

DIRECTORS' REPORT

The Directors have pleasure in submitting to shareholders their annual report and the audited financial statements for the year ended 31 December 2002.

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 and bottled gas in the People's Republic of China (the "PRC").

RESULTS

The results of the Group for the year ended 31 December 2002 are set out in the consolidated income statement on page 48.

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 financial information of the Group for the past four years are set out on page 19.

PROPERTY, PLANT AND EQUIPMENT

During the year, the Group continued to expand its pipeline infrastructure and other related facilities. An aggregate of RMB495 million has been incurred in acquiring property, plant and equipment.

During the year, the Group revaluated certain of its properties, resulting in a revaluation surplus amounting to RMB26 million. This has been credited directly to the 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 during the year in the share capital of the Company are set out in note 26 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 28 to the financial statements.

BANK AND OTHER LOANS

Details of bank and other loans of the Group are provided in Note 24 to the financial statements.

CHARITABLE DONATIONS

Charitable donations by the Group for 2002 amounted to HK\$1,000,000 (2001: HK\$ Nil).

DIRECTORS

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

Executive Directors:

Wang Yusuo	(Chairman)
Yang Yu	(Chief Executive Officer)
Zhao Jinfeng	
Qiao Limin	
Jin Yongsheng	
Yu Jianchao	
Cheung Yip Sang	(appointed on 10 April 2002)
Cheng Chak Ngok	(appointed on 10 April 2002)

Non-executive Director:

Zhao Baoju

Independent non-executive Directors:

Wang Guangtian
Xu Liang

In accordance with Articles 99 and 116 of the Company's Articles of Association, Messrs Yang Yu, Zhao Jinfeng and Yu Jianchao 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, except that of Mr. Cheung Yip Sang and Mr. Cheng Chak Ngok who were appointed during the year and have an initial term commencing 10 April 2002 and expiring on 29 February 2004, is of an initial term of three years commencing 1 March 2001 and expiring on 29 February 2004. Each service agreement 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' INTERESTS IN SHARES

As at 31 December 2002, the interests of each Directors of the Company in the equity securities of the Company as recorded in the register required to be kept under Section 29 of the Securities (Disclosure of Interests) Ordinance (“SDI Ordinance”) or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies were as follows:

Name of Director	Number of ordinary shares held				Total
	Personal interests	Family interests	Corporate interests	Other interests	
Wang Yusuo (“Mr. Wang”)	3,044,000	–	430,000,000	–	433,044,000
Zhao Baoju (“Ms. Zhao”)	–	3,044,000	430,000,000	–	433,044,000

The above corporate interests of 430,000,000 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 2002, the register maintained by the Company pursuant to Section 29 of the SDI Ordinance recorded no other interests of the Directors in the equity or debt securities of the Company and its associated corporations nor any rights to subscribe for equity or debt securities of the Company granted to any Directors or their respective spouse or children under 18 years of age nor the exercise of any such rights.

SHARE OPTIONS

Particulars of the Company's share option scheme are set out in note 27 to the financial statements.

Details of the options granted to certain Directors and employees to subscribe for shares in the Company on 31 January 2002 are as follows:

Name of Director	Number of options granted during the year and balance at 31 December 2002
Yang Yu	2,400,000
Zhao Jinfeng	1,500,000
Qiao Limin	1,500,000
Jin Yongsheng	1,500,000
Yu Jianchao	1,500,000
Cheung Yip Sang	1,500,000
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	9,900,000
Employees	8,100,000
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	18,000,000
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The options were granted at an exercise price of HK\$2.625 each. The closing price of the shares immediately before the date on which the options were granted was HK\$2.725. 50% of the options may be exercised between the period of 1 August 2002 and 31 January 2004, and thereafter, options may be exercised at any time up until 31 January 2012.

No share option was cancelled, lapsed or exercised by the Directors and employees during the year.

As at 31 December 2002, the number of shares in respect of which options had been granted under the 2001 share option scheme was 18,000,000 (2001: Nil), representing 2.4% of the shares of the Company in issue at that date.

No fair value of the options granted is disclosed as in the opinion of the Directors, certain assumptions need to derive the fair values using the Black-Scholes option pricing model and these cannot be reasonably determined for such share options.

ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

Other than the share option schemes disclosed above, at no time during the year was the Company, its ultimate holding company or any of its subsidiaries a party to any arrangement to enable the Directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate, and none of the Directors, or their spouses or children under the age of 18, had any right to subscribe for the securities of the Company, or had exercised any such right during the year.

DIRECTORS' INTERESTS IN CONTRACTS AND CONNECTED TRANSACTIONS

During the year, the Group has entered into the following transactions and arrangements as described below with persons who are “connected” for the purposes of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited:

On 1 January 2001, Langfang Xinao Gas Company Limited (“Langfang Xinao”), the wholly-owned subsidiary of the Company, signed two contracts for a term of four years with Langfang Xinao Property Management Company Limited (“Langfang Xinao Property Management”) (note 1), which provides property management services to Langfang Xinao for two office buildings situated in Langfang City with an annual service fee of RMB1,380,000.

On 1 January 2001, Langfang Xinao leased a staff quarter situated in Langfang City to Langfang Xinao Property Management and another staff quarter also situated in Langfang City to Xinao Group Company Limited (XGCL) (note 1) and signed contracts with them individually for a term of four years with annual rental of RMB329,611 and RMB435,823 respectively.

Langfang Xinao entered into a property leasing agreement and a supplemental property leasing agreement with XGCL in relation to the leasing of the office building situated in Langfang City. The annual rental is RMB1,039,185 plus a reimbursement of management fee of RMB264,000 per annum. The contract term is for four years commencing from 1 January 2001.

During the year, Langfang Xinao provided gas connection services to Langfang Xincheng Property Development Company Limited (“Xincheng Property”) (note 1) with the contract sum of RMB72,000.

During the year, the subsidiaries of the Company, including Langfang Xinao, Yantai Xinao Gas Company Limited, Yangzhou Xinao Gas Company Limited, Zouping Xinao Gas Company Limited, Taixing Xinao Gas Company Limited, Laiyang Xinao Gas Company Limited, Xinao Gas Development Company Limited, Liaocheng Xinao Gas Company Limited, Huaian Xinao Gas Company Limited and Haian Xinao Gas Company Limited, acquired compressed natural gas truck trailers, pressure regulating and gas equipment from Xinao Group Shijiazhuang Chemical and Machinery Company Limited (“Xinao Machinery”) (note 1) in order to operate compressed natural gas (“CNG”). The total considerations of the contracts are RMB25,980,000.

On 9 May 2002, Zhucheng Xinao Gas Company Limited (“Zhucheng Xinao”), the subsidiary of the Company, entered into the acquisition agreement with Zhucheng City Gas and Heating Corporation, the PRC JV partner of Zhucheng Xinao, to acquire a parcel of land, which has been used as Zhucheng Xinao’s office. The consideration is RMB1,560,000.

During the year, Huaian City Gas Corporation (“Huaian City Gas”), Xinxiang City Gas Corporation (“Xinxiang City Gas”) and Chuzhou City Infrastructure Construction Company Limited, the PRC JV partners of the Company’s subsidiaries Huaian Xinao Gas Company Limited (“Huaian Xinao”), Xinxiang Xinao Gas Company Limited (“Xinxiang Xinao”) and Chuzhou Xinao Gas Company Limited (“Chuzhou Xinao”) respectively, had loans advanced to Huaian Xinao, Xinxiang Xinao and Chuzhou Xinao with the loan amounts of RMB28,254,000, RMB13,936,000 and RMB1,228,000 respectively. During the year, Huaian Xinao and Xinxiang Xinao paid loan interest of RMB248,000 and RMB165,000 to Huaian City Gas and Xinxiang City Gas respectively. The loans advanced to the subsidiaries were actually the acquisition of liabilities from respective PRC JV partners when forming the new JVs.

Note 1:

Langfang Xinao Property Management, XGCL, Xincheng Property and Xinao Machinery are controlled by Mr. Wang, the Chairman of the Company.

DIRECTORS' INTERESTS IN CONTRACTS AND CONNECTED TRANSACTIONS (CONT'D)

In the opinion of the independent non-executive Directors, 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 of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

SUBSTANTIAL SHAREHOLDERS

At 31 December 2002, the register of substantial shareholders maintained by the Company pursuant to Section 16(1) of the SDI Ordinance showed that the following parties had an interest of 10% or more in the Company's issued share capital:

Name	Number of shares held	Approximate percentage of shareholding
Easywin Enterprises Limited	430,000,000 (Note i)	58.34%
Mr. Wang	433,044,000 (Note ii)	58.76%
Ms. Zhao	433,044,000 (Note ii)	58.76%

Notes:

- i. The 430,000,000 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.
- ii. Other than the 430,000,000 shares as disclosed in (i) above, the remaining 3,044,000 shares are held by Mr. Wang, in which Ms. Zhao has a family interest.

POST BALANCE SHEET EVENTS

Details of significant events occurring after the balance sheet date are set out in note 38 to the financial statements.

CONVERTIBLE SECURITIES, OPTIONS, WARRANTS OR SIMILAR RIGHTS

Other than the share options as set out in note 27 to the financial statements, the Company had no other outstanding convertible securities, options, warrants or other similar rights as at 31 December 2002.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2002, 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.

CORPORATE GOVERNANCE

The group recognises the importance of corporate governance and shares the view that to maintain a highly transparent management system is critical to our shareholders, employees as well as the industry watchdog. We have established an Operation Management Committee to oversee both our existing operations in macro aspects and potential new investments. Additionally, we also have a Supervisory Committee to monitor our day to day operation.

It is part of our strategy to stay open and responsive to any queries that our shareholders and investors may have from time to time. Besides, our financial and operation management practice are highly regarded by the investment community, and as a result of that, we have received numerous awards from the community. It is also our aim to continue to enhance our management quality.

The Company has complied with the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities of the Stock Exchange of Hong Kong Limited throughout the year.

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.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

During the year, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

AUDIT COMMITTEE

The Company established an Audit Committee on 28 March 2001. The Audit Committee has reviewed with management the accounting principles and practices adopted by the Group and discussed auditing, internal controls and financial reporting matters. Members of the Audit Committee are Mr. Wang Guangtian, Mr. Xu Liang (all of the above are independent non-executive Directors) and Mr. Yu Jian Chao (an executive Director). The Audit Committee has reviewed the unaudited interim accounts and the audited annual accounts for 2002. Three Audit Committee meetings were held during the financial year.

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

WANG Yusuo

Chairman

Hong Kong, 8 April 2003