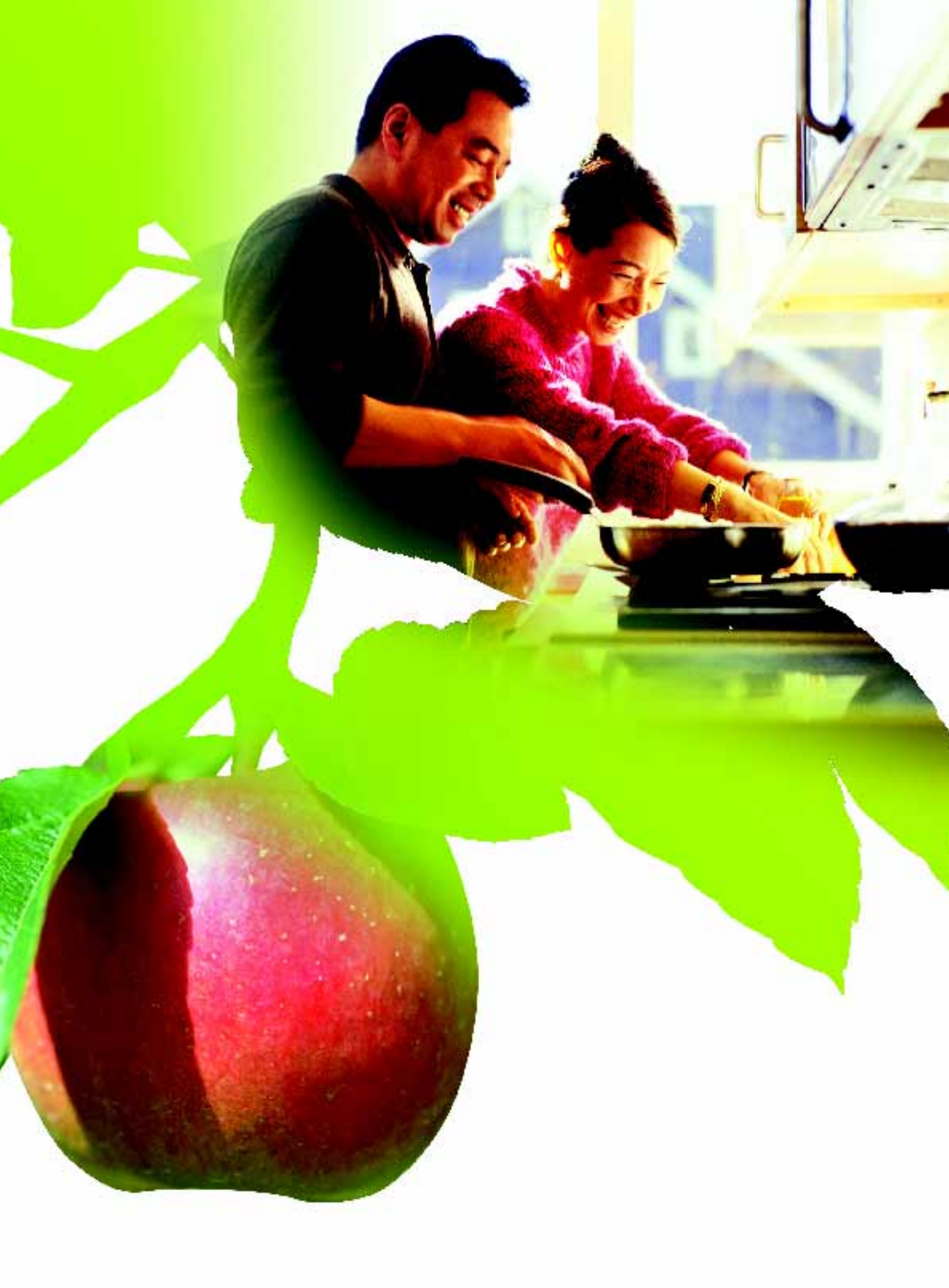




The Network

is Gaining Ground

The Group has a total of 7,268 km pipeline network, serving 1.79 million residential households and 4,041 commercial/industrial users (with a total designed daily capacity of 2,495,479 m³).



CHAIRMAN'S STATEMENT

RESULTS OF THE YEAR

The Group continued to record substantial growth in its results for 2005. The turnover and profit attributable to equity holders of the Company for the year reached RMB2,056,826,000 and RMB303,118,000 respectively, representing increases of 42.8% and 20.9% over last year respectively. Earnings per share increased by 15.2% to RMB34.1 cents.

This year, the Group secured seven new piped gas projects, of which three were located in Zhejiang Province and one each in Anhui Province, Fujian Province, Guangdong Province and Henan Province, more than the Group's target of securing four to six new projects set at the beginning of the year. Our total connectable population coverage rose by 11.2% to approximately 32,387,000.

Among the new projects secured, Quanzhou City, the Group's first project in Fujian Province, will construct a liquefied natural gas ("LNG") import terminal, which will greatly facilitate the Group's project

development in Fujian Province. The securing of a project with an LNG terminal also demonstrated the Group's competitive advantages in the industry.

During the year, the Group made new connections to 334,637 residential households and 1,140 commercial/ industrial ("C/I") customers (connected to gas appliances of a total installed designed daily capacity of 1,045,466 cubic meters). The year-on-year increase in residential households and designed daily capacity of C/I customers were 32.1% and 99.0% respectively. The sales volume of piped gas for the year also grew tremendously by 90.4%. The strong growth in new connections and gas sales further consolidated the Group's long term recurring revenue in the future.

FINANCIAL POSITION

As at the end of 2005, the Group's cash on hand was RMB1,784,055,000, and total debts were RMB3,547,202,000.

In August 2005, the Company issued US\$200 million (equivalent to RMB1,614,040,000) of 7-year high yield bonds with 7.375% coupon rate. The bonds provided adequate funds for the Group's project development and further enlarged our investor base. As a foreign investor investing in the gas markets of the People's Republic of China (the "PRC"), the Group may also enjoy the benefits of the continuous appreciation of Renminbi. The Group on the whole obtains foreign funding for the investment in the PRC gas projects. As the Group's profit is in Renminbi, it will be converted into foreign currencies for future repayment of the loans (including the US\$200 million bonds). Therefore, it will indirectly lower the Group's capital costs.

INTERNATIONAL AWARDS

Because of its excellent management, the Company continued to receive awards from various prominent international

Sustainable Growth

financial magazines during the year: "Asia's Best Managed Companies (Medium Cap in China)" by *AsiaMoney*, from which the Company has gained awards for five consecutive years, "Chinese Business 500" by *Yazhou Zhoukan* for five consecutive years and "The Best Small Cap" by *FinanceAsia*.

In addition, the Company's issue of US\$200 million of 7-year high yield bonds in August 2005 was highly regarded by the investment community: The bonds had a lowest-ever coupon rate among the Chinese high yield bonds and was awarded "Best Asian High Yield Bond Issue for 2005" by the renowned international financial magazine *EuroWeek*. These all showed that the market and the investors recognised and appreciated the Company's prospects and credibility.

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 maximised value for our shareholders and the Company.

CORPORATE MANAGEMENT

Since its listing, Xinao Gas has secured gas projects across 14 provinces, municipalities and autonomous regions in

the PRC. Therefore, the Group has established nine regional management centers (merging the 12 centers in 2004 for reducing operation costs). To enhance regional management and to ensure achievement of the Group's targets, senior management staff have been appointed as general managers of the regional centers, and professional directors of

The Group has further increased its market share and brand recognition in the PRC piped gas distribution market

WANG Yusuo
Chairman



marketing, finance, technology, personnel and construction cost management, etc. have been posted to each regional center.

To further enhance management quality, the Group has engaged IBM Global Services (China) Company Limited ("IBM") as consultant to launch a consultation project on process streamlining and information system management.

Learning from world-class enterprises and drawing on international best practices and experiences, the Group will carry out informatisation in full swing, which will enable us to have quicker response to customers, enhance service standards, facilitate the management to access timely and accurate information for business decision and development, and strengthen management capabilities.

CUSTOMER SERVICE

Since its establishment, the Group has always upheld principles of "based on people" and "ensuring healthy growth of staff, creating satisfaction for customers" and made the best efforts to provide safe, quality and efficient service to our customers. The Group's service principle of "361° service - more efforts, much more satisfaction" has impressed our customers. During the year, 11 project companies of the Group obtained awards like "Units with High Consumer Satisfaction", "Units Trusted by Consumers" and "Trustworthy Units", etc, from the local consumer councils and were regarded as models for other public utilities.

In 2005, seven more project companies of the Group also have launched the 95158 national customer service hotline. Our customers can simply dial 95158 to access their local 24-hour customer service centers. The Group's emergency-repair vehicles are linked to the 110 network to enable us to handle any

emergency situations immediately and efficiently and uphold our promise to arrive at the site within 20 minutes to carry out repair work.

During the year, the Group has optimised the customer service standards and workflow to ensure that customers' complaints can be handled more timely and effectively, so as to enhance the Group's customer service. In addition, the Group has provided leaflets of "Gas Usage Safety Standards" to new customers after connection and arranged staff to conduct safety checks twice a year on customers' gas appliances. As prevention is always better than cure, these measures help to eliminate potential safety problems for customers, and thus increase their trust and encourage potential customers to make piped gas connections.

At present, the Group has built up good image and brand recognition in the industry with its quality customer service, efficient operation management and sound safety track records. Our operating projects set good examples and become a competitive advantage for the Group to obtain new projects successfully when developing new markets.

In 2006, the Group will continue to focus on our customers. We will consult IBM and learn from it the successful experiences and practices of how other enterprises transformed into "service-oriented companies". The Group will consolidate and optimise our existing customer service resources to further enhance its performance and market competitiveness.

HUMAN RESOURCES

As at the end of 2005, the Group had 10,331 employees. The growth in manpower by 2,511 employees during the year was the result of the increasing

number of project cities from 52 to 59. It is expected that the number of employees will continue to grow with increased number of new projects and business expansion in the coming year.

The Group endorses the principle of "based on people" and believes that our employees are the source of the Group's competitiveness. Therefore, we put great emphasis on recruitment and internal training and offer learning and studying opportunities to employees as a kind of benefits and rewards. The Group encourages employees to have lifelong learning, tailor-makes practical career development plans for employees and creates open career paths for them, which in turn ensure adequate human resources for the Group's sustainable and healthy development.

During the year, the Group organised 40 training sessions and seminars on informatisation, sustainable growth, good leadership, financial systems, process streamlining, sales techniques, project management, operation and management of gas stations, knowledge on safety check, etc, to enable continuous learning of employees and hence further uplift the quality of employees and management.

PROSPECTS

The PRC government actively promotes the use of natural gas throughout the country as a clean energy source. The share of natural gas in the total energy consumption of the PRC will increase year by year in the future. According to the 11th Five-Year Plan, the PRC government will strengthen the development of basic industries and infrastructures,

emphasise both oil and gas, reinforce the exploration and exploitation of oil and gas, extend the cooperation with other countries, increase strategic oil reserve capacity and develop oil substitutes steadily. These measures clearly illustrate that the development of natural gas industry has become one of the basic state policies of the PRC. Currently, the PRC's three oil and gas giants (PetroChina, Sinopec, CNOOC) are actively exploring new oil and gas fields and participating in the exploration and acquisitions of overseas oil and gas fields to further ensure natural gas sources. For example, there has been breakthrough in exploration and exploitation of gas fields in the northeast of Sichuan and in the East China Sea, and agreements to import natural gas from Russia.

The Group has also prepared itself for long term development. The Group has strategic adjustments on its development plans from 2005 onwards: instead of focusing on obtaining a large number of new piped gas projects, we shift our emphasis to boosting gas penetration rates in our existing projects and developing compressed natural gas ("CNG") vehicle refuelling stations, which can increase the long term natural gas sales. The strategic adjustments are based on the Group's consideration that most of the rich cities with piped natural gas sources have been taken up by the existing gas operators, and the Group will not invest in projects that do not meet our stringent required rates of return. However, as there will be more piped natural gas sources in the future, such as the LNG import terminals to be completed in the coming years, the Group will continue to obtain some quality projects.

As at the end of 2005, the Group had a connectable population of 32,387,000, equivalent to approximately 10,796,000 households, and the penetration rate was

only 16.6%. According to the Group's past experience, the penetration rates can reach as high as 70% - 80%. Even if the Group slows down its acquisition and secures fewer new projects, the Group expects to maintain its high growth, as the gas penetration rates of residential households and the sales volume of C/I customers will grow rapidly in the coming three to four years impelled by the strong economic growth in the PRC. In addition, the Group has reached critical mass in terms of connectable population coverage, and the long term revenue is guaranteed by growing penetration rates and more CNG refuelling stations. Therefore, in the future, the Group will have higher flexibility to select projects with high quality, high return or strategic significance.

Natural gas source is the key factor for the development of the Group as well as the whole natural gas industry. Therefore, not only the three oil and gas giants continue the exploration of new oil and gas fields and the construction of more long distance pipelines and LNG import terminals, the Group also has started to develop upstream business. Apart from the development of the LNG project in Weizhou Island, Guangxi since 2004, the Group will also participate in the establishment of a company engaged in coal conversion business in 2006. The business is to convert coal into dimethyl ether ("DME") to enhance the supply of backup gas sources and support the Group's development. DME is a clean fuel and can directly substitute natural gas and LPG without any alternation to the existing piped gas facilities. It is expected that the coal conversion project will commence construction in 2006 and be put into production in 2009. It will guarantee future gas sources, stabilise gas cost and bring in additional long term revenue. Besides, it is in line with the PRC government's

policies of environmental protection and development of oil and gas substitutes, so it is strongly supported by the PRC government.

The Group believes that the city piped gas market in the PRC, after its rapid development in the past years, may enter into the stage of merges and acquisitions in the coming years. This will offer good opportunities for further development and expansion to the Group, a large and renowned gas operator.

With the Group's well-developed brand recognition in the industry, which is a result of our quality customer service and safe and efficient operation management, the Group has started to explore and develop value-added services based on our customer resources and brand name. We will try to develop other value added businesses in project cities with high penetration rates, so as to generate more revenue from diversifies services and create new profit without putting in additional resources.

Under all the favorable conditions, we believe that the Group will have better development prospects, higher ability to ensure reliable gas sources and higher flexibility in selecting new projects for business expansion. It is expected that with the Group's strategic adjustment, informatisation and streamlining of business processes, the Group can make more efficient use of resources and take full advantage of the Group's leading edges in the industry. We will gradually turn from a high growth company into a public utilities company in the future years, so as to minimise investment risks and maximise shareholders' wealth.

Wang Yusuo
Chairman
20 April 2006



Core Value

is the Keystone for Success

With the corporate culture of integrity and reliability, and the prudent and sound investment strategy, we continue to seize the golden opportunities in the PRC natural gas market.

