as set out in the respective supply contracts) for those customers with gas connections made.
- (5) Sites represent both commercial sites and industrial sites.

I BUSINESS ENVIRONMENT

1 Economic Development and Energy Consumption Pattern in the PRC

With the PRC's accession to the World Trade Organisation in 2001, there are ample opportunities in terms of economic growth as well as commercial and industrial development. China's GDP is forecasted to grow at an average rate of 7% per annum in the next five years. Since the economic growth needs to be facilitated by a coordinating development in energy related infrastructure, such growth will generate a positive effect on the future demand of energy.

Composition of energy consumption (1999)



In 2000, natural gas, coal, crude oil and hydro-electricity each accounted for 2.5%, 67%, 23.6% and 6.9% of the total PRC energy consumption respectively. The PRC government has expressly stated that natural gas will become the country's primary source of energy due to its abundant reserve. Furthermore, according to an air pollution study conducted by the World Health Organisation in 1998, seven of the 10 most polluted cities in the world were located in China. The policy of adopting natural gas as the main source of energy will help to reduce the level of pollution. On comparison, the amount of pollutants emitted by natural gas are minimal when compared to those emitted by the other energy sources such as coal, liquefied petroleum gas and crude oil. Thus underpinning the growth potential of natural gas consumption.

I BUSINESS ENVIRONMENT (CONT'D)


2 Future Development and Framework of the PRC Gas Industry

According to a research report published by 中國天然氣規劃辦公室 (The PRC Natural Gas Regulatory Office*) in 1999, natural gas reserves in China are estimated to be 43,000 billion cubic metres of which 30,000 billion cubic metres are on-shore and 13,000 billion cubic metres are off-shore. Furthermore, through continuous exploration of new gas fields in recent years, reserves of 30,000 to 35,000 billion cubic metres of coal bed methane were discovered. Currently, the proven natural gas reserve is expected to last for 70 years, which is far greater than the proven reserve of crude oil. It is expected that additional gas fields will be discovered in the future. The opening speech of 第十五屆全世界石油組織大會 (The 15th World Oil Organisation Conference*) , which was convened in China in 1998, declared that "The 21st Century is the Century of Natural Gas". This demonstrates that the natural gas industry is entering into an era of high growth. The PRC government officially announced policies in 1998 to encourage the participation by private sector in the development and construction of city natural gas pipelines and the distribution of natural gas. Such policies provided the opportunity and framework for the private sector to fully participate in the development and operation of piped gas distribution in cities which was previously monopolised by State-owned enterprises. As Xinao Gas has been engaging in the business of gas pipelines construction and gas distribution since 1993, the new policies provided Xinao Gas a first mover advantage when it further expanded into new markets after 1998. Xinao Gas' excellent safety track record in the past eight years has put the Group in a superior position from those competitors who entered into the business after 1998 since safety record is one of the most important factors when it comes to the selection of natural gas operator for any city.

Natural gas is a clean and efficient source of energy. The consumption of natural gas as a percentage of primary source of energy has stayed at a level of around 2% and the consumption in urban area for domestic purposes is only 10.8%, hence the growth potential is enormous. By 2005, it is forecasted that the total number of cities using natural gas will reach 121 and it will be increased to 262 cities by 2010. The PRC government forecasted that natural gas will account for 10% of the total energy consumption by 2010. This represents an excellent business opportunity for the industry.

* For identification only

II WEST TO EAST PIPELINES



The West to East Pipelines project involves the transport of natural gas from large gas fields located in the western part of China to the eastern coastal areas, through a 4,200 kilometres long distance pipelines connecting Xinjiang and Shanghai. This project is led by 中國石油天然氣集團公司 (China National Petroleum Corporation) and the total investment amounts to RMB46 billion, with gas supply expected between 2003 and 2004. Once completed, the supply of natural gas is expected to increase substantially. In order to match the supply increase with its consumption, it is essential to speed up the city gas pipeline networks construction. The West to East Pipelines project presents tremendous opportunities for the Group to develop new projects. In October 2001, Xinao Gas has secured the exclusive rights to develop and operate piped gas supply in the city of Bangbu, Anhui Province, which has a total population of 764,000 (representing a total of 255,000 households) at the end of 2000. This is currently the largest project undertaken by Xinao Gas to date and it is the first city foreign company engaged in the downstream markets of the West to East Pipelines project. This project demonstrates the Group's ability in market expansion and can serve as a role model for expanding into other downstream cities of the West to East Pipelines project. It is the Group's current strategy to focus its efforts in expanding into the affluent coastal provinces in China and it has already carried out feasibility studies and established contacts with local government officials in 54 districts and cities in Jiangsu, Zhejiang, Hunan, Anhui, Shanghai and Shandong. The Group currently has three projects located within the vicinity of the West to East Pipelines project and it is expected that the number of projects will continue to increase in the next few years. As at 31 December 2001, the Group has a total of 15 projects with operation rights, representing an increase of 11 projects when compared to 2000. Prior to the completion of the West to East Pipelines project, the three projects which are located within the vicinity of the West to East Pipelines project will make use of CNG instead of natural gas in order to accelerate the gas penetration rate in these cities and start earning the initial connection charges as soon as practicable. Upon completion of the West to East Pipeline project, the supply of piped natural gas will be commenced immediately.

III PIPELINE CONSTRUCTIONS AND CONNECTIONS



Cylinder-shaped gas storage tank in Langfang

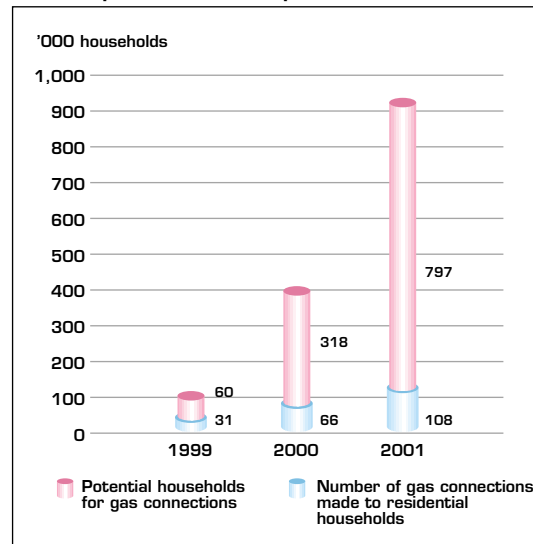
An one-off connection fees are collected from first time customers connecting to our network. In 2001, Xinao Gas made connections to a total of 41,748 households. The average connection fee per household was RMB2,666 in 2001 (RMB2,485 in 2000), an increase of 7.3% over 2000. Xinao Gas also provides natural gas to commercial and industrial customers and the connection fee is calculated according to the designed daily capacity of that particular commercial or industrial customer and multiply it by the unit charge per cubic metre. In 2001, the installed design daily capacity of gas appliance for commercial and industrial customers reached 130,445 cubic metres, an increase of 2.7

times over 2000. The average connection fee for commercial and industrial customers was RMB452 per cubic metre versus RMB548 per cubic metre in 2000. Connection fees were reduced in order to attract more high volume industrial and commercial users.

On the other hand, operating profit margin from connections has increased from 63.4% in 2000 to 69.3% in 2001. This is mainly the result of effective cost control on pipeline construction costs and the increase in the proportion of connections to industrial and commercial customers.

As the government is actively promoting the use of natural gas, all of our existing project companies are located where the local governments have made natural gas connection a prerequisite for the construction of new buildings. Since the exclusive right or first right of refusal obtained in all projects currently undertaken by the Group is for a term of 30 years, such requirement by the governments, not only contributed to the increase in penetration rate of those cities, but also the connection fees income of the Group. Furthermore, the Company has implemented various advertising programmes to promote the benefits of using natural gas, such as environmental friendliness and convenience, in order to increase the level of awareness and acceptance of natural gas by the residents. With the rapid expansion of the PRC economy, together with the flourishing industrial and commercial sectors, a growth in demand for energy is expected. Such factors can help to stabilise the Group's income from connection fee and gas consumption.

Gas penetration at operational locations



III PIPELINE CONSTRUCTIONS AND CONNECTIONS (CONT'D)

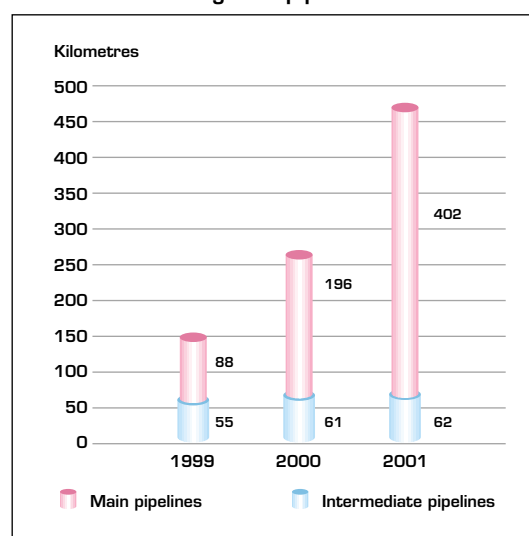
It is the Company's policy to collect a deposit when entering into connection agreement with any customer. The amount of deposit is set at a level to minimise completion risk. Upon completion of construction and prior to the commencement of supplying gas to the customer, the company will collect the remainder of the contracted amount. Since the Company is the only piped gas supplier in any of the project cities, the probability of the customers defaulting on the remaining balance of the connection fees is low.

For any new project city which have no existing pipeline infrastructure, the Group is required to complete the construction of the intermediate pipeline connecting the long distance pipelines and the pressure regulating station, the pressure regulating station and the main pipeline connecting the pressure regulating station and the city centre before it can make connections to customers and collect any connection fees. The construction of such infrastructure usually takes between six to 12 months to complete. Connection fees will only be recognised as income when the system is ready to supply gas. It normally takes less than two months to establish connections between the main pipelines and the buildings within residential districts.

Apart from maintaining emergency rescue units for safety measure, the Group does not maintain its own construction team for cost reason. Due to the severe weather condition during the winter season, construction team is generally unable to carry out any work in the northeastern provinces from the end of December to February. By outsourcing the construction work, the Group has managed to minimise cost by lowering the salary expenses and employee benefits due to a lower number of permanent staff.

The Group employs professional houses to design the pipeline network, taking into account the individual characteristics of each city. The Company also employs inspectors from independent construction supervising company to carry out on-site inspections at all of the construction sites to ensure the quality of construction works being carried out. The Group is involved in the development of new construction methods and materials to enhance the quality of construction.

Length of pipelines



IV GAS USAGE CHARGES

The current gas usage charges are calculated on a per cubic metre basis. In 2001, the Company sold a total of 14.1 million cubic metres and 20.5 million cubic metres of gas to residential households and commercial and industrial customers representing an increase of 149.8% and 82.0% in terms of usage over 2000 respectively. Total gas usage charges increased from RMB20.5 million in 2000 to RMB50.6 million in 2001. Natural gas is generally used in cooking, water and space heating, automobile and industrial manufacturing. Currently, commercial and industrial customers make up 58.8% of the total gas sales volume of the Group. The average gas consumption by residential households is 0.4 cubic metre per day which is similar to the level in 2000.

The operating profit margin from the sale of natural gas increased from 16.5% in 2000 to 43.9% in 2001. The main reason for the increase is that in the past, the Langfang project was the major contributor of gas usage charges income and the consumption level had remained at the 1993 level. When the penetration rate of the other new projects increases progressively and the Langfang project increased its unit price for gas usage charges in October 2001 by an average of 21%, operating profit margin from the gas usage increased tremendously. This is an important development for the gas market that relies on gas usage charges as a long-term revenue source.

Xinao Gas has adopted an advanced gas usage charges collecting system as early as 1996. Except for the initial 17,637 residential households signed on at the early stage of the Group's operation and the then existing customers from the newly acquired projects, majority of households are equipped with the new fee collection system that uses stored value cards. Households equipped with stored value card are required to pay gas charges in advance at the Company's local sales offices and the sales staff will credit the equivalent amount of gas units into the stored value card through a computer system. Customers are able to use natural gas once the prepaid card is inserted into the gas metre. The gas metre automatically signals an alarm when only three cubic metres of gas are left on the stored value card to remind customers to replenish the value on the stored value card. This system not only reduces the enormous amount of manpower required to record the individual household monthly gas consumption volume as well as the administration expenses incurred for the collection of gas usage charges. The system also eliminates the possibility of default payments. The stored value card is individually numbered and when any customer fails to replenish the stored value card for a consecutive period of three months or when abnormal high usage level is observed, the computer will automatically generate a list of those households for the Company to investigate.

V GAS PURCHASES

The wholesale price of natural gas in the PRC is set by the State and the current price is RMB0.90 per cubic metre plus the cost of purification and transportation. In January 2001, the PRC government allowed natural gas suppliers to include the purifying cost of RMB0.03 into the sales price. Purifying cost was previously billed as a separate item so the inclusion of this cost in the sales price will not create any extra burden on the natural gas distributors. With the current government policy of promoting the use of natural gas, it is forecasted that the wholesale price of natural gas will not increase substantially in the near future. Assuming the contrary, we believe distributors will still be able to pass on the additional cost to the customers. On a heat content adjusted basis, the average selling price of natural gas is still much cheaper than other source of energy; 50% cheaper than electricity, 30% to 60% cheaper than LPG, and 40% to 60% cheaper than coal gas. As far as the future wholesale price of the natural gas from the West to East Pipelines is concerned, it is expected to be higher when comparing to the current wholesale price due to the large investment cost incurred in the construction of the long distance pipelines. However, it will still be lower than the other sources of energy with the exception of coal. Taking into account that the price of natural gas is cheaper than other sources of energy and the target customers of the West to East Pipelines are mainly the affluent coastal cities, it is believed that the customers in these cities should be able accept a higher price.



A CNG truck

As far as the contract for gas supply is concerned, the government will usually require the contracted supplier to provide a guarantee of gas supply for the next 10 to 20 years, the supply of gas is in effect guaranteed by the supplier. The actual gas consumption and its wholesale price level will be agreed between the supplier and the distributor.

VI OPERATIONAL MANAGEMENT

- 1 In daily gas transmission, adjustment of transmission pressure is of extreme importance. During peak usage hours such as the evening when most of the households are preparing their dinner, the transmission pressure needs to be increased accordingly. At present, Xinao Gas has established a Supervisory Control and Data Acquisition System ("SCADA") in Langfang City.



SCADA in Langfang

VI OPERATIONAL MANAGEMENT (CONT'D)

Information such as incoming pressure, outgoing pressure and the volume of gas passing through the four processing stations and respective major gas usage points in the city and development zone will be sent to the control room via electronic signals. Operators can, according to actual demand, open or close any processing station in order to adjust the pressure of the transmission or processing station. All adjustments can be carried out in a central computer control room. For project cities other than Langfang, SCADA is incorporated into the development plan as early as the project is awarded, in order to enhance management efficiency and safety.

- 2 Xinao Gas has set up a 24-hour customer service centre. Customers Information are stored in the computer database according to their respective residential districts. Customers of the Group can access the customer service centre by dialing an exclusive number from anywhere within the PRC. The computer system will prompt the customer service officer on information relating to the caller including the caller's address and it will also enable the customer service officer to address the caller by their name to enhance amity. The customer service centre is mainly responsible for answering questions relating to the use of natural gas. In case of emergency, customer service centre will contact the repair and maintenance unit immediately and the maintenance crew will normally arrive at the site within 20 minutes from the time of call to carry out any repair work.



Call-centre

- 3 Xinao Gas fully understands and recognises the importance of a safe and effective operational management system for the natural gas industry. It is the intention of the Company to establish a Map Information System for every project city. Langfang City was the first to adopt this system in September 2001. The system is able to keep track of all relevant information relating to the pipeline network in the city including its location, construction history, diameters and lengths of the pipelines.



Equipment in a gas processing station

It enables the maintenance crew to carry out the maintenance works in a more effective manner to ensure a high safety standard is maintained. With the existing operational management system, the Company has managed to keep the repair and maintenance expenses at a relatively low level. For 2001, the Company incurred a total repair and maintenance expenses of RMB346,000. It represented less than 0.1% of the cost of fixed assets, which was below the international industry level of 2% to 3%.

VI OPERATIONAL MANAGEMENT (CONT'D)

4 The Company employs undergraduates and post-graduates from over 10 universities throughout China and recruits senior management and technical personnels from overseas. After joining the Company, employees will go through training courses specially tailored to expedite their knowledge relating to the Company's management and operations. According to the project development schedule, the Company will put in place adequate number of management and staff for each individual project company one year in advance.



5 Langfang Xinao has obtained ISO9001 certificate having established a quality assurance system that includes procurement, construction design and project management. Liaocheng Xinao and Huludao Xinao have commenced the process of applying for their ISO9001 certifications. Although the other companies have not yet applied for such certification, these project companies have adopted procedures in accordance with the ISO9001 standard which has greatly enhance our operational efficiency.

Consolidating the characteristics of the gas market, and making reference to international advance management experience, the Company has set up a "Gas Management Model" to further rationalise our business operation procedures, construction, operation, costing, finance/accounting and quality and safety of the Company thereby ensuring that the Company is managed scientifically, cautiously and efficiently.



In 2001, Xinao Gas has received numerous awards from renowned financial publishers including "The 200 Best Small Companies" by Forbes Global; "2001 Top 500 Chinese Enterprises in the World" by Yazhou Zhoukan and "The Best Small Cap IPO" by FinanceAsia. Asiamoney had ranked Xinao Gas as one of the "Best Small Company" in the PRC and one of the "Overall Best Managed Company 2001" in the PRC. In addition, the Chinese State of the Nation Research Association has approved Xinao Gas to be a national grade research base for city gas utility industry. All these awards demonstrated that Xinao Gas is highly regarded by the professional investment community as well as by the government.

"The 200 Best Small Companies" awarded by Forbes Global

VII SHARE PRICE PERFORMANCE

The offer price of Xinao Gas in its IPO in May 2001 was HK\$1.15 per share and the offer was 5 times over-subscribed. The share price increased to HK\$2.325 at the end of 2001, 100% higher than the offer price. Meanwhile, the market capitalisation grew from HK\$721 million to HK\$1,458 million. In retrospect, the share price performance and the various awards demonstrate investors' support and trust in the Company as well as their optimism on the future of natural gas industry.



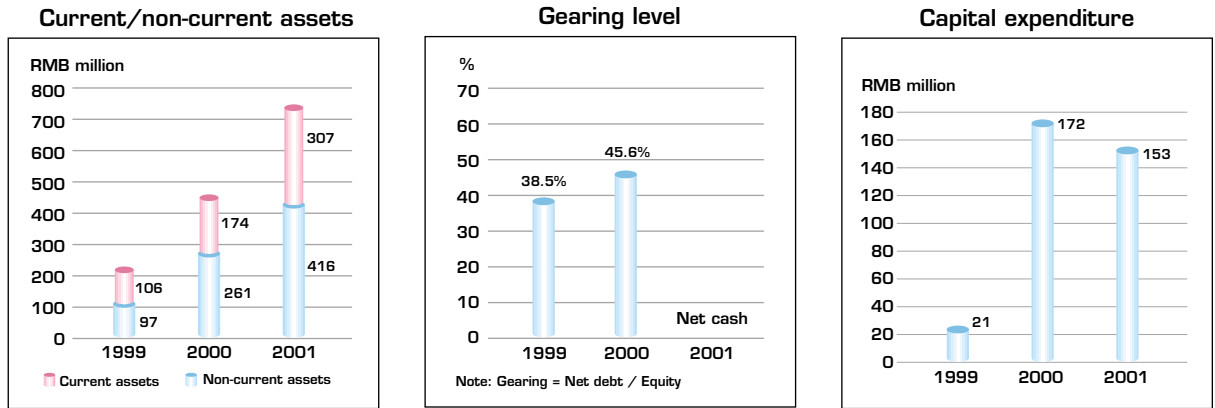
Listing ceremony in May 2001

VIII FINANCIAL MANAGEMENT

Taking into account the initial start-up cost and fixed assets depreciation in the first year, the profit level of a newly developed project is, in general, relatively low. As the gas penetration rate in a project city increases, the rate of return will gradually improve. The rate of return should reach a satisfactory level from the second year onwards. Prior to the making of any investment decision, the management will put in place a project team comprising all relevant technical and financial personnels to carry out on-site visits and prepare a comprehensive feasibility study, which includes sensitivity analysis on all important data. With respect to key financial information, the Company performs regular and stringent review on, among other things, gearing ratio, interest coverage ratio, asset liquidity and cash flow. The Company centralises the cash management and keeps records on the status of funds flow of each group companies on a daily basis. As such, the Company is able to maintain a reasonable level of cash and minimise the overall use of cash in order to reduce the Company's borrowing costs.

The Company's liquidity is sound. The Company reported a net current assets of RMB106.3 million in 2001, partly attributable by the fact that four projects have started to generate stable cashflow since they have been operating for more than one year, versus a net current liabilities of RMB160.4 million in 2000, partly attributable by the Group's reorganisation including debts of RMB81.4 million which had yet to be capitalised.

VIII FINANCIAL MANAGEMENT (CONT'D)



As Xinao Gas has to construct pipelines and processing station(s) in each of the project cities, its capital expenditure is relatively large. Depending on the size of the operation, capital expenditure of each project is incurred progressively within a timeframe of three to five years. Normally, a project will begin to record revenue in its first year of operation and such revenue can be used to fund part of the capital expenditure. Xinao Gas will also consider raising the necessary funding through other channels such as non-secured bank loans, syndicated loans, issuance of notes or through equity issues.

As the Group strives to secure additional projects each year, the future demand for capital will be enormous, mainly for the construction of gas pipelines and processing stations. The Group has just placed 110,000,000 shares to the institutional and professional investors at HK\$3.05 per share in March 2002. The net proceeds amounted to HK\$326 million will be used to satisfy the capital requirement for the coming year.

In terms of gearing, the Group had an aggregate short-term loan of RMB74.9 million, a long-term loan of more than one year of RMB48.2 million and cash of RMB182.5 million as at 31 December 2001. The Group is currently at a net cash position, and the Group is expected to finance its future development through the use of multiple funding channels including bank borrowings and equity issues.

VIII FINANCIAL MANAGEMENT (CONT'D)

The finance department of the Company coordinates the arrangement of all external financing for the group companies thereby reducing the financing risk and costs. The Company has put in place a comprehensive budget management system. At the beginning of each year, every departments are provided with an expense budget prepared based on the work requirement for that year. The budget is then used as a reference for expenditure and will be adjusted in accordance with the actual work progress.

IX COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS

Set out below is a comparison between the Group's actual business progress for the period from 23 April 2001 and up to 31 December 2001 and its business objectives and strategies as set out in the prospectus of the Company dated 27 April 2001 (the "Prospectus"):

	Targets as stated in the Prospectus	Actual business progress as at 31 December 2001
Sales and operations		
• Number of new residential household connections	53,490	39,827
• Additional installed designed daily capacity for commercial and industrial customers (m ³ /day)	72,615	120,833
• Residential gas consumption ('000 m ³)	9,178	10,839
• Commercial/industrial gas consumption ('000 m ³)	14,921	14,755
• Pipelines* to be constructed (km)	488	515
• New processing stations to be constructed	4	2
Research and development		
• Develop internal capability to manufacture stored value card gas metres	To commence supply in the second half of 2001	Commenced supply in June 2001

* Pipelines include the intermediate, main and branch pipelines

IX COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS (CONT'D)

Reasons for material difference between planned business objectives and actual business progress up to 31 December 2001 are set out below:

1 Sales and operations

The shortfall in the number of new residential household connections and the number of new processing stations was due to the unexpected delay in the establishment of 荊州新奧燃氣有限公司 (Jingzhou Xinao Gas Company Limited*, "Jingzhou Xinao"). As at the date hereof, Jingzhou Xinao has not yet been established as the Group is in the process of re-negotiating with its joint venture partner with a view to seeking more favourable terms for the Group. Due to the foregoing, the Group has re-allocated its original resources assigned for Jingzhou Xinao to focus on developing commercial and industrial customers in other operational locations. As a result of an effective marketing campaign, commercial and industrial customers have started to recognise the significant cost savings that can be achieved through the use of piped gas. The Group has successfully achieved its connection targets ahead of schedule by approximately 66.4%.

2 Research and development

The Group has speeded up its development of stored value card gas metres in order to take advantage of the cost savings that can be brought to the Group. Installation of production facilities with an annual capacity of 100,000 metres was completed in June 2001.

* For identification only

IX COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS (CONT'D)

Proceeds from the placement of new Shares in May 2001

From 10 May 2001 to 31 December 2001, the Group has invested HK\$104.7 million in sales and operations, research and development and others which is in accordance with the Group's business objectives and strategies as set out in the Prospectus.

	Planned use of proceeds as set out in the Prospectus	Actual use of proceeds from 10 May 2001 to 31 December 2001
	<i>HK\$'000</i>	<i>HK\$'000</i>
Sales and operations		
• Pipelines to be constructed	78,000	39,088
• New processing stations to be constructed	21,000	34,628
Research and development		
• Development of internal capability of manufacturing stored valued card gas metres	3,000	–
Others		
• Acquisition of three project companies	31,000	31,000
	<u>133,000</u>	<u>104,716</u>

IX COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS (CONT'D)

Reasons for difference between planned usage of proceeds and actual utilisation are set out below:

1 Sales and operation**a Construction of pipelines**

Due to effective cost management and improvement in construction work, the Group was able to reduce the overall construction cost for pipelines. The average cost for construction of pipelines was RMB220,000 per kilometre in 2001, compared to an average cost of RMB325,800 per kilometre in 2000.

b Construction of processing station

The installation of additional equipment and facilities for compressed natural gas in one of the processing stations constructed has resulted in an increase in the overall expenditure for the construction of new processing stations.

2 Research and development

The Group has invested HK\$3 million of internal resources to fund the development of stored value card gas metres, taking advantage of the tax benefit offered by the local tax bureau. The Group originally intends to use the HK\$3 million earmarked for such development as general working capital of the Group to support its ongoing operations and expansion.

EXECUTIVE DIRECTORS

Wang Yusuo, aged 37, is the co-founder and chairman of the Company and an executive Director. He is responsible for overseeing the Group's overall strategic planning. Mr. Wang has over 15 years of experience in the investment in, and management of, the gas business in the PRC. He graduated from 中國人民大學 (the People's University) in 1994 and is currently studying for a master's degree in Management at the 天津財經學院 (Tianjin College of Finance and Economics). Mr. Wang is the spouse of Zhao Baoju.

Yang Yu, aged 44, is an executive Director and the chief general manager of the Company responsible for managing and implementing the Group's investment in the PRC, ensuring the safety of the Group's projects, securing gas supply and exploring further gas investments and markets in the PRC. Mr. Yang joined the Group in 1998 from the 中國石油天然氣管道局 (China Petroleum and Natural Gas Pipelines Bureau). He graduated from the 石油工業部管道局職工學院 (Petroleum and Industrial Ministry Pipeline Bureau Technical Institute) in 1985. He holds a master's degree in banking from 中國人民大學 (Renmin University of China) in 1999. Mr. Yang has over 15 years of experience in the PRC gas industry.

Zhao Jinfeng, aged 34, is an executive Director and a deputy general manager of the Company. He is the head of the business development division and is responsible for assisting the general manager in managing and implementing the Group's investment projects in the PRC, supervising the safety of the Group's projects, securing gas supply and exploring the piped gas market in the PRC. He graduated from the 農業部鄉鎮企業管理幹部學院 (Management Institute of the Ministry of Agriculture). Mr. Zhao joined the Group in 1993 from 廊坊市機電公司 (Langfang City Electrical Company). Mr. Zhao has over nine years of experience in the PRC gas industry. Mr. Zhao is a brother of Zhao Baoju.

Qiao Limin, aged 43, is an executive Director and a deputy general manager of the Company responsible for the safety and operational matters of the Group. Prior to joining the Group in 1993, he worked at 包頭市師範專科學校 (Baotou Education College) and was an assistant lecturer at 廊坊市衛生學校 (Langfang City Health College). He graduated from Baotou Education College in 1984. Mr. Qiao has over nine years of experience in managing gas projects and supervising gas supply operations and safety.

Jin Yongsheng, aged 38, is an executive Director and deputy general manager of the Company responsible for overseeing legal matters of the Group. He graduated from the Tianjin College of Finance and Economics in 1986, specialising in finance. Prior to joining the Group in 1996, he was an assistant professor in 農業部鄉鎮企業管理幹部學院 (Management Institute of the Ministry of Agriculture). Mr. Jin is a qualified practising lawyer in the PRC and has over 10 years of experience in legal practice.

Yu Jianchao, aged 33, is the Finance Director of the Company. He joined the Group in January 1998. He graduated from the 河北財經學院 (Hebei Economics and Finance College) in 1993. Prior to joining the Group, Mr. Yu had worked as the chief accountant for a number of foreign enterprises including 全興工業廊坊有限公司 (GSK Industry (China) Co., Ltd.) and 日清中糧食品有限公司 (Nissin COFCO Foods Co., Ltd.). Mr. Yu has over 10 years of experience in accounting and finance.

NON-EXECUTIVE DIRECTOR

Zhao Baoju, aged 36, is the co-founder and a non-executive Director. She has over nine years of experience in investing in gas fuel projects in the PRC. She graduated from the 河北醫學院護士學校(Hebei Medical College Nursing School) in 1987 and the Chinese Language Faculty of 首都師範大學(Capital Education University) in 1998. Ms. Zhao is the spouse of Wang Yusuo.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Wang Guangtian, aged 38, is an independent non-executive Director appointed by the Company in March 2001. He holds a master's degree in World Economics from Hebei University and has over 20 years of experience in financial management and administrative management. He is currently the deputy general manager of Hebei Enterprises Limited (a company incorporated in Hong Kong) which is the window company for the Hebei Provincial Government in Hong Kong. He is also the general manager of Overseas Way (China) Limited (a company incorporated in Hong Kong).

Xu Liang, aged 61, is an independent non-executive Director appointed by the Company in March 2001. He studied coal gas engineering in 哈爾濱建築工程學院(Harbin Architecture and Engineering College). He worked in the 中國市政工程華北設計研究院(China Urban Engineering Huabei Design and Research Institute) for 36 years and is now their consultant and chief engineer.

SENIOR MANAGEMENT

Chen Jiacheng, aged 38, is the executive general manager of the Group. Mr. Chen joined the Group in January 2002 and is responsible for the business administration and management of the Group's gas projects. He holds a bachelor's degree in engineering from 西北工業大學 (Northwest Industrial University), a master's degree in business administration from 清華大學 (Qinghua University). Mr. Chen has over 10 years of experience in business administration and management.

Cheung Yip Sang, aged 35, is a deputy general manager of the Company. He holds a bachelor's degree in Legal Studies awarded by 中國人民武裝警察部隊學院(The Chinese People's Armed Police Force Academy). Prior to joining the Group in February 1998, he was the sales manager of Eastern Guangdong Region of 汕頭加丹啤酒有限公司(Shantou Jiadan Beer Company Limited). Mr. Cheung is experienced in marketing and sales.

Jiang Yongxin, aged 39, is the Chief Engineer of the Group. He graduated from 華東石油學院(Huadong Petroleum Institute) in 1985 with a bachelor's degree in engineering and is also a specialist in storage and transportation of petroleum and holds a master's degree in engineering in the storage and transportation of petroleum awarded by the 石油大學(China Petroleum University). Mr. Jiang joined the Group in August 2000 from the 中國石油天然氣管道科學研究院(Petroleum and Natural Gas Pipelines Research Institute in the PRC). Mr. Jiang has over 13 years of experience in the gas fuel industry in the PRC.

SENIOR MANAGEMENT (CONT'D)

Wang Dongzhi, aged 33, is the head of the finance department. Mr. Wang graduated in 1991 with a bachelor's degree in engineering management from 北京化工學院(Beijing Chemical College) (now known as 北京化工大學(Beijing Chemicals University)). In 1996, Mr. Wang obtained a bachelor's degree in Economics, and qualified as a PRC Certified Accountant through self study. Before joining the Group in August 2000, Mr. Wang was in charge of the finance department of a Sino-foreign joint venture company, and has extensive experience in treasury and cost management.

Ju Xilin, aged 44, is the general manager for Beijing and Tianjin areas. He graduated in 1987 from 牡丹江市委黨校(Mudanjiang City Communist Institute) specialising in Political Science. Prior to joining the Group in January 1996, he worked in state-owned enterprises where he was responsible for the operational management of those enterprises. Mr. Ju has over 20 years of experience in operational management.

Han Jishen, aged 37, is the general manager of Bengbu Xinao. He graduated from 保定職工學校(Baoding Staff College) in 1990. Mr. Han joined the Group at the end of 1993 and is responsible for management and operations. He had been the general manager of Langfang Xinao and is the general manager of Huludao Xinao. Mr. Han has over nine years of experience in the gas fuel industry in the PRC.

QUALIFIED ACCOUNTANT AND COMPANY SECRETARY

Cheng Chak Ngok, aged 31, is the qualified accountant and the secretary of the Company. Prior to joining the Group in November 2000, he worked in an international accounting firm and a freight forwarding company. He graduated from Manchester Metropolitan University with a first class honour bachelor's degree in accounting and finance. He is an associate member of the Hong Kong Society of Accountants and the Association of Chartered Certified Accountants in England, the Hong Kong Institute of Company Secretaries and the Institute of Chartered Secretaries and Administrators.

The directors of Xinao Gas ("Directors") has pleasure in presenting their first report and the audited financial statements of the Company and its subsidiaries (hereinafter collectively referred to as the "Group") for the year ended 31 December 2001.

CORPORATE REORGANISATION

The Company was incorporated in the Cayman Islands on 20 July 2000 with limited liability.

Pursuant to a reorganisation to rationalise the structure of the Group in preparation for the listing of the Company's shares ("Shares") on the Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), the Company became the holding company of the other companies now comprising the Group on 28 March 2001. Details of the reorganisation are set out in note 1 to the financial statements.

The Shares were listed on GEM on 10 May 2001.

PRINCIPAL ACTIVITIES

The Company acts as an investment holding company. Its subsidiaries are principally engaged in the investment in, and the operation and management of, gas pipeline infrastructure and the sale and distribution of piped gas in the People's Republic of China (the "PRC").

RESULTS

The results of the Group for the year ended 31 December 2001 are set out in the consolidated income statement on page 39.

The Directors do not recommend the payment of a dividend and propose that the profit for the year be retained.

FINANCIAL SUMMARY

Details of the summary of the published results of the Group are set out on page 81.

PROPERTY, PLANT AND EQUIPMENT

During the year, the Group continued to expand its pipeline infrastructure and other related facilities. An aggregate of RMB152 million has been incurred in acquiring property, plant and equipment.

During the year, the Group revalued certain of its properties, resulting in a revaluation surplus amounting to RMB12 million. This has been credited directly to the property revaluation reserve.

Details of the movements during the year in property, plant and equipment of the Group are set out in note 12 to the financial statements.

SHARE CAPITAL

Details of movements in the share capital of the Company since its incorporation are set out in note 27 to the financial statements.

RESERVES

Details of movements during the year in the reserves of the Company and the Group are set out in note 29 to the financial statements.

DIRECTORS

The Directors during the year and up to the date of this report were:

Executive directors

Wang Yusuo, Chairman	(appointed on 20 July 2000)
Yang Yu, Chief General Manager	(appointed on 4 December 2000)
Zhao Jinfeng	(appointed on 4 December 2000)
Qiao Limin	(appointed on 4 December 2000)
Jin Yongsheng	(appointed on 4 December 2000)
Yu Jianchao	(appointed on 4 December 2000)

Non-executive director

Zhao Baoju	(appointed on 20 July 2000)
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Independent non-executive directors

Wang Guangtian	(appointed on 28 March 2001)
Xu Liang	(appointed on 28 March 2001)

In accordance with the provisions of the Company's Articles of Association, Qiao Limin, Jin Yongsheng and Xu Liang will retire by rotation and, being eligible, offer themselves for re-election.

Each of the executive Directors has entered into a service agreement with the Company. Each service agreement is of an initial term of three years commencing 1 March 2001 and expiring on 29 February 2004 and shall continue thereafter until terminated by either party giving to the other not less than six months' prior written notice.

The non-executive Director and each of the independent non-executive Directors have been appointed for a term of three years, commencing 1 March 2001 and expiring on 29 February 2004 and thereafter are eligible for re-election.

DIRECTORS' EMOLUMENTS AND THE FIVE HIGHEST PAID INDIVIDUALS

Details of the Directors emoluments and of the five highest paid individuals in the Group are set out in note 7 to the financial statements.

DIRECTORS' INTERESTS IN SHARES

As at 31 December 2001, the interests of each of the Directors and their respective associates in the Company and its associated corporations (within the meanings of the Securities (Disclosure of Interests) Ordinance (Chapter 396 of the Laws of Hong Kong) (the "SDI Ordinance")) which were required to be notified to the Company and the Stock Exchange pursuant to Section 28 of the SDI Ordinance (including interests which were taken or deemed to have under Section 31 of, or Part I of the Schedule to, the SDI Ordinance) or which were required, pursuant to Section 29 of the SDI Ordinance, to be entered in the register required, pursuant to be kept therein, or which were required, pursuant to Rules 5.40 to 5.59 of the Rules Governing the Listing of Securities on GEM (the "GEM Listing Rules"), to be notified to the Company and the Stock Exchange were as follows:

	Personal interest	Family interest	Corporate interest	Other	Total
Mr. Wang Yusuo ("Mr. Wang")	–	–	420,000,000 Shares	–	420,000,000 Shares (<i>Note</i>)
Ms. Zhao Baoju ("Ms. Zhao")	–	–	420,000,000 Shares	–	420,000,000 Shares (<i>Note</i>)

Note: The two references to 420,000,000 Shares relate to the same block of Shares. Such Shares are held by Easywin Enterprises Limited, which is beneficially owned as to 50% by Mr. Wang and 50% by Ms. Zhao.

Save as disclosed above and disclosed under the heading "Arrangements to purchase Shares or debentures" in this report, as at 31 December 2001, none of the Directors or their associates had any personal, family, corporate or other interests in the Shares or any of its associated corporations as defined in the SDI Ordinance or which, pursuant to Rules 5.40 to 5.59 of the GEM Listing Rules, are required to be notified to the Company and the Stock Exchange.

SHARE OPTION SCHEME

The Company has adopted a share option scheme on 24 April 2001 (the "Scheme"). The purpose of the Scheme is to provide incentives for participants to strive for the goals of the Group whilst allowing them to enjoy the fruit of their efforts and contribution. Pursuant to the Scheme, the board of Directors may, at its discretion, invite any executive Directors and full time employees of the Group to take up options at HK\$1 per option to subscribe for Shares at an exercise price equal to at least the highest of (a) the closing price of the Shares on the Stock Exchange on the date of grant; (b) the average closing price of the Shares on the Stock Exchange for the five trading days immediately preceding the date of grant; and (c) the nominal value of a Share. The Scheme shall remain in force for a period of 10 years commencing on 24 April 2001 after which period no further options may be granted.

SHARE OPTIONS (CONT'D)

The maximum number of Shares in respect of which options may be granted under the Scheme may not exceed 30% of the issued share capital of the Company from time to time, which at the date of this annual report represents 221,100,000 Shares. Unless approved by shareholders of the Company in the manner set out in the GEM Listing Rules, the total number of Shares issued and to be issued upon exercise of the options granted to each participant (including both exercised and outstanding options) in any 12-month period must not exceed 1% of the Shares of the Company in issue. Where any further grant of options to a participant would result in the Shares issued and to be issued upon exercise of all options granted and to be granted to such person (including exercised, cancelled and outstanding options) in the 12-month period up to and including the date of such further grant representing in aggregate over 1% of the Shares in issue, such further grant must be separately approved by shareholders of the Company in general meeting with such participant and his associates (as defined in the GEM Listing Rules) abstaining from voting.

No share option was granted under the Scheme since its adoption and up to 31 December 2001.

ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

Pursuant to the Scheme, the Company has granted options on the Company's shares in favour of certain Directors and employees subsequent to the balance sheet date. Details of the options granted to the Directors are as follows:

	Number of share options granted subsequent to 31 December 2001 (Note)	Number of share options outstanding as at the date of this report
Yang Yu	2,400,000	2,400,000
Jin Yongsheng	1,500,000	1,500,000
Zhao Jinfeng	1,500,000	1,500,000
Qiao Limin	1,500,000	1,500,000
Yu Jianchao	1,500,000	1,500,000
	<u>8,400,000</u>	<u>8,400,000</u>

Note: The options were granted on 31 January 2002 at an exercise price of HK\$2.625 each. 50% of the options may be exercised between the period from 1 August 2002 and 30 January 2004 and thereafter, options may be exercised at any time up until 31 January 2012.

Save as disclosed above, at no time during the financial year ended 31 December 2001 was the Company, its ultimate holding company or its subsidiaries, a party to any arrangements to enable the Directors, their respective spouse or children under 18 years of age to acquire benefits by means of the acquisition of Shares in, or debentures of, the Company or any other body corporate.

DIRECTORS' INTERESTS IN CONTRACTS AND CONNECTED TRANSACTIONS

During the year, the Group had certain transactions with companies in which certain Directors have beneficial interests, details of which are set out in note 37 to the financial statements.

In the opinion of those Directors not having an interest in the above transactions, these transactions were carried out in the ordinary course of business of the Group and on normal commercial terms.

Other than as disclosed above, no other contracts of significance to which the Company, its ultimate holding company or its subsidiaries, was a party and in which a Director had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

SUBSTANTIAL SHAREHOLDERS

So far as the Directors are aware, as at 31 December 2001, the register of substantial shareholders maintained under Section 16 (1) of the SDI Ordinance showed that the Company has been notified of the following interests, being 10% or more of the Company's issued share capital:

Name	Number of Shares held	Approximate percentage of shareholding
Easywin Enterprises Limited	420,000,000 (Note)	66.99%
Mr. Wang	420,000,000 (Note)	66.99%
Ms. Zhao	420,000,000 (Note)	66.99%

Note: The three references to 420,000,000 Shares relate to the same block of Shares. Such Shares are held by Easywin Enterprises Limited, which is beneficially owned as to 50% by Mr. Wang and 50% by Ms. Zhao.

PURCHASE, SALES OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Shares during the financial year ended 31 December 2001.

COMPETING INTEREST

Each of the Directors and the management shareholders of the Company and their respective associates (as defined in the GEM Listing Rules) has confirmed that, none of them had any business or interest in companies that competes or may compete with the business of the Group.

SPONSOR'S INTEREST

As confirmed by the Company's sponsor, N M Rothschild & Sons (Hong Kong) Limited (the "Sponsor"), as at 31 December 2001, neither the Sponsor nor its directors, employees or associates (as referred in Note 3 to Rule 6.35 of the GEM Listing Rules) had any interests in the securities of the Company or any member of the Group or any rights to subscribe for or to nominate persons to subscribe for the securities of the Company or any member of the Group.

Pursuant to a sponsor's agreement dated 10 May 2001 between the Company and the Sponsor in connection with services to be rendered by the Sponsor pursuant to Rules 6.01 and 17.81 of the GEM Listing Rules, the Sponsor is entitled to receive fees for acting as the Company's retained sponsor for the period from 10 May 2001 to 31 December 2003.

POST BALANCE SHEET EVENTS

Details of significant events occurring after the balance sheet date are set out in note 40 to the financial statements.

AUDIT COMMITTEE

The Company established an audit committee on 28 March 2001 with written terms of reference in compliance with Rules 5.23 to 5.25 of the GEM Listing Rules and with reference to guidance published by the Hong Kong Society of Accountants. The primary duties of the audit committee are to review and supervise the financial reporting and internal control procedures of the Group.

The audit committee comprises three members, Wang Guangtian, Xu Liang and Yu Jianchao. Three meetings have been held by the committee members since the establishment of the audit committee.

BOARD PRACTICES AND PROCEDURES

Since the date of listing of the Shares on GEM on 10 May 2001 and up to 31 December 2001, the Company was in compliance with the Board Practices and Procedures as set out in Rules 5.28 to 5.39 of the GEM Listing Rules.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2001, the aggregate amount of turnover and purchases attributable to the Group's five largest customers and suppliers respectively accounted for less than 30% of the Group's total turnover and purchases.

PRE-EMPTIVE RIGHTS

There are no provision for pre-emptive rights under the Company's Articles of Association, or the laws of the Cayman Islands, which would oblige the Company to offer new Shares on a pro-rata basis to existing shareholders.

AUDITORS

A resolution will be submitted to the annual general meeting to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.



On behalf of the Board
Xinao Gas Holdings Limited

WANG Yusuo

Chairman

1 March 2002

德勤·關黃陳方會計師行

Certified Public Accountants
26/F, Wing On Centre
111 Connaught Road Central
Hong Kong

執業會計師
香港中環干諾道中111號
永安中心26樓

**Deloitte
Touche
Tohmatsu****TO THE SHAREHOLDERS OF XINAO GAS HOLDINGS LIMITED****新奧燃氣控股有限公司***(incorporated in the Cayman Islands with limited liability)*

We have audited the financial statements on pages 39 to 80 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2001 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Deloitte Touche Tohmatsu

Hong Kong, 1 March 2002

CONSOLIDATED INCOME STATEMENT

ANNUAL REPORT 2001 *For the year ended 31 December 2001*

	Notes	2001 RMB'000	2000 RMB'000
▶▶ Turnover	3	240,560	122,270
Cost of sales		(97,429)	(58,362)
Gross profit		143,131	63,908
Other revenue	4	7,946	945
Tax refund	5	5,388	5,180
Selling expenses		(4,446)	(2,041)
Administrative expenses		(40,780)	(9,153)
Other operating expenses		(1,323)	(357)
Profit from operations	6	109,916	58,482
Finance costs	8	(10,318)	(8,112)
Profit before taxation		99,598	50,370
Taxation	9	(11,081)	(6,976)
Profit before minority interests		88,517	43,394
Minority interests		(9,250)	(6,018)
Profit for the year		<u>79,267</u>	<u>37,376</u>
Dividends	10	<u>-</u>	<u>30,529</u>
Earnings per share	11	<u>14.3 cents</u>	<u>8.9 cents</u>

CONSOLIDATED BALANCE SHEET

At 31 December 2001 ANNUAL REPORT 2001

	Notes	2001 RMB'000	2000 RMB'000
Non-current assets			
Property, plant and equipment	12	409,889	260,999
Goodwill	13	7,787	–
Negative goodwill	14	(1,852)	–
		415,824	260,999
Current assets			
Inventories	16	31,994	12,903
Trade and other receivables	17	78,122	39,580
Amounts due from customers for contract work	18	11,778	4,143
Amounts due from related companies	19	3,115	74,548
Amount due from ultimate holding company	20	–	3,492
Bank balances and cash		182,472	39,366
		307,481	174,032
Current liabilities			
Trade and other payables	21	93,313	61,472
Amounts due to customers for contract work	18	16,364	5,505
Amounts due to related companies	22	13,660	90,482
Dividend payable to minority shareholder of a subsidiary		–	1,625
Amount due to ultimate holding company	23	–	81,374
Bank loans – due within one year	25	74,933	87,392
Tax payable		2,925	6,657
		201,195	334,507
Net current assets (liabilities)		106,286	(160,475)
Total assets less current liabilities		522,110	100,524
Non-current liabilities			
Bank loans – due after one year	25	48,215	20,915
Deferred taxation	26	3,730	–
		51,945	20,915
Minority interests		17,504	9,779
		452,661	69,830
Capital and reserves			
Share capital	27	66,462	–
Reserves	29	386,199	69,830
		452,661	69,830

The financial statements on pages 39 to 80 were approved and authorised for issue by the Board of Directors on 1 March 2002 and are signed on its behalf by:

WANG Yusuo
Director

YU Jianchao
Director

BALANCE SHEET

ANNUAL REPORT 2001 At 31 December 2001



	<i>Notes</i>	2001 RMB'000	2000 <i>RMB'000</i>
Non-current asset			
Interest in subsidiaries	15	<u>315,868</u>	—
Current assets			
Deposits and prepayments		4,994	—
Bank balances and cash		<u>49,443</u>	—
		54,437	—
Current liabilities			
Amounts due to subsidiaries	24	<u>54,060</u>	—
Net current assets		<u>377</u>	—
		<u>316,245</u>	<u>—</u>
Capital and reserves			
Share capital	27	66,462	—
Reserves	29	<u>249,783</u>	—
		<u>316,245</u>	<u>—</u>

WANG Yusuo

Director

YU Jianchao

Director

CONSOLIDATED STATEMENT OF RECOGNISED GAINS AND LOSSES

For the year ended 31 December 2001 ANNUAL REPORT 2001

	2001 RMB'000	2000 RMB'000
Net surplus arising on valuation of land and buildings not recognised in the consolidated income statement	8,725	–
Profit for the year	<u>79,267</u>	<u>37,376</u>
Total recognised gains	87,992	37,376
Negative goodwill arising on acquisition of subsidiaries	<u>–</u>	<u>5,590</u>
	<u>87,992</u>	<u>42,966</u>



CONSOLIDATED CASH FLOW STATEMENT

ANNUAL REPORT 2001 For the year ended 31 December 2001



	Notes	2001 RMB'000	2000 RMB'000
Net cash inflow from operating activities	30	<u>82,245</u>	<u>84,165</u>
Returns on investments and servicing of finance			
Interest received		2,875	202
Bank interest paid		(10,318)	(8,386)
Dividend paid		–	(30,529)
Dividends paid to minority shareholders		(2,975)	(13,471)
Net cash outflow from returns on investments and servicing of finance		<u>(10,418)</u>	<u>(52,184)</u>
Taxation			
PRC enterprise income tax paid		(14,813)	(7,433)
Tax refunded		10,568	–
Net cash outflow from taxation		<u>(4,245)</u>	<u>(7,433)</u>
Investing activities			
Purchase of property, plant and equipment		(111,154)	(24,206)
Acquisition of subsidiaries	31	(31,420)	(27,869)
Increase in interest in subsidiaries		(11,390)	(19,821)
Proceeds from disposal of property, plant and equipment		2,907	–
Net cash outflow from investing activities		<u>(151,057)</u>	<u>(71,896)</u>
Net cash outflow before financing		<u>(83,475)</u>	<u>(47,348)</u>
Financing	32		
Proceeds from shares issued		252,333	–
Shares issue expenses		(38,868)	–
Contribution from minority shareholders		1,333	–
New loans raised		86,977	68,507
Repayment of bank loans		(75,194)	(34,755)
Advance from ultimate holding company		–	51,186
Net cash inflow from financing		<u>226,581</u>	<u>84,938</u>
Increase in cash and cash equivalents		<u>143,106</u>	<u>37,590</u>
Cash and cash equivalents at beginning of the year		<u>39,366</u>	<u>1,776</u>
Cash and cash equivalents at end of the year		<u><u>182,472</u></u>	<u><u>39,366</u></u>
Analysis of the balances of cash and cash equivalents			
Bank balances and cash		<u><u>182,472</u></u>	<u><u>39,366</u></u>

1. GROUP RESTRUCTURING AND BASIS OF PREPARATION OF FINANCIAL STATEMENTS

The Company was incorporated in the Cayman Islands on 20 July 2000 as an exempt company under the Companies Law and its shares have been listed on The Growth Enterprise Market (“GEM”) of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) since 10 May 2001. Its ultimate holding company is Easywin Enterprises Limited (“Easywin”), a limited company incorporated in the British Virgin Islands.

The Company is an investment holding company. The activities of its principal subsidiaries are set out in note 41.

Under a group reorganisation scheme to rationalise the structure of the Group in preparation for the listing of the Company’s shares on GEM, the Company became the holding company of the other companies comprising the Group on 28 March 2001.

Details of the reorganisation are set out in the prospectus dated 27 April 2001 issued by the Company. The principal stages of the reorganisation which involved the exchange of shares, as the shares of the Company were issued and allotted to Easywin for the acquisition by the Company the entire issued share capital of Xinao Gas Investment Group Limited, the then holding company of the Group, from Easywin. The Group resulting from the reorganisation is regarded as a continuing entity. Accordingly, the financial statements of the Group have been prepared with the principles of merger accounting in accordance with the Statement of Standard Accounting Practice 27 “Accounting for group reconstructions”.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention as modified for revaluation of certain properties.

The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are as follows:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31 December each year.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant intercompany transactions and balances within the Group have been eliminated on consolidation.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Goodwill

Goodwill (negative goodwill) represents the difference between the cost of acquisition and the fair value of the Group's share of the identifiable assets and liabilities of a subsidiary at the effective date of acquisition.

Goodwill arising on acquisition prior to 1 January 2001 is held in reserves and will be charged to the income statement at the time of disposal of the relevant subsidiary, or at such time as the goodwill is determined to be impaired. Negative goodwill arising on acquisition prior to 1 January 2001 is held in reserves and will be credited to the income statement at the time of disposal of the relevant subsidiary.

Goodwill arising on acquisition after 1 January 2001 is capitalised and amortised on a straight line basis over its economic useful life which is not more than 20 years. Negative goodwill arising on acquisition after 1 January 2001 is recognised as income on a systematic basis over the remaining weighted average useful lives of the non-monetary assets acquired.

On disposal of a subsidiary, the attributable amount of unamortised goodwill or goodwill previously eliminated against or credited to reserves is included in the determination of the profit or loss on disposal.

Revenue recognition

Gas connection revenue is recognised when the outcome of a contract can be estimated reliably and the stage of completion at the balance sheet date can be measured reliably. Revenue from gas connection contracts is recognised on the percentage of completion method, measured by reference to the value of work carried out during the year. When the outcome of a gas connection contract cannot be estimated reliably, revenue is recognised only to the extent of contract cost incurred that it is probable to be recoverable.

Sales of gas and gas appliances are recognised when goods are delivered and title has been passed.

Interest income is accrued on a time basis by reference to the principal outstanding and at the interest rate applicable.

Rental income from properties under operating leases is recognised on a straight line basis over the lease terms.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Property, plant and equipment

Property, plant and equipment other than land and buildings and construction in progress are stated at cost less depreciation and amortisation and identified impairment losses.

Land and buildings are stated in the balance sheet at their revalued amount, being the fair value at the date of revaluation less any subsequent accumulated depreciation and amortisation and any subsequent impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

Any valuation increase arising on revaluation of land and buildings is credited to the revaluation reserve, except to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense, in which case the increase is credited to the income statement to the extent of the decrease previously charged. A decrease in net carrying amount arising on revaluation of an asset is dealt with as an expense to the extent that it exceeds the balance, if any, on the revaluation reserve relating to a previous revaluation of that asset. On subsequent sale or retirement of a revalued asset, the attributable surplus is transferred to retained profits.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the income statement.

Depreciation and amortisation is provided to write off the cost or valuation of property, plant and equipment other than construction in progress, over their estimated useful lives, and after taking into account their estimated residual value, using the straight line method, as follows:

Land use rights	Over the shorter of the term of the lease or the operation period of the relevant company
Buildings	Over the shorter of 30 years or the operation period of the relevant company
Pipelines	Over the shorter of 30 years or the operation period of the relevant company
Machinery and equipment	10 years
Motor vehicles	6 years
Office equipment	6 years

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Construction in progress

Construction in progress represents machinery and pipelines under construction and is stated at cost. Cost comprises direct and indirect costs of acquisition or construction. Completed items are transferred from construction in progress to proper categories of property, plant and equipment when they are ready for their intended use.

Investments in subsidiaries

Investments in subsidiaries are included in the Company's balance sheet at cost less any identified impairment loss.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets are capitalised as part of the assets. Capitalisation of such borrowing costs ceases when these qualifying assets are substantially ready for their intended use or sale.

All other borrowing costs are recognised as expenses in the period in which they are incurred.

Inventories

Inventories, including construction materials, gas appliances and gas for sales, consumables and spare parts are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method. Net realisable value is based on estimated selling prices in the ordinary course of business less estimated costs to completion and the estimated costs necessary to make the sale.

Construction contracts

When the outcome of a construction contract can be estimated reliably and the stage of contract completion at the balance sheet date can be measured reliably, contract costs are charged to the income statement by reference to the stage of completion of the contract activity at the balance sheet date on the same basis as contract revenue is recognised.

When the outcome of a construction contract cannot be estimated reliably, contract costs are recognised as expenses in the period in which they are incurred. When it is probable that total contract costs will exceed contract revenue, the expected loss is recognised as an expense immediately.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Research and development costs

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Expenditure on development is charged to the income statement in the year in which it is incurred except where a major project is undertaken and it is reasonably anticipated that development costs will be recovered through future commercial activity. The resultant asset is amortised on a straight line basis over its estimated economic life.

Taxation

The charge for taxation is based on the results for the year after adjusting for items which are non-assessable or disallowed. Certain items of income and expense are recognised for tax purposes in a different accounting period from that in which they are recognised in the income statement. The tax effect of the resulting timing differences, computed under the liability method, is recognised as deferred taxation in the financial statements to the extent that it is probable that a liability or asset will crystallise in the foreseeable future.

Foreign currencies

The Company and its subsidiaries maintain their books and records in Renminbi ("RMB"), the currency of which the majority of transactions are conducted. Transactions denominated in currencies other than RMB are translated into RMB at the applicable rates of exchange quoted by The People's Bank of China ("PBOC") prevailing at the dates of the transactions. Monetary assets and liabilities denominated in other currencies are re-translated into RMB at the applicable PBOC rates in effect at the period end dates. Gains and losses arising on exchange are dealt with in the income statement.

Retirement benefit scheme contribution

The retirement benefit scheme contribution charged to the income statement represent the Group's contribution payable to the retirement funds scheme managed by local social security bureau in accordance with the government regulations of the People's Republic of China ("PRC").

Operating leases

Rentals payable under operating leases are charged to the income statement on a straight line basis over the relevant lease term.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)**Impairment**

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. Impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount under another standard, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount under another standard, in which case the reversal of impairment loss is treated as a revaluation increase.

3. TURNOVER

	2001	2000
	RMB'000	RMB'000
Turnover comprises the following:		
Gas connection fees	184,796	101,282
Sales of gas	50,594	20,517
Sales of gas appliances	5,170	471
	<u>240,560</u>	<u>122,270</u>

4. OTHER REVENUE

	2001 RMB'000	2000 RMB'000
Other revenue comprises the following:		
Interest income	2,875	202
Income from rented premises under operating leases	1,805	–
Management fee income	264	–
Release of negative goodwill	96	–
Sundry income	2,906	743
	<u>7,946</u>	<u>945</u>

5. TAX REFUND

During the year, Langfang Xinao Gas Company Limited and Xinao Langfang Investment Limited, subsidiaries of the Company, applied for a refund of part of the income tax paid as an incentive for the investments in Langfang, the PRC, amounting to RMB5,388,000 (2000: RMB5,180,000). The application was approved by the relevant government authorities. The tax refund was recorded in the year when the relevant approval was obtained.

6. PROFIT FROM OPERATIONS

	2001 RMB'000	2000 RMB'000
Profit from operations has been arrived at after charging:		
Amortisation of goodwill	410	–
Auditors' remuneration	947	15
Depreciation and amortisation of property, plant and equipment	12,887	5,863
Loss on disposal of property, plant and equipment	143	2,035
Minimum lease payments under operating leases in respect of land and buildings	921	481
Provision for bad and doubtful debts	2,180	277
Research and development expenses	752	762
Staff costs	22,611	5,257
Less: Amount capitalised under construction in progress	–	(451)
	<u>22,611</u>	<u>4,806</u>

NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

ANNUAL REPORT 2001 *For the year ended 31 December 2001*

7. REMUNERATION OF DIRECTORS AND EMPLOYEES

	2001 <i>RMB'000</i>	2000 <i>RMB'000</i>
Directors		
Fees	191	–
Salaries and other benefits	3,357	–
Performance related incentive payments	235	–
Retirement benefits scheme contributions	15	–
	<u>3,798</u>	<u>–</u>
Analysed into:		
Director A	1,148	–
Director B	769	–
Director C	402	–
Director D	402	–
Director E	491	–
Director F	395	–
Director G	64	–
Director H	64	–
Director I	63	–
	<u>3,798</u>	<u>–</u>

The amounts disclosed above include directors' fees of RMB127,000 (2000: nil) payable to independent non-executive directors. None of the directors waived any emoluments in both years.

7. REMUNERATION OF DIRECTORS AND EMPLOYEES (CONT'D)

Employees

Details of the emoluments paid by the Group to the five highest paid individuals (including directors, details of whose emoluments are set out above, and employees) are as follows:

	2001 <i>RMB'000</i>	2000 <i>RMB'000</i>
Salaries and other benefits	3,303	141
Performance related incentive payments	107	–
Retirement benefits scheme contributions	16	6
	3,426	147

	2001 Number of individuals	2000 Number of individuals
Emoluments of the five highest paid individuals were within the following band:		

Nil – HK\$1,000,000	4	5
HK\$1,000,001 – HK\$1,500,000	1	–
Number of directors	3	–
Number of employees	2	5
	5	5

8. FINANCE COSTS

	2001	2000
	RMB'000	RMB'000
Interest on bank borrowings wholly repayable within five years	10,318	8,386
Less: Amount capitalised under construction in progress	—	(274)
	10,318	8,112

No interest was capitalised during the year. The annual capitalisation rate used to determine the amount of borrowing cost eligible for capitalisation in 2000 was 6.34%.

9. TAXATION

The charge represents enterprise income tax in the PRC for the year.

Pursuant to the relevant laws and regulations in the PRC, all the Company's PRC subsidiaries are entitled to exemption from PRC enterprise income tax for the first two years commencing from their first profit-making year of operation and thereafter, these PRC subsidiaries will be entitled to a 50% relief from PRC enterprise income tax for the following three years. The reduced tax rate for the relief period is ranging from 7.5% to 16.5%. The charge of PRC enterprise income tax for the years has been provided for after taking these tax incentives into account.

No provision for Hong Kong Profits Tax has been made as the Group's income neither arises in, nor is derived from, Hong Kong.

10. DIVIDENDS

No dividend has been paid or declared by the Company since its incorporation.

The comparative figure in 2000 represented the dividends declared by Langfang Xinao Gas Company Limited, paid to its then shareholders prior to the group reorganisation.

11. EARNINGS PER SHARE

The calculation of basic earnings per share for the year is based on the profit for the year of approximately RMB79,267,000 (2000: RMB37,376,000) and the weighted average of 553,446,575 (2000: 420,000,000) shares in issue during the year.

12. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings RMB'000	Pipelines RMB'000	Machinery and equipment RMB'000	Motor vehicles RMB'000	Office equipment RMB'000	Construction in progress RMB'000	Total RMB'000
THE GROUP							
COST/VALUATION							
At 1 January 2001	85,986	153,545	15,902	10,272	2,243	13,674	281,622
Acquired on acquisition of subsidiaries	8,996	19,103	2,012	1,513	535	10,099	42,258
Additions	5,687	4,682	5,376	4,255	2,010	89,144	111,154
Surplus on valuation	12,319	-	-	-	-	-	12,319
Reclassification	5,636	65,743	(10,418)	2,066	-	(63,027)	-
Disposals	(800)	(1,690)	(4)	(570)	(396)	(20)	(3,480)
At 31 December 2001	117,824	241,383	12,868	17,536	4,392	49,870	443,873
Comprising:							
At cost	12,694	241,383	12,868	17,536	4,392	49,870	338,743
At valuation	105,130	-	-	-	-	-	105,130
	117,824	241,383	12,868	17,536	4,392	49,870	443,873
DEPRECIATION AND AMORTISATION							
At 1 January 2001	4,010	13,353	501	2,281	478	-	20,623
Acquired on acquisition of subsidiaries	327	50	427	282	35	-	1,121
Provided for the year	3,703	5,612	764	2,421	387	-	12,887
Eliminated on valuation	(217)	-	-	-	-	-	(217)
Reclassification	-	267	(267)	-	-	-	-
Eliminated on disposals	-	(282)	(2)	(144)	(2)	-	(430)
At 31 December 2001	7,823	19,000	1,423	4,840	898	-	33,984
NET BOOK VALUES							
At 31 December 2001	110,001	222,383	11,445	12,696	3,494	49,870	409,889
At 31 December 2000	81,976	140,192	15,401	7,991	1,765	13,674	260,999

The land and buildings are situated in the PRC with medium term land use rights.

12. PROPERTY, PLANT AND EQUIPMENT (CONT'D)

In preparing the listing of the Company's shares on GEM, the Group revalued all of its land and buildings as at 31 January 2001, resulting in a revaluation surplus of RMB12,536,000 which has been credited to the revaluation reserve. The valuation was carried out by Chesterton Petty Limited, a firm of professionally qualified valuers, on open market value basis. The carrying value of these revalued land and buildings amounted to RMB105,130,000 at 31 December 2001. If they had not been revalued, they would have been included in the financial statements at historical cost less accumulated depreciation and amortisation of RMB92,984,000.

13. GOODWILL

	THE GROUP
	<i>RMB'000</i>
GROSS AMOUNT	
Arising on acquisition during the year and balance at 31 December 2001	8,197
AMORTISATION	
Charge for the year and balance at 31 December 2001	(410)
CARRYING VALUE	
At 31 December 2001	<u>7,787</u>

The amortisation period adopted for goodwill is 20 years.

14. NEGATIVE GOODWILL**THE GROUP**

RMB'000

GROSS AMOUNT

Arising on acquisition during the year and
balance at 31 December 2001

1,948

RELEASED TO INCOME

Released in the year and balance at 31 December 2001

(96)

CARRYING AMOUNT

At 31 December 2001

1,852

The negative goodwill is released to income on a straight line basis of 20 years, being the weighted average useful lives of non-monetary assets acquired.

15. INTEREST IN SUBSIDIARIES**THE COMPANY****2001**

2000

RMB'000

RMB'000

Unlisted shares, at cost

20,564

—

Amounts due from subsidiaries

295,304

—

315,868

—

The amounts due from subsidiaries are unsecured, interest free and are not repayable within the next year and accordingly, the amounts are shown as non-current.

Particulars of the principal subsidiaries are set out in note 41.

16. INVENTORIES

	THE GROUP	
	2001	2000
	RMB'000	RMB'000
Construction materials	27,722	10,988
Gas appliances	2,056	1,534
Piped gas	440	169
Spare parts and consumables	1,776	212
	<u>31,994</u>	<u>12,903</u>

All inventories were carried at cost at the balance sheet date.

17. TRADE AND OTHER RECEIVABLES

The Group allows an average credit period of 75 days to its trade customers.

	THE GROUP	
	2001	2000
	RMB'000	RMB'000
The following is an aging analysis of trade receivable:		
0 – 3 months	35,707	7,719
4 – 6 months	18,412	7,692
7 – 9 months	2,354	2,934
10 – 12 months	1,520	603
More than 1 year	3,993	–
	<u>61,986</u>	<u>18,948</u>
Trade receivable	61,986	18,948
Amount due from an officer	4,456	–
Prepayments, deposits and other receivables	11,680	20,632
	<u>78,122</u>	<u>39,580</u>

The amount due from an officer represents the amount advanced to Ms. Lam Hiu Ha, the Head of Hong Kong Office, which is unsecured, interest free and repayable on demand. The maximum amount outstanding during the year amounted to RMB4,456,000.

18. AMOUNTS DUE FROM (TO) CUSTOMERS FOR CONTRACT WORK

	THE GROUP	
	2001	2000
	<i>RMB'000</i>	<i>RMB'000</i>
Contract costs incurred plus recognised profits less anticipated losses	225,968	91,019
Less: Progress billings	(230,554)	(92,381)
	<u>(4,586)</u>	<u>(1,362)</u>
Analysed for reporting purposes as:		
Amounts due from customers for contract work	11,778	4,143
Amounts due to customers for contract work	(16,364)	(5,505)
	<u>(4,586)</u>	<u>(1,362)</u>

19. AMOUNTS DUE FROM RELATED COMPANIES

THE GROUP

Particulars of the amounts due from related companies are as follows:

Name of company	Balance at 31.12.2001 RMB'000	Balance at 1.1.2001 RMB'000	Maximum amount outstanding during the year RMB'000
北京市密雲化工公司 ("Beijing City Miyun Chemicals Company")	1,445	1,445	1,445
新奧集團石家莊化工機械股份有限公司 ("Xinao Group Shijiazong Chemical and Machinery Company Limited")	800	322	2,000
諸城市燃氣熱力總公司 ("Zhucheng City Gas and Heating Corporation")	501	-	501
廊坊新城房地產開發有限公司 ("Langfang Xincheng Property Development Company Limited")	369	-	369
廊坊市天然氣有限公司 ("Langfang City Natural Gas Company Limited")	-	29,876	29,876
廊坊開發區市政建設工程有限公司 ("Langfang Development Zone Urban Construction Engineering Company Limited")	-	20,400	20,400
Newstar Australia Pty. Ltd.	-	17,253	17,253
廊坊新奧物業管理有限公司 ("Langfang Xinao Property Management Company Limited")	-	2,745	2,745
廊坊新奧建築安裝工程有限公司 ("Langfang Xinao Construction and Decoration Engineering Company Limited")	-	2,000	2,000
北京新奧京昌燃氣有限公司 ("Beijing Xinao Jingchang Gas Company Limited")*	-	202	202
廊坊新奧酒店管理有限公司 ("Langfang Xinao Hotel Management Company Limited")	-	136	136
新奧集團太陽能有限公司 ("Xinao Group Solar Energy Company Limited")	-	100	100
北京新奧京谷燃氣有限公司 ("Beijing Xinao Jinggu Gas Company Limited")*	-	58	58
青島新奧燃氣有限公司 ("Qingdao Xinao Gas Company Limited")*	-	10	10
新奧集團股份有限公司 ("Xinao Group Company Limited")	-	1	326
	<u>3,115</u>	<u>74,548</u>	

19. AMOUNTS DUE FROM RELATED COMPANIES (CONT'D)

All the above related companies are controlled by Mr. Wang Yuso ("Mr. Wang") except for Beijing City Miyun Chemicals Company, which is the minority shareholder of Beijing Xinao Gas Company Limited, Zhucheng City Gas and Heating Corporation, which is the minority shareholder of Zhucheng Xinao Gas Company Limited and Newstar Australia Pty. Ltd., which is controlled by Ms. Zhao Baoju ("Ms. Zhao").

The amounts are unsecured, interest free and repayable on demand.

* *These companies were acquired by the Group during the year (see note 31).*

20. AMOUNT DUE FROM ULTIMATE HOLDING COMPANY

THE GROUP

The amount was unsecured and interest free.

21. TRADE AND OTHER PAYABLES

THE GROUP

2001	2000
RMB'000	RMB'000

The following is an aging analysis of trade payable:

0 – 3 months	36,299	17,082
4 – 6 months	8,120	7,163
7 – 9 months	5,306	4,833
10 – 12 months	3,043	9,475
More than 1 year	9,155	1,317
Trade payable	61,923	39,870
Advances received from customers	3,673	4,682
Accrued charges and other payables	27,717	16,920
	93,313	61,472

22. AMOUNTS DUE TO RELATED COMPANIES**THE GROUP**

Particulars of the amounts due to related companies are as follows:

Name of company	2001 RMB'000	2000 RMB'000
Langfang City Natural Gas Company Limited	10,000	1,023
北京市昌平市政經濟發展總公司 ("Beijing City Changping Urban Economic Development Head Corporation")	3,077	–
Xinao Group Shijiazhong Chemical and Machinery Company Limited	583	–
Xinao Group Company Limited	–	73,176
Langfang Xincheng Property Development Company Limited	–	10,346
Langfang Development Zone Urban Construction Engineering Company Limited	–	4,000
Beijing Xinao Jinggu Gas Company Limited*	–	1,312
Xinao Group Solar Energy Company Limited	–	503
Langfang Xinao Construction and Decoration Engineering Company Limited	–	122
	13,660	90,482

All the above related companies are controlled by Mr. Wang except for Beijing City Changping Urban Economic Development Head Corporation which is the minority shareholder of Changping Xinao Gas Company Limited. The amounts are unsecured, interest free and repayable on demand.

* The company was acquired by the Group during the year (see note 31).

23. AMOUNT DUE TO ULTIMATE HOLDING COMPANY**THE GROUP**

The amount was unsecured and interest free. The amount was fully capitalised during the year (see note 27(d)).

24. AMOUNTS DUE TO SUBSIDIARIES**THE COMPANY**

The amounts are unsecured, interest free and repayable on demand.

25. BANK LOANS

	THE GROUP	
	2001 <i>RMB'000</i>	2000 <i>RMB'000</i>
Secured bank loans	48,737	51,507
Unsecured bank loans	74,411	56,800
	<u>123,148</u>	<u>108,307</u>
The bank loans are repayable:		
Within one year	74,933	87,392
Between one to two years	37,798	20,210
Between two to five years	10,417	705
	<u>123,148</u>	<u>108,307</u>
<i>Less: Amount due within one year shown under current liabilities</i>	<u>(74,933)</u>	<u>(87,392)</u>
Amount due after one year	<u>48,215</u>	<u>20,915</u>

26. DEFERRED TAXATION

At the balance sheet date, the Group had deferred taxation amounting to RMB3,730,000 (2000: nil) arising on valuation of properties.

There was no other significant unprovided deferred taxation during the year or at the balance sheet date.

NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

ANNUAL REPORT 2001 For the year ended 31 December 2001

27. SHARE CAPITAL

	2001	2000	2001	2000
	Number of shares		HK\$'000	HK\$'000
Shares of HK\$0.10 each				
Authorised:				
At beginning of the year	1,000,000	–	100	–
Incorporation of the Company (note a)	–	1,000,000	–	100
Increase on 28 March 2001 (note c)	<u>2,999,000,000</u>	–	<u>299,900</u>	–
At end of the year	<u><u>3,000,000,000</u></u>	<u><u>1,000,000</u></u>	<u><u>300,000</u></u>	<u><u>100</u></u>
Issued and fully paid:				
At beginning of the year	10	–	–	–
Incorporation of the Company (note a)	–	2	–	–
Allotted on 21 August 2000 (note b)	–	8	–	–
Share exchange upon reorganisation (note c)	193,999,990	–	19,400	–
Capitalisation issue (note d)	226,000,000	–	22,600	–
Issue of shares on placing (note e)	180,000,000	–	18,000	–
Issue of shares on over-allotment (note f)	<u>27,000,000</u>	–	<u>2,700</u>	–
At end of the year	<u><u>627,000,000</u></u>	<u><u>10</u></u>	<u><u>62,700</u></u>	<u><u>–</u></u>
			RMB'000	RMB'000
Presented in financial statements as:				
At beginning of the year			–	–
Incorporation of the Company (note a)			–	–
Allotted on 21 August 2000 (note b)			–	–
Share exchange upon reorganisation (note c)			20,564	–
Capitalisation issue (note d)			23,956	–
Issue of shares on placing (note e)			19,080	–
Issue of shares on over-allotment (note f)			<u>2,862</u>	–
At end of the year			<u><u>66,462</u></u>	<u><u>–</u></u>

27. SHARE CAPITAL (CONT'D)

Notes:

- (a) On 20 July 2000, the Company was incorporated with an authorised share capital of HK\$100,000 divided into 1,000,000 shares of nominal value of HK\$0.10 each. On the same date, two shares were allotted and issued to the initial subscribers and each of such shares was then transferred to Mr. Wang and Ms. Zhao, respectively on 21 August 2000.
- (b) On 21 August 2000, the Company allotted eight shares at par as to seven shares to Mr. Wang and as to one share to Ms. Zhao, all of which were issued for cash at par.
- (c) On 28 March 2001, the Company increased its authorised share capital from HK\$100,000 to HK\$300,000,000, by the creation of an additional 2,999,000,000 shares and allotted and issued in aggregate 193,999,990 shares to Easywin credited as fully paid at HK\$19,399,999 in total for the acquisition by the Company of the entire issued share capital of Xinao Gas Investment Group Limited from Easywin.
- (d) On 9 May 2001, 226,000,000 shares were issued and credited as fully paid to Easywin by capitalising RMB81,374,000 (equivalent to approximately HK\$76,768,000) due from the Group to Easywin.
- (e) On 9 May 2001, 180,000,000 shares of HK\$0.10 each were issued at HK\$1.15 per share through an initial public offering by way of placing.
- (f) On 22 May 2001, 27,000,000 shares of HK\$0.10 each were issued at HK\$1.15 per share pursuant to the over-allotment option under the initial public offering aforesaid.

These shares rank *pari passu* with the existing shares in all respects. The net proceeds from shares issued under the initial public offering were used as general working capital and expansion of the Group.

28. SHARE OPTION SCHEME

Pursuant to the Company's share option scheme adopted on 24 April 2001 (the "Scheme"), the board of directors of the Company may, at its discretion, invite any executive directors and full time employees of the Group to take up options at HK\$1.00 per option to subscribe for shares in the Company at an exercise price equal to at least the highest of (a) the closing price of the Company's shares on the Stock Exchange on the date of grant and (b) the average closing price of the Company's shares on the Stock Exchange for the five trading days immediately preceding the date of grant; and (c) the nominal value of the Company's share.

No share option was granted under the Scheme since its adoption and up to 31 December 2001.

NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

ANNUAL REPORT 2001 *For the year ended 31 December 2001*

29. RESERVES

	THE GROUP		THE COMPANY	
	2001 RMB'000	2000 RMB'000	2001 RMB'000	2000 RMB'000
SHARE PREMIUM				
At beginning of the year	–	–	–	–
Arising on capitalisation issue (note 27(d))	57,418	–	57,418	–
Arising on shares issued upon initial public offering	230,391	–	230,391	–
Shares issue expenses	(38,868)	–	(38,868)	–
At end of the year	248,941	–	248,941	–
SPECIAL RESERVE				
At beginning of the year	21,731	21,731	–	–
Share exchange upon reorganisation (note 27(c))	(20,564)	–	–	–
At end of the year	1,167	21,731	–	–
GOODWILL RESERVE				
At beginning of the year	5,590	–	–	–
Negative goodwill arising on acquisition of businesses and subsidiaries	–	5,590	–	–
At end of the year	5,590	5,590	–	–
RETAINED PROFITS				
At beginning of the year	42,509	35,662	–	–
Profit for the year	79,267	37,376	842	–
Dividend	–	(30,529)	–	–
At end of the year	121,776	42,509	842	–
REVALUATION RESERVE				
At beginning of the year	–	–	–	–
Surplus arising on valuation of land and buildings	12,536	–	–	–
Tax effect on valuation surplus	(3,730)	–	–	–
Share of valuation surplus by minority shareholders	(81)	–	–	–
At end of the year	8,725	–	–	–
TOTAL RESERVES	386,199	69,830	249,783	–

29. RESERVES (CONT'D)

Under the Companies Law of the Cayman Islands, share premium is distributable to shareholders, subject to the condition that the Company cannot declare or pay a dividend, or make a distribution out of share premium, capital redemption reserve, unless immediately following the date on which distributions or dividend is proposed to be paid, the Company shall be able to pay its debts as they fall due in the ordinary course of business.

At the balance sheet date, the Company's reserves available for distribution to shareholders amounted to RMB249,783,000 (2000: nil).

30. RECONCILIATION OF PROFIT BEFORE TAXATION TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	2001	2000
	RMB'000	RMB'000
Profit before taxation	99,598	50,370
Loss on disposal of property, plant and equipment	143	2,035
Depreciation of property, plant and equipment	12,887	5,863
Amortisation of goodwill	410	–
Release of negative goodwill	(96)	–
Tax refund	(5,388)	(5,180)
Interest income	(2,875)	(202)
Interest expenses	10,318	8,112
Increase in inventories	(12,669)	(1,612)
Increase in trade and other receivables	(20,395)	(26,484)
Increase in amounts due from customers for contract work	(7,635)	(4,143)
Decrease in amounts due from related companies	71,433	5,405
Decrease (increase) in amount due from ultimate holding company	3,492	(3,492)
(Decrease) increase in trade and other payables	(1,015)	16,001
Increase in amounts due to customers for contract work	10,859	5,505
(Decrease) increase in amounts due to related companies	(76,822)	31,987
	82,245	84,165
Net cash inflow from operating activities	82,245	84,165

31. ACQUISITION OF SUBSIDIARIES

During the year ended 31 December 2000 and 2001, the Group acquired the following companies, particulars of which are as follows:

For the year ended 31 December 2000

Name of subsidiary	Acquired company	Equity interest acquired	Consideration <i>RMB'000</i>	Date of acquisition
Xinao Miyun Investment Limited	Beijing Xinao Gas Company Limited	80%	7,930	30 July 2000
Xinao Huludao Investment Limited	Huludao Xinao Gas Company Limited	90%	9,011	3 August 2000
Xinao Liaocheng Investment Limited	Liaocheng Xinao Gas Company Limited	90%	14,424	7 August 2000

For the year ended 31 December 2001

Name of subsidiary	Acquired company	Equity interest acquired	Consideration <i>RMB'000</i>	Date of acquisition
Xinao Huangdao Investment Limited	Qingdao Xinao Gas Company Limited	90%	18,232	23 May 2001
Xinao Pinggu Investment Limited	Beijing Xinao Jinggu Gas Company Limited	70%	6,996	18 June 2001
Xinao Changping Investment Limited	Beijing Xinao Jingchang Gas Company Limited	80%	7,920	16 August 2001

31. ACQUISITION OF SUBSIDIARIES (CONT'D)

The acquisition has been accounted for by the acquisition method of accounting and particulars of the acquisition are:


	2001 RMB'000	2000 RMB'000
Net assets acquired		
Property, plant and equipment	41,137	64,026
Inventories	6,422	8,419
Trade and other receivables	23,327	6,701
Amounts due from related companies	–	7,503
Bank balances and cash	1,728	3,496
Tax recoverable	–	105
Trade and other payables	(32,856)	(24,504)
Amounts due to related companies	–	(3,068)
Tax payable	–	(889)
Bank loans	(3,058)	(24,800)
Minority interests	(6,387)	(4,560)
	30,313	32,429
Goodwill (negative goodwill)	2,835	(1,064)
Total consideration	<u>33,148</u>	<u>31,365</u>
Satisfied by		
Cash consideration	<u>33,148</u>	<u>31,365</u>
Outflow of cash and cash equivalents arising on acquisition		
Cash consideration	33,148	31,365
Bank balances and cash acquired	(1,728)	(3,496)
Net outflow of cash and cash equivalents in respect of purchase of subsidiaries	<u>31,420</u>	<u>27,869</u>

NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

ANNUAL REPORT 2001 For the year ended 31 December 2001

31. ACQUISITION OF SUBSIDIARIES (CONT'D)

The financial impacts of the subsidiaries acquired during the year are:



	2001 <i>RMB'000</i>	2000 <i>RMB'000</i>
Results		
Contribution to the Group's turnover	36,888	24,980
Contribution to the Group's profit for the year	<u>16,265</u>	<u>6,636</u>
Cash flows		
Contribution to the Group's net operating cash flows	38,703	12,712
Payment in respect of the net returns on investments and servicing of finance	(116)	(703)
Payment in respect of taxation	(59)	(902)
Utilisation of funds for investing activities	(34,926)	(9,268)
Fund (utilised) raised in respect of financing activities	<u>(17)</u>	<u>521</u>

32. ANALYSIS OF CHANGES IN FINANCING DURING THE YEAR

	2001 RMB'000	2000 RMB'000
SHARE CAPITAL AND PREMIUM		
At beginning of the year	–	–
Capitalisation issue	81,374	–
Share exchange upon reorganisation	20,564	–
Shares issued upon initial public offering	252,333	–
Shares issue expenses	(38,868)	–
	<u>315,403</u>	<u>–</u>
At end of the year	<u>315,403</u>	<u>–</u>
MINORITY INTERESTS		
At beginning of the year	9,779	38,644
Contribution from minority shareholders	1,333	–
On acquisition of subsidiaries	6,387	4,560
Share of profits and reserves by minority shareholders of subsidiaries	9,331	6,018
Dividend paid	(1,350)	(13,471)
Dividend payable	–	(1,625)
Increase in interest in subsidiaries	(7,976)	(24,347)
	<u>17,504</u>	<u>9,779</u>
At end of the year	<u>17,504</u>	<u>9,779</u>
BANK LOANS		
At beginning of the year	108,307	49,755
New loans raised	86,977	68,507
On acquisition of subsidiaries	3,058	24,800
Repayments	(75,194)	(34,755)
	<u>123,148</u>	<u>108,307</u>
At end of the year	<u>123,148</u>	<u>108,307</u>
AMOUNT DUE TO ULTIMATE HOLDING COMPANY		
At beginning of the year	81,374	30,188
Advance during the year	–	51,186
Capitalisation issue	(81,374)	–
	<u>–</u>	<u>81,374</u>
At end of the year	<u>–</u>	<u>81,374</u>

33. MAJOR NON-CASH TRANSACTIONS

During the year ended 31 December 2001, the Company acquired the entire issued share capital of Xinao Gas Investment Group Limited from Easywin by way of share exchange (see note 27(c)) and also capitalised the amount due to Easywin (see note 27(d)).

During the year ended 31 December 2000, the Group acquired property, plant and equipment amounting to RMB83,471,000 which were settled by setting off against the amounts due from related companies.

34. CAPITAL COMMITMENTS

	2001 <i>RMB'000</i>	2000 <i>RMB'000</i>
Capital expenditure in respect of the acquisition of property, plant and equipment contracted but not provided for in the financial statements	<u>2,375</u>	<u>3,311</u>

35. LEASE COMMITMENTS

The Group as lessee

At the balance sheet date, the Group had commitments for future minimum lease payments under non-cancellable operating leases in respect of rented premises which fall due as follows:

	2001 <i>RMB'000</i>	2000 <i>RMB'000</i>
Within one year	997	549
In the second to fifth years inclusive	1,915	583
Over five years	<u>188</u>	<u>—</u>
	<u>3,100</u>	<u>1,132</u>

Leases are negotiated for an average term of 2 years with fixed rentals.

35. LEASE COMMITMENTS (CONT'D)

The Group as lessor

Certain of the Group's properties with a carrying amount of RMB21,115,000 (2000: nil) are held for rental purposes. The depreciation charge of these properties amounted to RMB1,559,000 (2000: nil) for the year. The properties are expected to generate rental yields of 8.5% on an ongoing basis. All of the properties held have committed tenants for the next two years.

At the balance sheet date, the Group had contracted with tenants for the following future minimum lease payments:

	2001 <i>RMB'000</i>	2000 <i>RMB'000</i>
Within one year	1,805	—
In the second to fifth years inclusive	1,805	—
	3,610	—

The Company had no operating lease commitments at the balance sheet date for both years.

36. PLEDGE OF ASSETS

At the balance sheet date, the Group pledged certain assets as securities for general credit facilities granted as follows:

	2001 <i>RMB'000</i>	2000 <i>RMB'000</i>
Property, plant and equipment	48,737	130,235

NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

ANNUAL REPORT 2001 For the year ended 31 December 2001

37. RELATED PARTY TRANSACTIONS

Name of related party	Nature of transaction	2001 RMB'000	2000 RMB'000
Langfang Xincheng Property Development Company Limited	Provision of gas connection services by the Group (Note i)	7,785	11,360
	Acquisition of land and buildings by the Group (Note iv)	–	7,600
Langfang Xinao Hotel Management Company Limited	Provision of gas connection services by the Group (Note i)	–	453
	Sales of gas by the Group (Note ii)	885	125
Langfang Xinao Property Management Company Limited	Provision of gas connection services by the Group (Note i)	330	82
	Sales of gas by the Group (Note ii)	6,690	3,927
	Provision for management services to the Group (Note iii)	1,056	–
	Lease of premises by the Group (Note v)	330	–
Xinao Group Solar Energy Company Limited	Sales of gas by the Group (Note ii)	46	65
Langfang City Natural Gas Company Limited	Acquisition of land and buildings by the Group (Note iv)	–	540
	Acquisition of pipelines and related facilities (Note iv)	–	27,431
Xinao Group Company Limited	Sales of gas by the Group (Note ii)	362	525
	Acquisition of land and buildings by the Group (Note iv)	–	47,900
	Lease of premises by the Group (Note v)	1,475	–
	Reimbursement of management fee (Note v)	264	–
	Lease of premises to the Group (Note v)	136	–
Xinao Group Shijiazhong Chemical and Machinery Company Limited	Acquisition of compressed natural gas truck trailers, pressure regulating and gas equipment (Note vi)	7,755	–

37. RELATED PARTY TRANSACTIONS (CONT'D)

Notes:

- (i) The provision of gas connection services was charged in accordance with rates agreed between the Group and the related parties by reference to the Group's similar transactions with outside customers.
- (ii) The sales of gas were charged in accordance with rates agreed between the Group and the related parties by reference to the Group's similar transactions with outside customers.
- (iii) The provision of management services was determined in accordance to the contract entered into between the Group and the related company.
- (iv) The consideration for the acquisition of property, plant and equipment from the related parties during the year ended 31 December 2000 was determined by reference to valuation made by an independent valuer.
- (v) Rental for lease of premises and reimbursement of management fee were determined in accordance to the contracts entered into between the Group and the related companies.
- (vi) The consideration for acquisition of compressed natural gas truck trailers, pressure regulating and gas equipment was charged in accordance with prices by reference to the similar transactions with outsiders.

In the opinion of the directors of the Company, all of the above-mentioned transactions were entered into in the ordinary course of business of the Group.

38. SEGMENT INFORMATION**(a) Business segments**

For management purposes, the Group is currently divided into three divisions, gas connection, sales of gas and sales of gas appliances. These divisions are the basis on which the Group reports its primary segment information.

An analysis of the Group's turnover and contribution by business segment during the year is as follows:

	2001	2000
	RMB'000	RMB'000
Turnover		
Gas connection fees	184,796	101,282
Sales of gas	50,594	20,517
Sales of gas appliances	5,170	471
	<u>240,560</u>	<u>122,270</u>
Profit from operations		
Gas connection fees	128,076	64,171
Sales of gas	22,199	3,391
Sales of gas appliances	460	164
Unallocated other revenue	13,334	6,125
Unallocated expenses:		
– depreciation and amortisation (<i>Note</i>)	(7,604)	(3,818)
– corporate expenses	(46,549)	(11,551)
	<u>109,916</u>	<u>58,482</u>

Note: The amount represents principally depreciation and amortisation of property, plant and equipment relating to the gas connection and piped gas operation.

38. SEGMENT INFORMATION (CONT'D)

(a) Business segments (Cont'd)

An analysis of the Group's total assets and liabilities by business segment is as follows:

	2001	2000
	RMB'000	RMB'000
Assets:		
Segment assets		
– gas connection fees	71,452	26,645
– sales of gas	57,428	6,549
– sales of gas appliances	11,177	756
– unallocated segment assets	320,492	200,053
Unallocated corporate assets	262,756	201,028
	<u>723,305</u>	<u>435,031</u>
Liabilities:		
Segment liabilities		
– gas connection fees	50,600	16,563
– sales of gas	19,831	8,220
– sales of gas appliances	2,740	–
– unallocated segment liabilities	26,369	37,443
Unallocated corporate liabilities	153,600	293,196
	<u>253,140</u>	<u>355,422</u>

(b) Geographical segment

More than 90 per cent. of the Group's assets are located in the PRC, including Hong Kong, as at the balance sheet date.

All of the Group's businesses are derived from activities in the PRC, including Hong Kong, in both years.

39. RETIREMENT BENEFITS SCHEMES

According to the relevant laws and regulations in the PRC, the PRC subsidiaries are required to contribute a certain percentage of the payroll of their employees to the retirement benefits schemes to fund the retirement benefits of their employees. With effect from 1 December 2000, a subsidiary of the Company is required to join a Mandatory Provident Fund Scheme for all its employees in Hong Kong. The only obligation of the Group with respect to the retirement benefits schemes is to make the required contributions under the respective schemes. During the year, there were no forfeited contributions, which arose upon employees leaving the retirement benefits schemes, available to reduce the contribution payable in the future periods.

	2001	2000
	RMB'000	RMB'000
Retirement benefit contribution made during the year	<u><u>1,167</u></u>	<u><u>377</u></u>

40. POST BALANCE SHEET EVENTS

Subsequent to the balance sheet date, the following significant events took place:

- (a) On 4 February 2002, Yantai Xinao Gas Company Limited, a wholly owned subsidiary of the Company, entered into an agreement with Xinao Group Shijiazhong Chemical and Machinery Company Limited to purchase two compressed natural gas truck trailers with gas storage facility at a consideration of RMB1,700,000.
- (b) On 4 February 2002, Yangzhou Xinao Gas Company Limited, a wholly owned subsidiary of the Company, entered into an agreement with Xinao Group Shijiazhong Chemical and Machinery Company Limited to purchase pressure regulating equipment at a consideration of RMB800,000.
- (c) On 20 February 2002, the Company made an advance booking of an application for the proposed listing to the Main Board of the Stock Exchange by way of an introduction.

The Company has also informed the Stock Exchange of its intention to voluntary withdraw listing of its shares on GEM which will be conditional upon, among other things, the successful outcome of the application for the proposed listing of the shares on the Main Board.

41. PARTICULAR OF PRINCIPAL SUBSIDIARIES

Name of company	Place of incorporation/ establishment	Issued and fully paid share capital/ registered capital	Proportion of nominal value of issued capital/ registered capital held by the Company	Principal activities
北京新奥燃气有限公司 ("Beijing Xinao Gas Company Limited")	The PRC	Registered capital US\$1,195,600	95%	Investment in gas pipeline infrastructure and provision of piped gas
北京新奥京昌燃气有限公司 ("Beijing Xinao Jingchang Gas Company Limited")	The PRC	Registered capital RMB9,900,000	80%	Investment in gas pipeline infrastructure and provision of piped gas
北京新奥京谷燃气有限公司 ("Beijing Xinao Jinggu Gas Company Limited")	The PRC	Registered capital RMB9,900,000	70%	Investment in gas pipeline infrastructure and provision of piped gas
蚌埠新奥燃气有限公司 ("Bengbu Xinao Gas Company Limited")	The PRC	Registered capital RMB110,000,000	70%	Investment in gas pipeline infrastructure and provision of piped gas
葫蘆島新奥燃气有限公司 ("Huludao Xinao Gas Company Limited")	The PRC	Registered capital US\$1,207,700	90%	Investment in gas pipeline infrastructure and provision of piped gas
廊坊新奥燃气有限公司 ("Langfang Xinao Gas Company Limited")	The PRC	Registered capital US\$9,333,900	100%	Investment in gas pipeline infrastructure and provision of piped gas

NOTES TO THE FINANCIAL STATEMENTS (CONT'D)

ANNUAL REPORT 2001 For the year ended 31 December 2001

41. PARTICULAR OF PRINCIPAL SUBSIDIARIES (CONT'D)

Name of company	Place of incorporation/ establishment	Issued and fully paid share capital/ registered capital	Proportion of nominal value of issued capital/ registered capital held by the Company	Principal activities
廊坊新奧燃氣設備有限公司 ("Langfang Xinao Gas Equipment Company Limited")	The PRC	Registered capital US\$360,000	100%	Manufacture of stored value card gas metre
聊城新奧燃氣有限公司 ("Liaocheng Xinao Gas Company Limited")	The PRC	Registered capital RMB16,000,000	90%	Investment in gas pipeline infrastructure and provision of piped gas
青島新奧燃氣有限公司 ("Qingdao Xinao Gas Company Limited")	The PRC	Registered capital RMB20,000,000	90%	Investment in gas pipeline infrastructure and provision of piped gas
青島新奧新城燃氣有限公司 ("Qingdao Xinao Xincheng Gas Company Limited")	The PRC	Registered capital US\$1,610,000	90%	Investment in gas pipeline infrastructure and provision of piped gas
新奧(中國)燃氣發展有限公司 ("Xinao (China) Gas Development Company Limited")	The PRC	Registered capital US\$6,000,000	100%	Sourcing of compressed natural gas
揚州新奧燃氣有限公司 ("Yangzhou Xinao Gas Company Limited")	The PRC	Registered capital US\$1,300,000	100%	Investment in gas pipeline infrastructure and provision of piped gas

41. PARTICULAR OF PRINCIPAL SUBSIDIARIES (CONT'D)

Name of company	Place of incorporation/ establishment	Issued and fully paid share capital/ registered capital	Proportion of nominal value of issued capital/ registered capital held by the Company	Principal activities
煙台新奧燃氣有限公司 ("Yantai Xinao Gas Company Limited")	The PRC	Registered capital US\$2,100,000	100%	Investment in gas pipeline infrastructure and provision of piped gas
諸城新奧燃氣有限公司 ("Zhucheng Xinao Gas Company Limited")	The PRC	Registered capital US\$3,000,000	80%	Investment in gas pipeline infrastructure and provision of piped gas
Xinao Gas Investment Group Limited	British Virgin Islands	Share capital US\$1,000	100%	Investment holding

All of the above subsidiaries, except for Xinao Gas Investment Group Limited, are indirectly held by the Company.

All subsidiaries operate principally in their respective place of incorporation/establishment.


The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results or net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

None of the subsidiaries had any loan capital subsisting as at 31 December 2001 or at any time during the year.

FINANCIAL SUMMARY

ANNUAL REPORT 2001

Results



	1998 <i>RMB'000</i>	1999 <i>RMB'000</i>	2000 <i>RMB'000</i>	2001 <i>RMB'000</i>
Turnover	<u>41,109</u>	<u>52,923</u>	<u>122,270</u>	<u>240,560</u>
Profit before taxation	15,822	25,572	50,370	99,598
Taxation	<u>(2,373)</u>	<u>(3,836)</u>	<u>(6,976)</u>	<u>(11,081)</u>
Profit before minority interests	13,449	21,736	43,394	88,517
Minority interests	<u>(4,117)</u>	<u>(6,653)</u>	<u>(6,018)</u>	<u>(9,250)</u>
Profit for the year	<u>9,332</u>	<u>15,083</u>	<u>37,376</u>	<u>79,267</u>


1. The results of the three years ended 31 December 2000 have been extracted from the Company's prospectus dated 27 April 2001.
2. The Company was incorporated in the Cayman Islands on 20 July 2000. The only balance sheets for the Group that have been prepared over the past five years are those set out on page 40.

NOTICE IS HEREBY GIVEN that the Annual General Meeting (the “Meeting”) of Xinao Gas Holdings Limited (the “Company”) will be held at Taishan Room, 5th Floor, Island Shangri-La Hong Kong, Pacific Place, Supreme Court Road, Admiralty, Hong Kong on Tuesday, 21 May 2002 at 9:30 am for the following purposes:

1. To receive and consider the audited financial statements and the reports of the directors and auditors for the year ended 31 December 2001;
2. To re-elect retiring directors and to authorise the board of directors to fix the directors’ fees;
3. To re-appoint the auditors and to authorise the board of directors to fix their remuneration; and
4. As special business, to consider and, if thought fit, pass, with or without modification, the following resolutions which will be proposed as ordinary resolutions:

(1) **“THAT:**

- (a) subject to paragraph (c) below, and pursuant to the Rules Governing the Listing of Securities on the Growth Enterprise Market (“GEM”) of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) or the Rules Governing the Listing of Securities on the Stock Exchange, the exercise by the directors of the Company during the Relevant Period (as hereinafter defined) of all the powers of the Company to allot, issue and deal with any unissued shares in the capital of the Company and to make or grant offers, agreements and options (including but not limited to warrants, bonds and debentures convertible into shares of the Company) which might require the exercise of such power be and is hereby generally and unconditionally approved;
- (b) the approval in paragraph (a) shall authorise the directors of the Company during the Relevant Period (as hereinafter defined) to make or grant offers, agreements and options (including but not limited to warrants, bonds and debentures convertible into shares of the Company) which might require the exercise of such power after the end of the Relevant Period (as hereinafter defined);
- (c) the aggregate nominal value of the share capital allotted or agreed conditionally or unconditionally to be allotted or issued (whether pursuant to an option or otherwise) by the directors of the Company pursuant to the approval in paragraph (a) above, otherwise than pursuant to (i) a Rights Issue (as hereinafter defined); or (ii) an issue of shares upon the exercise of the subscription rights attaching to any warrants which may be issued by the Company from time to time; or (iii) an issue of shares upon the exercise of options which may be granted under any option scheme or similar arrangement for the time being adopted or to adopt for the grant or issue to any officers, employees and/or directors of the Company and/or any of its subsidiaries and/or any other participants of such scheme or arrangement of shares or rights to acquire shares; or (iv) any scrip dividend scheme or



similar arrangement providing for the allotment and issue of shares in lieu of the whole or part of a dividend on shares in accordance with the articles of association of the Company; or (v) a specific authority granted by the shareholders of the Company in general meeting, shall not exceed 20 per cent. of the aggregate of the total nominal value of share capital of the Company in issue at the date of passing of this Resolution, and the said approval shall be limited accordingly; and

- (d) for the purpose of this Resolution:

“Relevant Period” means the period from the passing of this Resolution until whichever is the earlier of:

- (i) the conclusion of the next annual general meeting of the Company;
- (ii) the expiration of the period within which the next annual general meeting of the Company is required by the articles of association of the Company or any applicable laws to be held; or
- (iii) the passing of an ordinary resolution by shareholders of the Company in general meeting revoking, varying or renewing the authority given to the directors of the Company by this Resolution; and

“Rights Issue” means an offer of shares or issue of options, warrants or other securities giving the right to subscribe for shares, open for a period fixed by the directors of the Company to holders of shares whose names appear on the register of shareholders of the Company (and, where appropriate, to holders of other securities of the Company entitled to the offer) on a fixed record date in proportion to their then holdings of such shares (or, where appropriate, such other securities), subject in all cases to such exclusions or other arrangements as the directors of the Company may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of, or the requirements of any recognised regulatory body or any stock exchange in, any territory applicable to the Company.

- (2) **“THAT:**

- (a) subject to paragraph (b) below, the exercise by the directors of the Company during the Relevant Period (as hereinafter defined) of all powers of the Company to repurchase securities of the Company on the Growth Enterprise Market (“GEM”) or on the Main Board of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”), subject to and in accordance with all applicable laws and/or the requirements of the Rules Governing the Listing of Securities on the GEM or the Rules Governing the Listing of Securities on the Stock Exchange as amended from time to time, be and is hereby generally and unconditionally approved;

(b) the aggregate nominal value of securities of the Company repurchased by the Company pursuant to the approval in paragraph (a) above during the Relevant Period (as hereinafter defined) shall in the case of shares not exceed 10 per cent. of the aggregate of the total nominal value of share capital of the Company in issue at the date of passing of this Resolution, and the authority granted pursuant to paragraph (a) above shall be limited accordingly; and

(c) for the purposes of this Resolution,

“Relevant Period” means the period from the passing of this Resolution until whichever is the earlier of:

(i) the conclusion of the next annual general meeting of the Company; or

(ii) the expiration of the period within which the next annual general meeting of the Company is required by the articles of association of the Company or any applicable laws to be held; or

(iii) the passing of an ordinary resolution by shareholders of the Company in general meeting revoking, varying or renewing the authority given to the directors of the Company by this Resolution.”

(3) “**THAT** conditional upon Resolutions numbered 1 and 2 set out in item 4 of the notice of this meeting being passed, the general mandate granted to the directors of the Company and for the time being in force to exercise the powers of the Company to allot, issue and deal with any unissued shares pursuant to Resolution numbered 1 set out in item 4 of the notice of this meeting be and is hereby extended by the addition to the aggregate nominal value of the share capital of the Company which may be allotted or agreed conditionally or unconditionally to be allotted by the directors of the Company pursuant to such general mandate of an amount representing the aggregate nominal value of the share capital of the Company repurchased by the Company under the authority granted pursuant to Resolution numbered 2 set out in item 4 of the notice of this meeting, provided that such extended amount shall not exceed 10 per cent. of the aggregate of the total nominal value of share capital of the Company in issue at the date of passing of the said Resolution.”

By order of the Board
Xinao Gas Holdings Limited
CHENG Chak Ngok
Company Secretary

Hong Kong, 28 March 2002

Principal place of business in Hong Kong:



Xinao Gas Holdings Limited
Room 4202
Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong

Notes:

1. In order to qualify for attending the forthcoming Meeting of the Company, all share transfers accompanied by the relevant share certificates must be lodged with the Company's branch share registrar in Hong Kong, Central Registration Hong Kong Limited, Rooms 1901-5, 19th Floor, Hopewell Centre, 185 Queen's Road East, Wanchai, Hong Kong not less than 48 hours before the appointed time for holding the Meeting.
2. Every shareholder of the Company entitled to attend and vote at the Meeting is entitled to appoint one or more proxies to attend and, on a poll, vote in his stead. A proxy need not be a shareholder of the Company.
3. To be valid, a form of proxy and the power of attorney or other authority (if any) under which it is signed or a notarially certified copy of that power or authority, must be deposited at the Company's branch share registrar in Hong Kong, Central Registration Hong Kong Limited, Rooms 1901-5, 19th Floor, Hopewell Centre, 185 Queen's Road East, Wanchai, Hong Kong not less than 48 hours before the time appointed for holding the Meeting.
4. Completion and delivery of the form of proxy will not preclude a shareholder of the Company from attending and voting at the Meeting if the shareholder of the Company so desires.
5. An explanatory statement containing further details regarding Ordinary Resolution numbered 2 set out in item 4 of the notice of this Meeting as required by the Rules Governing the Listing of Securities on the Growth Enterprise Limited of The Stock Exchange of Hong Kong Limited and the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited will be despatched to the shareholders of the Company together with The Company's 2001 annual report.