

# Report of the Directors

The Board of Directors of the Company is pleased to submit their report together with the audited consolidated financial statements of the Group for the seventeen months ended 31 December 2006.

## CHANGE OF COMPANY NAME

Pursuant to the special resolution passed at the special general meeting of the Company held on 22 September 2006 and approved by the Registrar of Companies in Bermuda and Registrar of Companies in Hong Kong, the Company has changed its name to "China Oil And Gas Group Limited" in English and, for identification purpose adopted "中油燃氣集團有限公司" as its Chinese name with effect from 13 October 2006.

## PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The Group is principally engaged in investments in natural gas and energy related businesses.

## RESULTS AND APPROPRIATIONS

The Group's profit for the period ended 31 December 2006 and the state of affairs of the Group as at that date are set out in the consolidated financial statements on pages 28 to 113.

The Directors do not recommend the payment of a final dividend for the seventeen months ended 31 December 2006 (2005: Nil).

## 2007 ANNUAL GENERAL MEETING

The 2007 Annual General Meeting of the Company ("2007 AGM") will be held on Friday, 18 May 2007.

## CLOSURE OF REGISTER OF MEMBERS

For the purpose of determining the identity of the shareholders entitled to attend and vote at the 2007 AGM, the register of members of the Company will be closed from Wednesday, 16 May 2007 to Friday, 18 May 2007, both days inclusive, during which period no transfer of shares will be effected. All transfers accompanied by the relevant certificates must be lodged with the Company's branch share registrar in Hong Kong, Computershare Hong Kong Investor Services Limited, Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong for registration not later than 4:00 p.m. on Tuesday, 15 May 2007.

## SUMMARY OF FINANCIAL INFORMATION

A summary of the results and of assets and liabilities of the Group for the last five financial years, as extracted from the audited financial statements and reclassified as appropriate, is set out on page 114. This summary does not form part of the audited financial statements.

## SEGMENT INFORMATION

An analysis of the Group's turnover and contribution to results by principal activities and geographical area of operations for the period ended 31 December 2006 is set out in note 6 to the financial statements.

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## PROPERTY, PLANT AND EQUIPMENT

Details of movements in the property, plant and equipment of the Group during the period under review are set out in note 17 to the financial statements.

## CONVERTIBLE NOTES

Details of the convertible notes of the Company are set out in note 36 to the financial statements.

## SHARE CAPITAL AND SHARE OPTIONS

Details of movement in the Company's share capital, share options during the period under review, together with the reasons therefor, are set out in notes 31 and 32 to the financial statements.

## SHARE OPTION SCHEMES

Share options have been granted to eligible participants under the share option scheme of the Company adopted on 31 January 2002, details of which are set out in note 32 to the financial statements.

## PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Bye-laws or the laws of Bermuda, being the jurisdiction in which the Company was incorporated, which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

## PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

Neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the period ended 31 December 2006.

## DISTRIBUTABLE RESERVES

As at 31 December 2006, no reserve of the Company was available for distribution to shareholders of the Company. In addition, the Company's share premium account will be in a position to pay off its debts as and when they fall due in the ordinary course of business. The share premium account may also be distributed in the form of fully paid bonus shares.

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## MAJOR CUSTOMERS AND SUPPLIERS

The percentage of purchases and sales attributable to the Group's major suppliers and customers are as follows:

	2006	2005
	%	%
Purchases		
– the largest supplier	40	56
– five largest supplier combines	43	77
Turnover		
– the largest customer	10	4
– five largest customers combined	18	12

None of the Directors or any of their associates (as defined in the Rules Governing the Listing of Securities ("Listing Rules") on The Stock Exchange of Hong Kong ("Stock Exchange")) or any shareholders (who, to the knowledge of the Directors, own more than 5% of the Company's share capital) had any beneficial interests in the Group's five largest customers or five largest suppliers.

## DIRECTORS

The Directors of the Company during the period and up to the date of this report were as follows:

### Executive Directors

XU Tie-liang ( <i>Chairman</i> )	(appointed on 30 August 2006)
QU Guo-hua ( <i>Chief Executive Officer</i> )	(appointed on 30 August 2006)
ZENG Xiao	(appointed as Director and Chairman on 13 January 2006 and resigned as Chairman on 30 August 2006)
CHEUNG Shing	(appointed on 13 January 2006)
Masanori SUZUKI	(resigned on 30 August 2006 as Director and Deputy Chairman)
Eiji SATO	(resigned on 30 August 2006)
WONG King Shiu, Daniel	(resigned on 30 August 2006)
WONG Kui Shing, Danny	(resigned on 30 August 2006)
LIN Che Chu, George	(resigned on 16 September 2005)

### Independent Non-Executive Directors

CHEUNG Man Yau, Timothy	
SHI Xun-zhi	(appointed on 30 August 2006)
PENG Long	(appointed on 13 January 2006)
KIM Kwi Nam, Takao	(resigned on 30 August 2006)

In accordance with the Company's Bye-law 87, Mr. Cheung Shing, Mr. Cheung Man Yau, Timothy and Mr. Peng Long shall retire from office as Directors by rotation at the 2007 AGM and being eligible, offer themselves for re-election.

# Report of the Directors

## INDEPENDENCE CONFIRMATION

The Company has received, from each of the independent non-executive Directors, an annual confirmation of independence pursuant to Rule 3.13 of the Listing Rules. The Company considers all of the independent non-executive Directors are independent.

## DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Save as disclosed above, at no time during the period was the Company or any of its subsidiaries a party to any arrangements to enable the Directors to acquire such rights in any other body corporate.

## DIRECTORS' SERVICE CONTRACTS

The Company entered into a service contract with each of Mr. Xu Tie-liang and Mr. Qu Guo-hua on 30 August 2006 for an initial fixed term of two years commenced on 1 September 2006 and shall continue thereafter until it is terminated pursuant to the terms of the respective service contract.

Save as disclosed above, none of the Directors who are proposed for re-election at the 2007 AGM has a service contract with the Company which is not determinable within one year without payment of compensation, other than statutory compensation.

## DIRECTORS' INTERESTS IN CONTRACTS

Save as disclosed under the section headed "Connected Transaction" below, no Director had a significant beneficial interest, either directly or indirectly, in any contract of significant to the business of the Group to which the Group or its subsidiaries was a party during the period.

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## DIRECTORS' INTERESTS IN SHARES

At 31 December 2006, the interests or short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO") which were notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provision of the SFO), or which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code"), are set out below:

### Interests in shares, underlying shares and debentures of the Company

Name of Director	Capacity	Long position/ Short position	Notes	Number of ordinary shares/ underlying shares held	Percentage of the Company's issued share capital
Xu Tie-liang	Interest in a controlled corporation	Long position	1	321,018,300	12.74%
	Interest in a controlled corporation	Long position	2	775,000,000	30.76%

#### Notes:

1. These 321,018,300 ordinary shares of the Company are held through Sino Advance Holdings Ltd., a company incorporated in the British Virgin Islands with limited liability which is wholly and beneficially owned by Mr. Xu Tie-liang.
2. Sino Vantage Management Limited, a company wholly and beneficially owned by Mr. Xu Tie-liang was interested in the derivative of 775,000,000 ordinary shares of the Company pursuant to the sale and purchase agreement dated 15 December 2006 entered into between the Company and Sino Vantage Management Limited for the acquisition of natural gas business by the Group, whereby the Company shall issue to Sino Vantage Management Limited 400,000,000 ordinary shares and a convertible note in the principal amount of HK\$90,000,000 which is convertible into 375,000,000 ordinary shares of the Company upon completion of the above agreement. Mr. Xu is therefore deemed to be interested in the said derivatives.

Save as disclosed above, none of the Directors or chief executive of the Company had any interests or short positions in shares, underlying shares or debentures of the Company which were recorded on the register required to be kept under section 352 of the SFO or notified to the Company and the Stock Exchange pursuant to the Model Code.

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## SUBSTANTIAL SHAREHOLDERS

At 31 December 2006, the interests or short positions of every person in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the SFO, are set out below:

### Interests in the shares and underlying shares of the Company

Name of shareholder	Notes	Capacity	Long position/ short position	Number of ordinary shares/ underlying shares held	Percentage of the Company's issued share capital
Sino Advance Holdings Ltd. ("Sino Advance")	1	Beneficial owner	Long position	321,018,300	12.74%
Sino Vantage Management Limited ("Sino Vantage")	2	Beneficial owner	Long position	775,000,000	30.76%
Topfaith Group Limited ("Topfaith")	3	Beneficial owner	Long position	105,000,000	4.17%
Chu Ming Ming	3	Interest in a controlled corporation	Long position	105,000,000	4.17%
New Stamina Investments Limited ("New Stamina")	4	Beneficial owner	Long position	275,000,000	10.91%
Lo Chung	4	Interest in controlled a corporation	Long position	275,000,000	10.91%
	5	Family interest	Long position	34,000,000	1.35%

#### Notes:

- Sino Advance, a company incorporated in the British Virgin Islands with limited liability is wholly and beneficially owned by Mr. Xu Tie-liang. Hence, Mr. Xu is deemed to be interested in 321,018,300 ordinary shares of the Company owned by Sino Advance.
- Sino Vantage was interested in the derivative of 775,000,000 ordinary shares of the Company pursuant to the sale and purchase agreement dated 15 December 2006 entered into between the Company and Sino Vantage for the acquisition of natural gas business by the Group, whereby the Company shall issue 400,000,000 ordinary shares and a convertible note in the principal amount of HK\$90,000,000 which is convertible into 375,000,000 ordinary shares of the Company to Sino Vantage upon completion of the above agreement. Sino Vantage is a company incorporated in the British Virgin Islands with limited liability which is wholly and beneficially owned by Mr. Xu Tie-liang.
- Topfaith, a company incorporated in the British Virgin Islands with limited liability of which 71% is controlled by Mr. Chu Ming Ming. Mr. Chu is therefore deemed to be interested in 105,000,000 ordinary shares owned by Topfaith.
- New Stamina was interested in the derivative of 275,000,000 ordinary shares of the Company pursuant to the sale and purchase agreement dated 11 December 2006 entered into between the Company and New Stamina for the acquisition of natural gas business by the Group, whereby the Company shall issue a convertible note in the principal amount of HK\$66,000,000 to New Stamina which is convertible into 275,000,000 ordinary shares of the Company upon completion of the above agreement. New Stamina is a company incorporated in the British Virgin Islands and is wholly and beneficially owned by Mr. Lo Chung, and therefore, Mr. Lo Chung is deemed to be interested in the said derivatives.
- These 34,000,000 ordinary shares are held by the spouse of Mr. Lo Chung, and therefore, Mr. Lo Chung is deemed to be interested in these shares.

Save as disclosed above, no other parties were recorded in the register of the Company required to be kept under section 336 of the SFO as having interests or short positions in the shares or underlying shares of the Company as at 31 December 2006.

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## MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted the Model Code set out in Appendix 10 to the Listing Rules as the code of conduct regarding securities transactions by the Directors. Having made specific enquiry of all Directors, the Company confirmed that all Directors have complied with the required standard set out in the Model Code.

## CONNECTED TRANSACTION

On 15 December 2006, All Praise Investments Limited, a wholly-owned subsidiary of the Company, entered into an agreement with Sino Vantage Management Limited, a company wholly and beneficially owned by Mr. Xu Tie-liang, Chairman of the Company, for the sale and purchase of the entire issued share capital and shareholder's loan in Vast China Group Limited ("Vast China") at a total consideration of HK\$196,370,793 for the natural gas business in Maanshan. The consideration is satisfied partly in cash in the amount of HK\$10,370,793, partly by the issue and allotment of 400,000,000 ordinary shares of the Company and the issue of a convertible note in the principal amount of HK\$90,000,000. The transactions contemplated under the agreement constituted a connected transaction of the Company under Chapter 14A of the Listing Rules. A special general meeting was convened and held on 15 March 2007 to approve the agreement and transactions contemplated there under.

Save as disclosed above, there were no other transactions which need to be disclosed as connected transactions in accordance with the requirements of the Listing Rules.

## PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the Directors, the Company has maintained a sufficient public float as required under the Listing Rules during the period and up to the date of this report.

## POST BALANCE SHEET EVENTS

Details of the post balance sheet events of the Group are set out in note 43 to the financial statements.

## CORPORATE GOVERNANCE

A report on the principle corporate governance practices adopted by the Company is set out on pages 19 to 25 of the annual report.

## AUDIT COMMITTEE

The Company established an audit committee ("Audit Committee") in 1998. The Audit Committee comprises three independent non-executive Directors, namely Mr. Cheung Man Yau, Timothy, Mr. Shi Xun-zhi and Mr. Peng Long. The Audit Committee has reviewed the audited financial statements of the Group for the period ended 31 December 2006.

## AUDITORS

Ernst & Young resigned as auditors of the Company with effect from 22 March 2005 and KLL Associates CPA Ltd. was appointed as auditors of the Company to fill the vacancy with effect from 6 May 2005. Following the merger of practices by KLL Associates CPA Ltd. with BDO McCabe Lo Limited, KLL Associates CPA Ltd. resigned with effect from 20 September 2005 and BDO McCabe Lo Limited was appointed as auditors of the Company to fill the vacancy with effect from 14 November 2005 and resigned on 26 April 2006. At the special general meeting of the Company held on 30 May 2006, Ting Ho Kwan & Chan was appointed as auditors of the Company to fill the vacancy arising from the resignation of BDO McCabe Lo Limited. Save as disclosed above, there were no changes in auditors during the past three years.

A resolution will be submitted to the 2007 AGM to re-appoint Ting Ho Kwan & Chan as auditors of the Company.

On behalf of the Board  
**China Oil And Gas Group Limited**  
**Xu Tie-liang**  
*Chairman*

Hong Kong, 17 April 2007