Management Discussion and Analysis

BUSINESS REVIEW

Year 2002 has been another year of consolidation of the Group's business, as the Group's Chairman, Mr. Zhu Jia Zhen said. Oil transportation business has maintained a stable source of revenue and cash flow for the Group despite some interruption of business due to floods in the summer. Together with the acquisition of equity interests in the natural gas pipeline networks in Korla City in Xinjiang Autonomous Region ("Xinjiang") and Jilin City in Jilin Province, the Group has been able to achieve encouraging results.

Due to the withdrawal from the food business last year, the Group's turnover for the year ended 31 December 2002 amounted to approximately RMB180 million, representing a drop of 11% in comparison with that of last year. However, the profit attributable to shareholders for the year ended 31 December 2002 amounted to approximately RMB57.9 million, representing a 32% increase compared with the preceding year. This increase evidences our first successful step of strategic transformation and the Board is confident that the investments in energy related businesses will provide additional and sustained growth for the Group in future years.

Oil transportation business

Notwithstanding the fact that the operating result of the Xinjiang Xingmei Oil Pipeline Company Limited ("Xingmei") was affected by floods in Xinjiang during the summer, Xingmei recorded a successful year in 2002. Turnover and profit from operations remained strong at approximately RMB131.6 million and approximately RMB94.4 million respectively.

With international oil price rocketed to new highs amid the Middle East tension, SINOPEC is driven to produce more crude oil to take advantage of the recent oil price rally. Thus, Xingmei, being the sole operator of oil transportation and storage for SINOPEC's Tahe Oil Field in Xinjiang, benefits directly during the second half of the year.

For the last few years, the density of crude oil passing through Xingmei's 70 km pipeline was all below 0.92 gram per cm^3. However, Xingmei has made a number of enhancements in its facilities to meet with SINOPEC's requirement to transport heavy crude oil with a density of 0.945 gram per cm^3. This was mainly attributable to the construction of a relay station applying heat and pressure to improve oil circulation in the pipeline.

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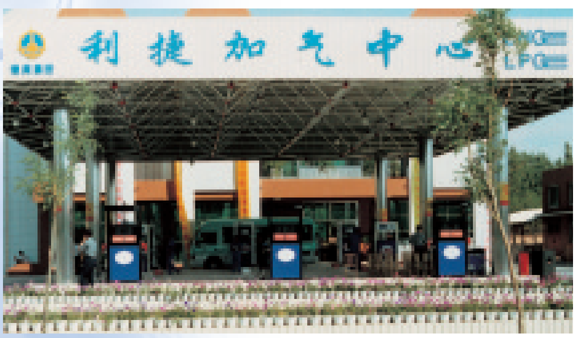
Xingmei will also install a 4,000kw electric heater in the first station of the Tahe Oil Field to ensure that heavy crude oil will not freeze in the pipeline during winter with a temperature of –20°C.

Year 2002 marks another milestone for Xingmei with the completion and grand opening of its new headquarters on 20 November 2002. The new headquarters will improve not only the operational efficiency but the corporate image of Xingmei in the region as well.

Xingmei places great emphasis on management quality by implementing the "HSE" management model which has been adopted by major international oil players in recent years. It highlights the importance of harmony among health, safety and environment with normalization of daily operation, formation of contingency plan and precautionary measures, and participation of management and staff.



Natural gas pipeline network

Korla City of Xinjiang

After acquiring an effective equity interest of 32% of Lejion Gas Company Limited ("Lejion") in 2001, the Group further acquired equity interest in Lejion from an independent third party in April 2002 so as to increase its effective equity interest in Lejion to 72%. Lejion is principally engaged in the provision of natural gas and liquefied petroleum gas ("LPG") for the city of Korla, which is the second largest city in Xinjiang.

Lejion recorded a turnover and profit from operations of approximately RMB48.7 million and approximately RMB18.7 million respectively since Lejion became a subsidiary of the Group in April 2002.

Phase one construction period of Korla city natural gas network which lasted for three years ended in October 2002. During the period, Lejion has completed a mid-pressure pipeline network of 85km, together with a low-pressure pipeline of 90km. The designed capacity of the city gas network is 40.1 million m^3 annually and the actual annual supply of natural gas in Korla was approximately 38.3 million m^3 in 2002.

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Despite the fact that there are 4 LPG suppliers and the competition is keen in the area, Lejion, being the sole supplier of natural gas in Korla, is still able to procure a 70% market share of LPG by providing quality services and having instant response to changes in market conditions. While agricultural area has long been categorized as scattered and not economically feasible for laying pipeline for natural gas, Lejion is promoting the use of LPG in these areas successfully. In Korla, Lejion has over 20 sales points for LPG. Together with the Government's intention to develop the western area, LPG sales is expected to account for a bigger slice of Lejion's turnover and profit in the future.

Jilin City of Jilin Province

On 18 January 2002, the Group had entered into an agreement pursuant to which the Group agreed to purchase from its controlling shareholder, Mr. Sun Tian Gang ("Mr. Sun"), an effective interest of 30.87% of Jilin City Jimei Gas Company Limited ("Jimei"). Jimei is principally engaged in the operation of a natural gas pipeline network in Jilin City of Jilin Province, the PRC. The natural gas pipeline network extends approximately 520km and covers the majority of the residential areas in Jilin. It is the second largest city in Jilin Province with a population of over 1.3 million.

Jimei has become an associated company of the Group since April 2002. Jimei's profit attributable to the Group since acquisition to 31 December 2002 amounted to approximately RMB6.7 million.

Property development in Jilin experienced a downturn in late 2002 amid intervention from both banks and government, gas connection fees, which account for a substantial part of the Jimei's net profit, was inevitably reduced. The Board is of the opinion that Jimei's earnings will slow down with the uncertain property regulating measures. Subsequent to the year end, the Group has entered into an agreement with Mr. Sun on 10 April 2003 to sell its entire interest in Jimei back to Mr. Sun for a cash consideration of RMB135 million. Details of the transaction will be disclosed in a circular to be despatched to the shareholders. The sale proceeds will provide strong financial resources to the Group to take advantage of the potential attractive investment opportunities, if any.

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Turnover

As mentioned above, due to the withdrawal from the food business last year, turnover for the Group for the year ended 31 December 2002 decreased by 11% to approximately RMB180 million (2001: RMB203 million). Turnover was mainly sourced from two different segments, oil transportation and natural gas pipeline network. The oil transportation operation recorded a turnover of approximately RMB131.6 million for the year ended 31 December 2002 (2001: RMB106.7 million) while the natural gas pipeline network business recorded a turnover of approximately RMB48.7 million for the eight months ended 31 December 2002 since having successfully increased the effective equity interest of Lejion to 72% at the end of April 2002.

Profit attributable to shareholders

After the successful business transformation in 2001, the oil transportation and other energy related businesses have achieved a higher return. Profit attributable to shareholders significantly increased by 32% to approximately RMB57.9 million compared with approximately RMB43.7 million in 2001. The Group's earnings in 2002 are mainly contributed by the oil transportation operation and natural gas network business. The profits from these operations amounted to approximately RMB94.4 million and RMB18.7 million respectively during the year. On the other hand, the Group also shared profits from associates engaged in the natural gas network business of approximately RMB8.9 million.

Funding and financing

As at 31 December 2002, the net assets of the Group have increased to approximately RMB410.7 million (2001: RMB303.7 million) while its total assets were approximately RMB977.1 million (2001: RMB763.9 million). The Group's borrowings were approximately RMB466.8 million, of which 18.6%, 6.4%, 40.7% and 34.3% were due within one year, in the second year, from the third to fifth year and after the fifth year, respectively. As at balance sheet date, the borrowings of the Group were secured and fixed interest loans denominated in Renminbi. The bank loans were secured by certain fixed assets and fixed deposits of the Group with a total carrying value of approximately RMB257 million (2001: RMB303 million). The Group's gearing ratio based on shareholders' equity was 113.6% (2001: 124.4%). Although it has been slightly improved compared to that of last year, the Group will continue to exercise stringent measures to monitor future capital expenditure and retain sufficient cash flow to meet loan repayment. Notwithstanding the high gearing ratio, the Board considers given the reliable cash flow from oil transportation and the natural gas network business and low cost of financing, the Group is still in a strong financial position, not only to meet its loan commitments but also to take advantage of new attractive investment opportunities that may arise.

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As the business transactions as well as the bank borrowings of the Group are all denominated in Renminbi, the Directors consider that foreign exchange exposure does not pose a significant risk given that the exchange rates of these currencies are fairly stable and no hedging measure is currently necessary.

EMPLOYEE INFORMATION

As at 31 December 2002, the Group employed approximately 276 employees. They were remunerated according to the nature of their job and market condition. The Group also provides other benefits to eligible employees such as share options, housing allowances, discretionary bonus and medical scheme.

PROSPECTS

In order to enhance the earnings base, the Board will study the feasibility of increasing the oil transporting capacity of Xingmei so as to match the development of Tahe Oil Field. Further, the operation of natural pipeline networks in Korla has to be further consolidated. The Board will continuously search for suitable opportunities to strengthen the Group's investment in energy related industries, in particular in the mid and down stream oil or gas transportation and petroleum product businesses. The Directors believe that there is immense market potential for the energy related business in the region and the Group will continue to take an active role in seeking suitable investment opportunities in order to maximize the shareholders' return.