

CHAIRMAN'S STATEMENT

THE COMPANY HAS FURTHER
INCREASED ITS MARKET SHARE
AND BRAND RECOGNITION IN THE
PRC PIPED GAS DISTRIBUTION
MARKET



WANG Yusuo
Chairman

Xinao Gas Holdings Limited, formerly listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited, has by way of introduction been moved to the Main Board since 3 June 2002. Xinao Gas is the second company that has successfully transferred its listing status from the Growth Enterprise Market to the Main Board. This fully exemplifies the ability and earning power of the Group and offers an opportunity for major international fund management companies to invest in and share the rapid growth of the PRC enterprises.

RESULTS OF THE YEAR

Building on its previous encouraging results, the Group continued to record a substantial growth. The turnover and profit for the year were RMB544.5 million and RMB127.9 million respectively, representing increases of 1.3 times and 61.4% as compared to last year. Earnings per share increased 25.9 % to RMB18.0 cents.

The Group secured 14 new projects this year, including one in a provincial capital, eight in cities at prefecture level and five in cities at county level, thus accomplishing the target of securing six to eight new projects this year. Four of the new projects secured this year are in Jiangsu Province, three in Zhejiang Province, three in Anhui Province and one in each of the provinces of Shandong, Henan, Liaoning and Hebei. Coverage of connectable population increased 1.8 times to approximately 9.5 million. The new project company in Hebei Province is Shijiazhuang Xinao Gas Company Limited. The Group secured the exclusive right to distribute piped gas in Shijiazhuang, the provincial capital of Hebei, at the end of last year. The Shijiazhuang project is the Group's first project in a provincial capital and the largest one in terms of population. The securing of the Shijiazhuang project reflects the Group's ability in investment, operation and management and also demonstrates that the Group has invested shareholders' capital into projects of medium to large size to take the advantage of economies of scale and to maximise shareholder's return.

As at the end of 2002, the Group made natural gas connections to a total of 210,850 residential households and 502 commercial/industrial customers (connected to a total installed designed daily capacity of 365,113 m³ of gas appliances), representing increases of 102,849 residential households and 147 commercial/industrial customers (with an increase of total installed designed daily capacity of 95,366 m³) when compared to 2001. The sales volume of natural gas for the year also increased by 43.2%.

FINANCIAL POSITION

As at the end of 2002, the Group's cash on hand was RMB631.5 million, and bank and other borrowings were RMB467.4 million while net cash amounted to RMB164.1 million. Together with the credit facilities of RMB700 million granted by local financial institutions to the Group's project companies, the Group has adequate resources for future development. The Company placed 110 million shares at HK\$3.05 per share to international assets management companies and professional investors in March 2002 and secured a 3-year term syndicated loan amounting to US\$30 million in September 2002. These fully demonstrate that the existing performance of Xinao Gas and the prospects of the industry are highly recognised by international investors and banks.



INTERNATIONAL AWARDS

The Company was awarded by *FinanceAsia* as one of the “10 Best Financial Management” in 2002. Since the selection was based on the votes of more than 300 professional investors from international financial institutions, it fully demonstrates the Company’s strength in financial management. Besides, some renowned financial publishers gave the Company awards, such as “The 200 Best Small Companies” by *Forbes Global*, the “Best Small Companies in the PRC” by *AsiaMoney* and the “Top 500 Chinese Enterprises in the World” by *Yazhou*

Zhoukan, for the second consecutive year. Xinao Gas was also awarded the “Top 20 Chinese Enterprises of Revenue Growth” by *Yazhou Zhoukan* in 2002 for the first time.

The above awards, voted by investors from international financial institutions, demonstrate that Xinao Gas is highly regarded by the professional investment community for its outstanding and farseeing management, solid financial position and effective operating system, which enable the Group to maintain its leading position in the industry.

CORPORATE MANAGEMENT

After Langfang Xinao Gas Company Limited ("Langfang Xinao"), Huludao Xinao Gas Company Limited ("Huludao Xinao") and Liaocheng Xinao Gas Company Limited ("Liaocheng Xinao") also obtained the ISO9001 certification. As the work of all other project companies is also carried out in compliance with the standards set out under ISO9001, it is evident that the Group is operated under a sound and systematic management.

In 2002, based on past experience, the Group revised the "Gas Management Standards" and extended their practice to all project companies to further improve the management and operation flow of the project companies. In addition, after the national 24-hour customer services hotline "95158" being put into use at the 24 hours call centre in Langfang Xinao last year, call centres also commenced operation in Huludao Xinao and Liaocheng Xinao this year.

HUMAN RESOURCES

As at the end of 2002, the Group had 3,238 employees, representing an increase of 1.8 times compared to last year. It was mainly because the number of operating project companies increased from 12 to 25, most of them being larger in scale. The Group's actual manpower resources maintained at the same level as last year when taking into account the fact that the connectable population of the Group also increased by 1.8 times during the year.

Throughout the year, the Group looked for suitable candidates by various means. Quite a few of senior executives were recruited, and most of them are middle and senior management staff from the industry with extensive professional knowledge and management experience. The recruitment of such executives helps the Group to cope with its rapid expansion. The Group also provides intensive internal training to build up a pool of high-calibre personnel.

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April 2003

PROSPECTS

The use of natural gas, a clean and efficient source of energy, is strongly promoted by the central government, and foreign investors are encouraged to invest in the downstream gas distribution market.

The "West-to-East Pipelines" ("W-E") extends from Xinjiang to Shanghai, passing through cities in 10 provinces, such as Xinjiang, Gansu and Ningxia. The pipelines are approximately 4,200 kilometres long and with a designed annual capacity of 12 billion m³. The pipelines are expected to be operational by 2004. The construction of the pipelines commenced in July 2002 and has been progressing smoothly since then. Recently, the construction has been extended into Gansu. Starting from 1 March 2003, the construction work in Gansu has been in full swing, and a trial gas supply will begin in October 2003 in provinces like Anhui, Henan and Jiangsu. This favours the development of our project companies within such regions.

On 27 December 2002, the Ministry of Construction of the PRC issued a memorandum on the "Opinion concerning the speeding up of the development of market economy in the public utilities sector" requiring local authorities to open up the market for the construction and operation of public utilities according to the situation in each place. This further ensures the liberalisation of the city gas market.

Under such favourable environment, we believe that the Group will be able to obtain new projects without much difficulty. It is expected that the Group will still be able to secure six to eight new quality projects in large and medium cities in 2003. Despite the huge market opportunities, we will remain prudent and conduct detailed feasibility study on each project before making any investment decision, so as to maximise shareholders' wealth.