Connecting Everybody

Natural gas is used in urban households for cooking, showering and heating

INDUSTRY REVIEW

ENERGY CONSUMPTION PATTERN IN PRC

With the steady high economic growth in the People's Republic of China (the "PRC"), its demand for energy also continued to increase tremendously in 2005. The PRC's current major sources of energy are coal, electricity, oil, liquefied petroleum gas ("LPG") and natural gas. While the PRC is the world's second largest energy consumer, its energy consumption pattern is very different from that of the world. For instance, in 2004, oil, natural gas and coal made up 36.8%, 23.7% and 27.2% respectively in the world's energy consumption; in the PRC, coal is the predominant energy source and made up 67.7% of its total energy consumption, while oil made up 22.7%, and natural gas 2.6% only.

The PRC has ample coal resources, though the use of coal causes serious pollution to the environment. In 2005, the PRC central and local governments tightened the safety control on coal productions and closed down many coal mines that were below safety standards.

Therefore, coal price in the PRC increased over 10% during the year. The rapid economic development in the PRC drove up its demand for electricity, and the supply of electricity in the PRC still could not meet its demand in 2005. As a result, there were 12 provinces experienced limited supply of electricity in peak time during the year, which might indirectly cause the commercial/industrial ("C/I") customers to switch to using natural gas.

During the year, the demand for oil in the PRC continued to soar. Because the output of crude oil in the PRC could not meet its demand, imported crude oil accounted for over 40% of consumption in the PRC in 2005. International oil prices also rose over 40% for the year. These would all indirectly promote the demand for oil substitutes, such as natural gas and dimethyl ether ("DME").

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 LPG and electricity. Therefore, the PRC government is vigorously promoting the use of natural gas as a clean energy source. According to the statistics of Energy Bureau, National Development and Reform Commission ("NDRC"), in 2005, the output of natural gas in the PRC increased 22.5% from 40.8 billion cubic meters in 2004 to 50.0 billion cubic meters in 2005. As forecasted by Energy Research Institute, NDRC, the demand growth of natural gas will be well ahead of coal and oil in the PRC in the future 20 years. With accelerated urbanisation and higher urban environmental protection standards in the PRC, the natural gas industry will have even wider prospects in the PRC energy market.

PRC POLICIES ON CITY PIPED NATURAL GAS MARKET

Since the issue of "Opinion concerning the speeding up of the development of market economy in the public utilities sector" by the Ministry of Construction of the PRC at the end of 2002 and "Opinions on encouraging the development of non-state-owned economy" by the State Council of the PRC at the beginning of 2005, the market liberalisation of urban gas industry in the PRC has been accelerated. Private and foreign investors have actively participated in the investment in, and the construction and operation of, city gas business in the PRC.

According to "Circular on reforming natural gas wellhead price to establish a pricing mechanism and making appropriate increase in natural gas wellhead price in the recent period" issued by the NDRC on 23 December 2005, the price of natural gas will change from being stable in the past to being pegged with the prices of oil, coal and LPG. The natural gas industry will greatly benefit from this new policy. Firstly, in the PRC, natural gas is in average 30% - 50% cheaper than coal gas, electricity and LPG; when natural gas wellhead price is pegged with these energy sources, natural gas will always maintain its price competitiveness over those major substitute energy sources in the PRC, and so more users will switch to using natural gas. Secondly, the current natural gas price in the PRC is only about 40% of the international prices. As the prices of the pegged energy sources are expected to rise, the natural gas price will also be pushed up, which will facilitate large volume import of liquefied natural gas ("LNG"). The availability of natural gas sources is the key for the development of the whole natural gas industry. Sufficient gas sources can help enhance the sustainable development of the industry, and the market liberalisation of the city piped natural gas industry will become more comprehensive and mature.

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.

The construction of various branch pipelines of the West-East Pipeline, the commencement of gas supply of Zhongxian-Wuhan Pipeline, the exploration of offshore natural gas and the smooth progress of the LNG import projects in coastal areas, together with the central and local governments' emphasis on using natural gas, all facilitate the rapid and continuous development of downstream natural gas business. As a result, the Group will have even greater business development prospects.

BUSINESS REVIEW

The principal businesses of the Group are the construction of gas pipelines, the sale of piped gas, the sale of bottled LPG and the sale of gas appliances.

CONSTRUCTION OF GAS PIPELINES

During the year, the Group had strategic adjustments to slow down the acquisition of new projects and boost connections in existing projects. As the Group's piped gas users only accounted for 16.6% of the total connectable population, it is expected that the Group will continue to have huge revenue from connection, and connection will still be the major revenue source of the Group. With the rapid growth in the number of residential households and C/I customers in the piped gas projects, the Group's natural gas sales volume also increased remarkably. As the proportion of gas sales will increase year by year, in spite of the strong growth in connection fees, the Group expects that the proportion of connection fees to total turnover will decline gradually.

Residential Customers

During the year, the Group continued to devote lots of efforts to connecting more residential households in the project cities. Flats connected to piped natural gas are in general preferred by new home buyers. Also, the continuous upsurge of international oil prices drove up the price of LPG, the main substitute of natural gas, and enlarged the price difference between LPG and natural gas. These boosted the connection business of the Group and lowered the costs for developing new customers.

During the year, the Group made natural gas connections for 334,637 residential households, 32.1% more than last year. The average connection fee paid by households was RMB2,647. As at the end of 2005, the Group provided natural gas connections to a total of 969,315 households, which accounted for 9.0% of the overall connectable population of the Group. If the 302,495 acquired/converted natural gas users were added, the penetration rate would be 11.8%. And if the other piped gas users were also added, the total number of residential users was 1,793,216, and the penetration rate would be 16.6%. Such penetration rates also show that the Group still has a large pool of potential customers for new connections.

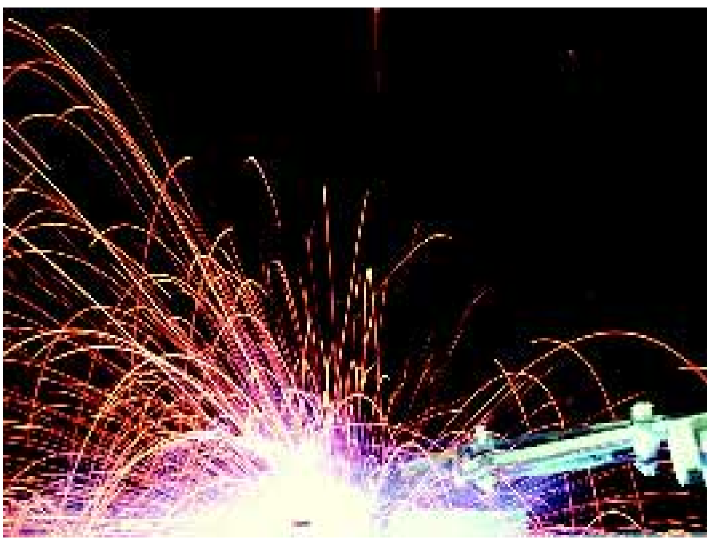
Commercial/Industrial Customers

As the local governments in the PRC have implemented more stringent measures for environmental protection and put more efforts in controlling industrial pollution, more and more cities restrict the use of coal and require new commercial or industrial projects to use clean energy. However, other clean energy sources, such as electricity and LPG, are much more expensive than natural gas. Hence, it facilitates the promotion of natural gas among C/I customers. In addition, more large projects of the Group have been or will be connected to piped natural gas sources, such as West-East Pipeline and Zhongxian-Wuhan Pipeline, as well as the Guangdong LNG terminal to be completed in 2006; it facilitates the Group to make massive connections to C/I customers in an organised manner.

C/I customers are the Group's major gas users, and over 60% of natural gas sales comes from them. To accelerate the market development of C/I customers, the Group has strengthened the technological support for sales and marketing. Besides, the Group has established 54 demonstration sites of connected C/I customers, which consist of 27 industries and spread out in 13 project locations. It can increase the potential customers' confidence in using natural and promote C/I business effectively.

Prefecting Partnership

Natural gas can be the fuel for various industries, such as steel, glass, pottery and dyeing, etc.



During the year, the Group provided natural gas connections for 1,140 C/I customers (connected to gas appliances of a total installed designed daily capacity of 1,045,466 cubic meters), 99.0% more over last year, which clearly illustrates the Group's effective marketing strategy and the competitive advantages of natural gas over other fuel substitutes. The average connection fee was RMB268 per cubic meter, 11.3% lower than last year. As C/I customers are the major gas users and consume huge volume of gas, the Group offered discounts to large C/I customers in projects with piped natural gas sources in order to increase future gas sales volume.

As at the end of 2005, the Group provided piped natural gas connections for a total of 2,655 C/I customers (connected to gas appliances of a total installed designed daily capacity of 2,103,580 cubic meters). If the acquired and converted natural gas users were added, the Group would supply natural gas to a total of 3,439 C/I customers (connected to gas appliances of a total installed designed daily capacity of 2,286,861 cubic meters). If the other piped gas users were also added, the Group would supply natural gas to a total of 4,041 C/I customers (connected to gas appliances of a total installed designed daily capacity of 2,495,479 cubic meters).

New Projects

In 2005, the Group started its strategic adjustments. The Group has slowed down the acquisition of new projects and switched focus from obtaining many new piped gas projects to boosting penetration rates in existing projects and developing CNG vehicle refuelling stations ("CNG stations"), which will increase long term natural gas sales. The Group considers 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. The strategic adjustments also enable the Group to concentrate resources and have more effective management of the 59 projects across 14 provinces, municipalities and autonomous regions.

Currently, the Group has an overall penetration rate of 16.6% only, and from 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 with growing penetration rate 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.

In 2005, the Group secured seven new piped gas projects, more than the Group's target of securing four to six new projects set at the beginning of the year, and the Group's number of projects increased from 52 last year to 59 this year, and the connectable population grew by 11.2 % to 32,387,000 (approximately 10,796,000 households) by the end of 2005 from 29,128,000 (approximately 9,709,000 households) last year. This makes the Group one of the largest professional city gas operators interms of population coverage in the PRC.

New projects secured by the Group during the year are as follows:

Province	Project	Connectable population
Anhui Province	Fengyang	110,000
Fujian Province	Quanzhou	991,000
Guangdong Province	Zhaoqing High New Development Zone	63,000
Henan Province	Luoyang	1,474,000
Zhanjiang Province	Hangzhou Xiaoshan	259,000
Zhanjiang Province	Taizhou Huangyan	285,000
Zhanjiang Province	Yongkang	229,000

As always, the Group emphasises strategic development of project cities. In general, the projects secured this year are cities with strong economy, well-developed industries, large population and good development potentials. For instance, Quanzhou has well-developed industrial and commercial sectors; Luoyang, with its prosperous industrial/commercial activities and high income per capita, is a pivotal city in Henan Province in terms of economy. In addition, the Group has project development in new regions: Quanzhou, the first piped gas project the Group secured in Fujian Province, signifies the Group's breakthrough in Fujian, a lucrative region. Furthermore, the Group has further expanded its strategic cooperation. The Group established strategic cooperation relations with Daqing Petroleum Administration Bureau during the year for jointly developing downstream business. Also, the Group secured Luoyang project together with China Huayou Group Company in 2005 and established Luoyang Xinao Huayou Gas Company Limited, which is our first successful joint acquisition after entering into the strategic cooperation agreement with China Huayou Group Company in 2004. Moreover, the Group has built up a successful development model from the experience of Fengyang project: the expansion from a core project to periphery cities and towns. As Fengyang is only 8 km away from the pipeline network of the Group's existing Bengbu project, which has direct access to natural gas from West-East Pipeline, the Group can make better use and increase the value of resources with relatively low cost, and hence maximise the value by fully utilising gas and other resources.

SALE OF PIPED GAS

During the year, the Group sold 198,488,000 cubic meters and 273,051,000 cubic meters piped gas to residential households and C/I customers respectively, representing increases of 89.2% and 91.2% respectively over last year. The sales volume of gas to C/I customers made up 57.9% of the total volume of gas sales, showing that the Group has large volume consumers, who lay a solid foundation to support the Group's long-term revenue.

With the Group's strategic adjustments to boost penetration rates in the coming years, and more piped natural gas sources available, which enables the Group to connect more large volume C/I customers, it is expected that the Group will continue to have considerable growth in gas sales in the coming years. It will further consolidate the Group's long term revenue and provide large and stable cash flow.

During the year, the Group and the joint venture partner in Shijiazhuang, the capital of Hebei Province, made further investment in the project, and acquired about 270,000 residential households using coal gas into Shijiazhuang Xinao Gas Company Limited, the Group's subsidiary. The Group will convert those coal gas users into piped natural gas users gradually. Apart from contributing to environmental protection, it can also increase the Group's gas sales revenue in the long run.

Gas Source

Natural gas source is the critical factor for the development of the Group as well as the whole natural gas industry. Therefore, with more projects and higher gas sales volume, the Group has also further increased its non-pipeline transmission capacity in addition to the Group's existing piped natural gas sources. The Group has one of the largest non-pipeline transmission systems in the PRC and possesses 114 LNG/CNG trucks, with a total one-time transmission capacity of up to 18,800,000 cubic meters. LNG/CNG can be used when necessary, so as to ensure gas supply. The Group has devoted great efforts in developing a contingency system that ensures gas sources and has set up a designated team. If any projects have tight supply of gas sources, the systems, together with the gas supply control center, can enhance the guarantee of gas supply.

The construction of the LNG project in Weizhou Island, Beihai, Guangxi was completed in 2005, and the project is now undergoing shakedown tests before commencing operation. It will be the fourth LNG plant in the PRC when put into production. It will mainly supply LNG to the Group's project in the south to meet the gas demand of the projects and further reduce the purchase cost of gas.

To further ensure gas sources, reduce purchase cost of gas and support the Group's policy of boosting penetration rates, the Group will participate in the establishment of a company engaged in coal conversion business in 2006. The business is to convert coal into DME, which can 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. The coal conversion project 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. After years of research on coal conversion projects, the Group completed the construction of a production line with an annual production capacity of 10,000 tons of DME in Bengbu City, Anhui Province, and it commenced production by the end of the year. Besides, the Group has started the research on the technology for replacing natural gas by DEM.

Apart from the Group's five projects that has used natural gas from West-East Pipeline since 2005, the Groups projects in Changsha, Zhuzhou and Xiangtan in Hunan Province also started to use the natural gas from Zhongxian-Wuhan Pipeline, and Yantai project used the offshore natural gas. After having access to piped natural sources, Changsha, Zhuzhou, Xiangtan and Yantai projects had more than 100,000 coal gas residential users converted into natural gas users. With the completion of more long distance pipelines, more and more of the Group's large projects use natural gas transmitted by pipelines. It facilitates new connections and minimises the additional cost of using CNG/LNG.

Because of the significant increase in international energy prices in 2005, the PRC government also adjusted the domestic energy pricing policy and further promoted market liberalisation of the natural gas industry. The government made adjustments to the policy on natural gas wellhead price at the end of 2005, and it is expected that natural gas price may follow other major energy prices to rise in the coming years. The PRC government also consents that natural gas downstream distributors should be allowed to make adjusts to gas tariffs according to the regulations. The Group has reinforced the communication with upstream suppliers like PetroChina to ensure gas supply. At the same time, the Group has also made application to local governments for gas tariff adjustments, so as to shift the adjusted costs to customers to protect the earning of the Group.

CNG Vehicle Refuelling Stations

Since vehicle emission is one of the major source of pollution in the large cities in the PRC, the PRC governments promotes the policies on converting vehicles to using clean energy. This will further accelerate the CNG station business. Besides, as the price of natural gas is on average 30-50% lower than gasoline, it is highly welcome by public vehicle companies and vehicle owners.

The Group has taken active measures to develop CNG stations business in its existing projects. By the end of 2005, the Group has obtained approval from governments to build 60 CNG stations, of which 10 have been completed and are in operation. It is expected that CNG station will become one of the major sources for increasing gas sales in the long term.

Advanced Collection System for Gas Usage Charges

The Group continues to adopt the prepaid stored-value card system for all projects. Under the system, every residential customer will receive a stored-value card and is required to prepay for the gas. This system can totally eliminate the possibility of default payment and save huge administrative expenses, thus enhancing the Group's cash flow.

Starting from last year, some of the Group's project companies started to cooperate with local banks. They use the widespread network resources of the banks for collecting gas usage charges. This cooperation makes it more convenient for our customers, reduces the Group's administrative costs and increases cost efficiency.

SALE OF BOTTLED LPG

During the year, the Group sold 45,179 tons of bottled LPG, increased by 19.6% over last year's 37,760 tons. The sales of bottled LPG increased because that the some of the new projects the Group acquired during the year had bottled LPG business. The operating profit of LPG increased from RMB908,000 last year to RMB3,960,000 this year.

The Group has been principally engaged in the sale of piped natural gas. However, some of the projects were mainly engaged in the sale of bottled LPG before being acquired by the Group. Bottled LPG is now only sold to customers not connected to piped natural gas or in peripheral towns, and it is expected to be replaced by piped natural gas gradually.

SALE OF GAS APPLIANCES

The Group sells cooking stoves, water boilers, heaters and stored-value card meters, which are relating to gas connections. The Group produces stored-value card meters, most of which are used by the Group in its own connection business. The Group lowers the average cost of meters by 30% by producing them itself. Besides, in 2005, the Group continued to sell meters to other gas distributors, which generated additional income for the Group.

GROSS AND NET PROFIT MARGINS

The Group's overall gross and net profit margins (after minority interests) were 37.5% and 14.7% respectively, and the margins dropped when compared to last year. One of the major causes for the drop was the change in the Group's revenue structure. As the penetration rates of the gas projects gets higher, although the overall penetration rate of the Group remains at 16.6% and leaves plenty of room for connection fee revenue growth, the proportion of connection fee revenue to total turnover will decline steadily: its ratio decreased from 57.1% in 2004 to 50.3% in 2005. The proportion of piped gas sales to total turnover will grow steadily with the rise of the penetration rates: its ratio increased from 29.8% in 2004 to 37.3% in 2005. As the margins of connection fee revenue are higher than piped gas sales, the change in the revenue structure will make the Group's future gross and net profit margins to be on a decreasing trend, until the revenue structure becomes relatively stable. On the other hand, this trend also reflects the enhancement in the Group's revenue structure, which shifts gradually from relying on one-off connection fee revenue to recurring and steady piped gas sales.

The other cause for the drop in the margins was the increase in minority shareholders' interests in the gas project companies, which was a result of the Group shifting from securing small-to-medium projects to medium-to-large projects. The percentage of minority interests in net profit increased from 17.4% last year to 22.3% this year. The Group still has high operation efficiency after taking into account of the change in revenue structure and profits before minority interests.

To reduce the Group's operation costs and enhance its operation efficiency, in 2005, the Group continued to strengthen the implementation of the measures from the consultation project by BearingPoint Management Consulting (Shanghai) Limited, especially on enhancing internal control and cost and expenses management. As a result, the Group has good control over selling expenses and administrative expenses and achieves more efficient operation management.

ADVANCED SAFETY MANAGEMENT SYSTEM

The Group has always put paramount priority on safe operation. The Group uses advanced IT systems for daily operations and management and also plans to launch informatisation in 2006 to enhance safe and efficient operation.

In 2005, the Group uplifted the safety operation level of the natural gas stations and launched certified safety operation of gas stations. All the 26 Type A gas stations of the Group have obtained the safe operation certificates. All the potential risks identified during the process of acquiring the certificates have been removed. In addition, 365 operating staff in the CNG/LNG stations have received training and obtained qualified certificates.

In 2005, the Group continued the development of the gas professional training centre, which was established together with Utilise Training & Development Solutions Limited in 2003. It draws on the safety and operation standards of the natural gas industry in the UK, and launched professional training and qualification recognition system to enhance the professional qualification and expertise of the employees. During the year, the training center conducted 52 sessions of training courses, and there were 1,181, 63 and 8 employees passed Level 1, Level 2 and Level 3 of the Operational Qualification and Recognition Examinations respectively. In 2006, the Group will introduce Level 4 and Level 5 Examinations, as well as the Gas Service Qualification and Recognition Examinations to foster more qualified personnel to enhance safety and operational efficiency.

OUTSTANDING MANAGEMENT

Because of its excellent management, the Company continued to receive awards from various prominent international 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*. These awards, voted or nominated by international institutional investors and analysts, prove that the Company is highly regarded by investors for its high management quality and transparency.

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. The project will implement informatisation to provide accurate and timely information to the management, assist the management in problem solving, decision making and achieving the targets set by the Board of Directors. The project enables the Group to carry out informatisation in full swing and draw on international best practices and experiences of world class enterprises. Some project companies will launch a pilot system, and it is expected that the first phase of the project will be completed in May 2006. The implementation of the informatisation project is expected to minimise the management risks for the Group.

CUSTOMER SERVICE

Quality customer service is the key for maintaining good and long term relations between the Company and customers and the bedrock for the Group's sustainable business development. Because of our quality service, the project companies of the Group have won recognition and credit from local customers as well as government authorities in the cities they operate and become the models for other public utilities to follow. The best evidence is that 11 project companies obtained awards like "Units with High Consumer Satisfaction", "Units Trusted by Consumers" and "Trustworthy Units", etc, from the local consumer councils during the year.

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.

In addition, the project companies follow the Group's policy to issue leaflets of "Gas Usage Safety Standards" to our customers and conduct safety checks twice a year on pipeline networks and customers' gas appliances. These measures help to eliminate potential safety problems, and thus increase the trust of our customers.

HUMAN RESOURCES

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 depend on human resources. Therefore, we put great emphasis on recruitment and internal training.

During the year, we continued to recruit high-calibre undergraduates from renowned universities all over the PRC as well as experienced professionals in the industry or from overseas according to our development needs. The Group has comprehensive induction training for new employees to ensure that they can become qualified employees quickly and be able to provide quality service to customers, so as to maintain smooth operations of the Group.

The Group encourages staff to have lifelong learning and offers learning and studying opportunities to employees as a form of benefits and rewards. Therefore, we have sponsored some employees to study for MBA or to attend other related technical courses in renowned universities, so as to enhance their competence, professional skills and quality. The Group also emphasises internal training and arranges two days of training every month to all employees. 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.

As at 31 December 2005, the Group had 10,331 employees, of which seven based in Hong Kong and the others based in the PRC. They were remunerated at market level with benefits like bonus, retirement benefits, insurance, professional training, share option scheme, etc.

FINANCIAL RESOURCES REVIEW

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2005, the Group's cash on hand (included pledged bank deposits) was RMB1,784,055,000 (2004: RMB911,537,000), and its total debts amounted to RMB3,547,202,000 (2004: RMB1,864,458,000). Its net gearing ratio, i.e. the ratio of net debt to equity (excluded minority interests), was 75.6% (2004: 49.6%).

Under the US$25,000,000 Loan Agreements with International Finance Corporation ("IFC"), the private sector arm of the World Bank Group, the Company, Mr. Wang Yusuo ("Mr. Wang") and the Borrowers (i.e. Bengbu Xinao Gas Company Limited, Shijiazhuang Xinao Gas Company Limited and Xiangtan Xinao Gas Company Limited, subsidiaries of the Company) have entered into the Share Retention Agreements with IFC on 18 May 2004 whereby Mr. Wang has agreed that, so long as any monies remain due or to become due and owing by the Borrowers to IFC under or in respect of the Loan Agreements, he and Ms. Zhao Baoju ("Ms. Zhao") will own, in aggregate, directly or, at any time that he and Ms. Zhao own in aggregate all the shares of Xinao Group International Investment Limited (formerly known as Easywin Enterprises Limited) ("XGII"), indirectly through XGII, at least 35% of the issued share capital of the Company. Mr. Wang and Ms. Zhao are the beneficial and legal owners of XGII, which is owned as to 50% by Mr. Wang and 50% by Ms. Zhao. As at 31 December 2005, XGII and Mr. Wang together held 42.88% interests of the Company.

Five-year Zero Coupon Convertible Bonds

The Company issued five-year convertible bonds ("CB" or "CBs") in an aggregate principal amount of HK$550,000,000 on 15 November 2004. The CBs are zero coupon bonds; the issue price is 100% whereas the redemption price is 106.43%, which means that the effective interest rate is 1.25% per annum. The bondholders have the option to require the Company to redeem the CBs 2.5 years after the issue date. If the bondholders do not exercise the option of redemption, then they have to hold the CBs to maturity or exercise the conversion right during the conversion period. Bondholders can exercise the conversion right between 15 December 2004 and 15 November 2009 and convert the CBs into ordinary shares of HK$0.10 each of the Company, and the Company has the option to issue share or pay cash in lieu of shares to such bondholders. The conversion price for each ordinary share at the issue date of the CBs was HK$5.4375, which is subject to adjustment for events, if any, which may have diluting effects after the issue.

As at 31 December 2005, HK$79,570,000 (equivalent to RMB82,753,000) of CBs was converted into 14,633,560 ordinary shares of the Company. There were HK$470,430,000 (equivalent to RMB489,247,000) of CBs outstanding. If all the outstanding CBs are converted into shares, approximately 86,515,862 ordinary shares of the Company will be issued, equivalent to 9.57% of the total issued share capital of the Company as at 31 December 2005.

Seven-year 7.375% Fixed Rate Bonds

On 5 August 2005, the Company issued 7-year bonds in the aggregate principle amount of US$200,000,000 (equivalent to RMB1,614,040,000) with issue price and redemption price of 100%, which are unconditionally and irrevocably guaranteed by the guarantor subsidiaries. The guarantor subsidiaries are wholly-owned subsidiaries of the Company and are primarily holding companies that operate through subsidiaries. The coupon of the bonds is 7.375%, and interests are paid semi-annually. The net proceeds after deducting all expanses are US$194,000,000 (equivalent to RMB1,565,619,000). The net proceeds of the bonds will be used for business expansion, including construction of CNG stations and acquisition of new projects, and for general corporate purposes of the Group, including refinancing of existing debts. The major terms and conditions of the bonds were disclosed in the Company's announcement dated 29 July 2005.

The Group captured the chance of record-low interest rate in the USA to finance business expansion. As the Group's acquisition strategy will focus on large sized cities, the 7 year term of the Bonds can match the payback period of the investment in large sized cities. With the rising US interest rate cycle, the costs of financing with floating rates are getting higher and higher. Therefore, the Group believed that fixed rates for 7 years could facilitate the Group to have even better cost control. Also, the bonds had 5 times subscription and a lowest-ever coupon rate among Chinese bonds in similar nature at the time of issue. The bonds were also awarded "Best Asian High Yield Bond Issue for 2005" by the renowned financial magazine EuroWeek. These showed that the bondholders and investors gave strong credit to the Group and recognized the prospect of the Group's business. The issue of the bonds also facilitated the Group to enlarge investor base and enhance its financing ability.

The Group believed that the appreciation of RMB would continue in the future. As all the operations of the Group are in the PRC, the Group will benefit from earning RMB and repaying foreign currency debts.

Currently, the Group's operating and capital expenditures are funded by operating cash flow, internal liquidity, bank loans and issued bonds. The Group has sufficient sources of funds and unutilised banking facilities to meet the future capital expenditure and working capital requirements.

BORROWINGS STRUCTURE

As at 31 December 2005, the Group's total debts amounted to RMB3,547,202,000 (2004: RMB1,864,458,000), including bonds of US$200,000,000 (equivalent to RMB1,614,040,000), zero coupon CBs of HK$470,430,000 (equivalent to RMB489,247,000), loans of US$25,000,000 (equivalent to RMB201,755,000) and a secured loan of HK$10,088,000 (equivalent to RMB10,492,000). Apart from the zero coupon CBs and the fixed rate US dollar bonds, the other US dollar and HK dollar loans bear interest at floating rates, and the remaining bank and other borrowings are denominated in Renminbi at fixed interest rates. The project companies used the Renminbi loans as their working capital and operational expenditure. Except for the loan amount of RMB109,947,000 that has to be secured by assets with the carrying amount of approximately RMB88,209,000, all of the other loans are unsecured. Short-term loans amounted to RMB566,457,000 while the remaining were long-term loans falling due after more than a year.

As all the operations of the Group are in the PRC, revenues and expenses were mainly denominated in Renminbi. Hence, there were no a significant foreign exchange exposures or risks. The Group has entered into interest rate swap contracts for the US dollar bonds. The Group will monitor the market trends of interest and exchange rates closely and make appropriate adjustments when necessary.

CONTINGENT LIABILITIES

As at 31 December 2005, the Group had contingent liabilities of RMB77,000,000 (2004: Nil).

CAPITAL COMMITMENTS

As at 31 December 2005, the Group had contracted but not provided for capital commitments of RMB15,227,000 (2004: RMB22,673,000) and had no authorised but not contracted for capital commitments (2004: RMB14,200,000) for the purchase of property, plant and equipment.

As at 31 December 2005, the Group had contracted but not provided for capital commitments of RMB161,390,000 (2004: RMB114,125,000) for the Group's share in joint ventures.

Natural Gas -

Adding Quality to Our Life

The use of natural gas, a clean, safe, efficient and economical energy source, reduces the pollution caused by a coal-fired economy.