



# EMPOWERING PRODUCTION

Natural gas is used in industrial process in steel, glass, pottery and dyeing industries, etc. Using natural gas as the power for production can enhance industrial efficiency and product quality.



The Group sold

**143** million m<sup>3</sup>

of natural gas to commercial and industrial users in 2004



**CLOTHING** - Using natural gas to dry clothes is more economical and convenient.



**FOOD** - Apart from being used for cooking, natural gas can also be used as an industrial fuel for food processing.



In 2004, the total installed daily capacity of commercial and industrial users reached

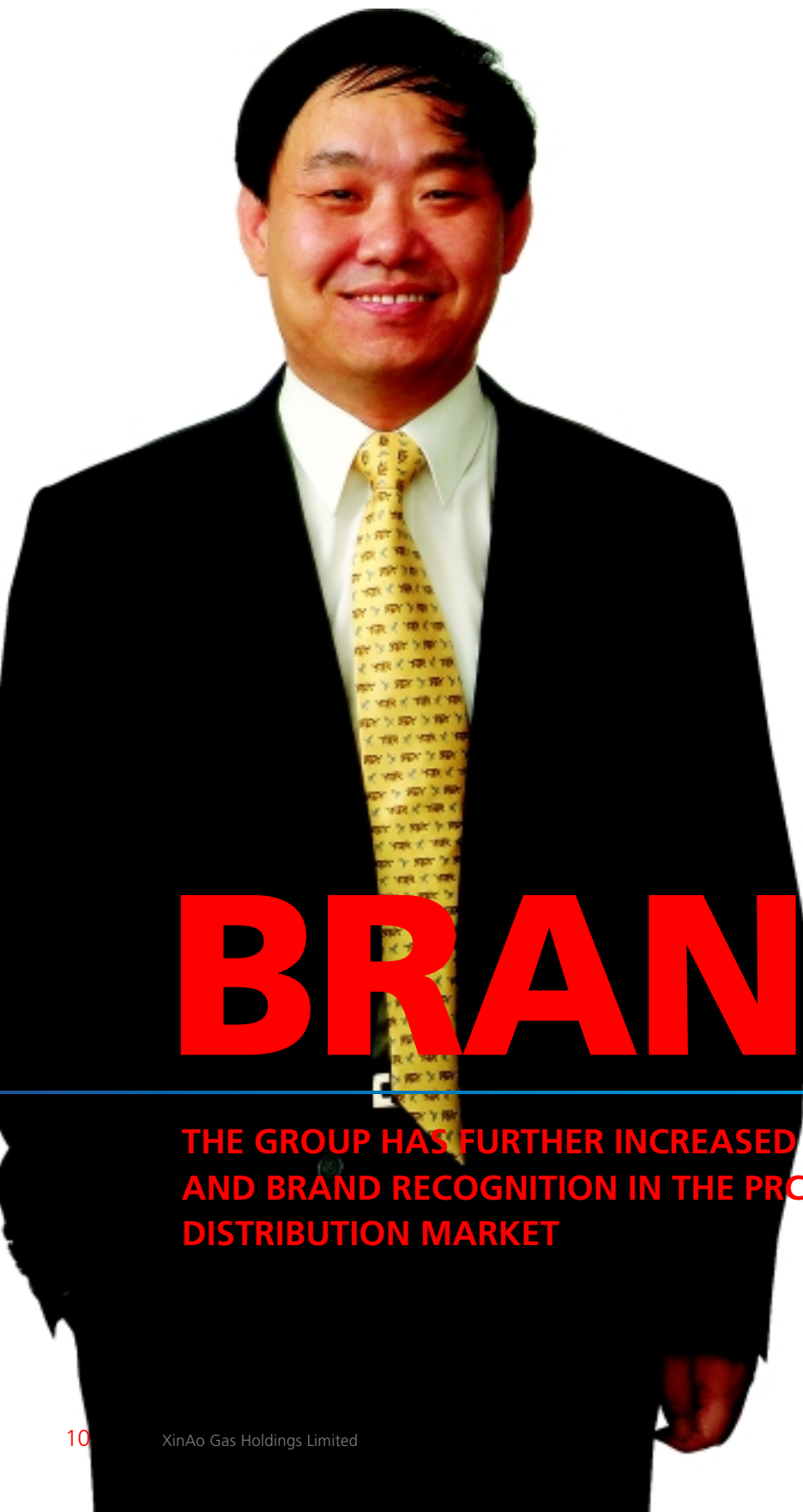
**1.21** million m<sup>3</sup>



# DELIVERING DELIGHT

The Group has connected 2,023 commercial and industrial users, among which are restaurants that use natural gas for cooking and deliver delight and delicacies for our enjoyment.





**WANG Yusuo**

Chairman

# BRAND RE

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

## RESULTS OF THE YEAR

Building on its previous encouraging results, the Group continued to record substantial growth this year. The turnover and profit for the year reached RMB1,439,945,000 and RMB252,257,000 respectively, representing increases of 64.0% and 37.8% over last year respectively. Earnings per share increased by 19.8% to RMB29.7 cents.

The Group secured 11 new projects this year, including Yantai, a million city, and thus accomplished more than this year's target of securing six to eight new projects. Of the new projects secured this year, two are located in Guangdong Province, two in Guangxi Autonomous Region, two in Zhejiang Province, and one each in Hebei Province, Henan Province, Inner Mongolia Autonomous Region, Shaanxi Province and Shandong Province. Our total connectable population coverage rose by 55.7% to approximately 29,128,000. By obtaining projects of medium to large size, the Group has taken advantage of economies of scale and maximized shareholders' return by making good investment of shareholders' capital. It also has demonstrated once again the

Group's high competence in investment, operation and management as well as its competitive advantages in the industry.

The outstanding performance, safety track record and quality service of the project companies has increased Xinao Gas' brand recognition and influence in the regions. With higher esteem and stronger influence in the industry, the Group has become one of the professional gas operators with the largest scale and highest competitiveness.

As at the end of 2004, the Group made natural gas connections for a total of 634,678 residential households and 1,515 commercial/industrial ("C/I") customers (connected to gas appliances of a total installed designed daily capacity of 1,058,114 cubic meters), representing increases of 253,395 residential households and 733 C/I customers (with an increase of a total installed designed daily capacity of 525,321 cubic meters) when compared to 2003. Taken into account of those acquired or converted customers, the Group had a total of 461,899 residential households and 2,023 C/I customers (connected to a total

installed daily capacity of 1,214,314 cubic meters). The sales volume of natural gas for the year also grew tremendously by 70.1%. These all demonstrate the benefits of economies of scale and the Group's prosperous business development.

## FINANCIAL POSITION

As at the end of 2004, the Group's cash on hand was RMB911,537,000, and bank and other borrowings were RMB1,917,160,000.

In the first half of the year, the Group successfully brought in International Finance Corporation ("IFC"), the private sector arm of the World Bank Group, as our long term shareholder. IFC also agreed to provide five-year loans for a total of US\$25,000,000 (equivalent to RMB206,700,000) to the project companies of the Group, and the loans were drawn in the second half of the year as part of their working capital. The fact of IFC becoming the Group's shareholder and lender does not just illustrate the Group's distinctive status, ability and positive prospects, but also shows IFC's recognition of the Group's importance and contribution in the environmental industry.

# COGNITION



During the year, the Company raised funds with net proceeds more than HK\$990,000,000 (equivalent to RMB1,049,400,000) by a share placement and a convertible bond issue in February and November respectively. The market response for the Company's financing activities was very positive, showing the confidence of professional investors and shareholders in the Group's business and prospects. Apart from providing the capital the Group required, these financing activities have also enlarged the Group's shareholder base and capital base and hence enhanced the Group's strength.

#### INTERNATIONAL AWARDS

Because of the excellent management, the Company continued to receive many awards from various prominent international financial magazines during the year: "Overall Best Managed Company in China (Medium Cap)" by *AsiaMoney* for the first time, and five other individual awards, namely, "Clearest Corporate Strategy", "Best Financial Management", "Best Investor Relations", "Best Annual Reports" and "Most Improved Website"; "Chinese Business 500" for four consecutive years and "Top 20 Chinese Enterprises of Highest Total Asset Growth" for two consecutive years by *Yazhou Zhoukan*.

The above awards, voted by international institutional investors and analysts, have proved that Xinao Gas is highly regarded by investors for our leading position in the industry with outstanding and perceptive management team, healthy financial positions and efficient operation model. It was not easy to obtain such achievements, but the Group's management will endeavor to maintain our outstanding performance and continue to achieve even better results and reputation, so as to create maximized

value for our shareholders and the Company.

#### CORPORATE MANAGEMENT

Since its listing, Xinao Gas has secured gas projects across 13 provinces, municipalities and autonomous regions in the People's Republic of China (the "PRC"). With rapid of business growth, the management scope of the Group has also expanded quickly. Therefore, the Group has set up 12 regional management centers to enhance regional management: the Group appoints senior management staff who are familiar with corporate operation and culture as general managers of the regional centers, and professional directors of marketing, finance, technology, personnel and construction cost management, etc. are posted to each regional center. The Chief Executive Officer communicates with the regional general managers frequently to strengthen management of the Group as a whole and ensure that the Group's targets can be fulfilled.

#### CUSTOMER SERVICE

Quality customer service is the key for maintaining good and long term relations between the Company and customers. The Group upholds the principle of "361° service – more efforts, much more satisfaction" and makes every effort to provide safe, efficient and high quality service to our customers. Because of our quality service, the project companies of the Group continue to win recognition and credit from local customers as well as government authorities in the cities they operate: during the year, many of the project companies continued to be awarded "Unit with High Consumer Satisfaction" by local consumer councils, and five employees of Langfang Xinao Gas Company Limited ("Langfang Xinao")

received "National Female Courtesy Award" for their remarkable good service. Quality customer service, good safety track record and efficient operation management help the Group to build up good image and brand recognition. Our operating projects set good examples and become a crucial advantage for the Group to obtain new projects successfully when developing new markets.

In 2004, Dongguan Xinao Gas Company Limited ("Dongguan Xinao"), Kaifeng Xinao Gas Company Limited ("Kaifeng Xinao"), Lianyungang Xinao Gas Company Limited and Beijing Xinao Gas Company Limited launched the "95158" national 24-hour hotline, which means that 11 of our project companies have launched such service. Our customers can simply dial 95158 to access their local 24-hour customer service centers and communicate with us conveniently. In case of emergency, we uphold our promise to arrive at the site within 20 minutes to carry out repair work.

In 2004, Liaocheng Xinao Gas Company Limited and Beijing Xinao Jingchang Gas Company Limited finished setting up the information technology systems; Liaocheng Xinao Gas Company Limited and Bengbu Xinao Gas Company Limited completed the establishment of Geographic Information System; seven of the our project companies, namely, Langfang Xinao, Changsha Xinao Gas Company Limited, Kaifeng Xinao, Changzhou Xinao Gas Company Limited, Dongguan Xinao, Zhuzhou Xinao Gas Company Limited and Huaian Xinao Gas Company Limited cooperated with local banks for collecting gas usage charges. These technology establishments have reinforced the Group's high operation and service efficiency, strengthened the Group's ability in safe operation and

further lowered the Group's operating costs.

## HUMAN RESOURCES

As at the end of 2004, the Group had 7,820 employees, representing an increase of 26.3% over last year. The growth in manpower was the result of increased number of project cities from 41 to 52. The Group's actual manpower productivity increased a lot when taking into account the fact that the connectable population of the Group increased by 55.7% during the year. It is expected that the number of employees will continue to grow with more projects being obtained in the coming year.

We always believe that our employees are our most valuable assets and the basis of the Group's competitiveness; the Group's continuous development and success are rooted at our human resources. Therefore, we uphold the principle of "based on people" and put great emphasis on recruitment and internal training. The Group offers learning and studying opportunities to employees as a kind of benefits and rewards, so as to raise our employees' competitiveness and enlarge our human resource reserve.

## PROSPECTS

Natural gas is not just one of the cleanest, safest, most efficient and economical energy sources, but also has obvious advantages in environmental and social efficacy and is more competitive in price than other clean energy sources like liquefied petroleum gas ("LPG") and electricity. Therefore, the PRC central and local governments in general emphasize the use of natural gas and vigorously promote the use of natural gas throughout the country as a clean energy source.

According to the statistics of Energy Research Institute, National Development and Reform Commission ("NDRC"), in 2004, the output of natural gas in the PRC increased 18.5% to 40.8 billion cubic meters when compared to 2003. As forecasted by Energy Bureau, NDRC, the demand growth of natural gas will be well ahead of coal and oil in the PRC in the future 20 years. By 2010, natural gas consumption will make up 6% – 7% of the total energy consumption in the PRC and reach 93.8 billion cubic meters; by 2020, natural gas consumption will further increase to 10% of the total energy consumption and reach 203.7 billion cubic meters.

At the end of 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" allowing local authorities to open up the market for the investment in construction and operation of public utilities, including city gas. Foreign investors are now allowed to participate in the market by various means, such as setting up wholly-owned enterprises, equity joint ventures or operation joint ventures. In February 2005, the State Council of the PRC also issued "Opinions on encouraging the development of non-state-owned economy", which also explicitly encourages private investors and foreign investors to enter urban public utilities sector. The implementation of these PRC government policies will facilitate and accelerate the healthy development of city piped natural gas market and further reduce the investment risks.

With the support of relevant policies from the government, the construction of various branch pipelines of the West-to-

East Project, the linking up of Zhong-Wu Pipelines, the exploration of natural gas under seabed and imported liquefied natural gas ("LNG") projects in coastal areas have progressed smoothly. These developments, together with quickened urbanization, higher standards for urban environmental protection and higher popularity of natural gas among consumers, facilitate the rapid and continuous development of downstream natural gas business.

At present, natural gas users only account for 10% of the total urban residential gas users in the PRC, and the ratio is expected to increase to 30% by 2010 and 40% by 2020, which reveal the positive market prospect of natural gas industry in the PRC. The Group believes that, after rapid development, the city piped gas market in the PRC is entering into the stage of merges and acquisitions, which will offer good opportunities to Xinao Gas and other large and renowned gas operators for further development and expansion.

Under all the favorable conditions, we believe that the Group will have better development prospects, more chances for exploring new projects and higher ability to ensure reliable gas sources. It is expected that in 2005, the Group will, as always, be able to secure new quality projects in large and medium cities. Despite the huge market opportunities, we will remain prudent and conduct cautious feasibility study on each project before making any investment decision, so as to minimize investment risks and maximize shareholders' wealth.

**Wang Yusuo**  
Chairman

20 April 2005