

Connecting...

'Life'





The Group's total sales volume of gas increases

1.8 times

in 2006



Our total connectable urban population reaches

39,073,000



The Chinese characters “Xin” and “Ao” mean “New” and “Profound” respectively. “New” implies exploration: continuous innovation that builds eternity. “Profound” reflects thorough knowledge: perfect quality that wins the future.

WANG Yusuo
Chairman



Connecting...

'XinAo'

Results of the Year

The Group continued to record substantial growth in its results for 2006. The revenue and profit attributable to shareholders for the year reached RMB3,396,536,000 and RMB379,617,000 respectively, representing increases of 65.1% and 40.3% over last year respectively. Earnings per share — basic increased by 32.8% to RMB40.5 cents.

During the year, the Group secured five new gas projects, which were located in Nanan City, Huian City, Shishi City and Jinjiang City in Fujian Province and Laiian City in Anhui Province. As of the end of 2006, there were 64 city piped gas projects, and the connectable urban population increased by 20.6% to 39,073,000. Reaping from the advantage of possessed resources, the Group has instigated to develop compressed natural gas ("CNG") vehicle refuelling station ("refuelling station") business from 2002. Apart from acquiring large-scaled refuelling station business in Shanghai, the Group has also built up 15 refuelling stations in eight cities during the year.

Consequently, the aggregate number of refuelling stations has been increased to 57, which fortifies the Group's gas sales volume and revenue in the long run.

During the year, the Group made piped natural gas connections to 451,072 residential households and 1,493 commercial/industrial ("C/I") customers (connected to gas appliances of a total installed designed daily capacity of 1,481,611 cubic meters). As of the end of 2006, the accumulated number of residential households and C/I customers of natural gas were 2,069,783 and 5,778 (connected to gas appliances of a total installed designed daily capacity of 4,372,540 cubic meters) respectively, and the accumulated number of residential households and C/I customers of other piped gas were 388,952 and 512 (connected to gas appliances of a total installed designed daily capacity of 651,112 cubic meters) respectively. The sales volume of gas for the year also grew tremendously by 1.82 times whilst the share of piped gas revenue over total revenue was raised drastically to 47.8%,

revealing an economy of scale and the prosperous development of the Group, which consolidated the Group's long term recurring revenue in the future.

Financial Position

As at 31 December 2006, the Group's cash on hand was RMB1,567,552,000 (2005: RMB1,784,055,000), and total debts were RMB4,022,936,000 (2005: RMB3,654,669,000). The net gearing ratio (the ratio of net debt to equity excluding minority interest) was 80.3% (2005: 83.8%). Whilst the Group has changed from massive acquisition of new projects to boosting gas penetration rate in our existing projects, and the maturing gas projects also bring stable cash flow, there are sufficient financial resources to support the development of the Group in the long run.

Corporate Management

With a view to drawing on the best practical management experience of the corporations in the industry worldwide, so as to bring the Group's management

quality in line with the state-of-the-art corporations in this field, the Group has joined force with IBM Global Services (China) Company Limited ("IBM") in 2006 to launch a consultation project on process streamlining and information system management. In June 2006, the total IT solutions project was commenced officially. Four subsidiaries were selected as the trial run units. The Group was the pioneer enterprise with parallel implementation of the enterprise management software SAP utilities solution, oil and natural gas industry solution and enterprise resource planning. The total IT solutions project was put into practice on 8 January 2007 as scheduled.

As of the end of 2006, the Group has gas projects across 14 provinces, municipalities and autonomous regions in the People's Republic of China ("PRC"). Therefore, the Group has established eight regional management centers (merging the nine centers in 2005 for reducing operation costs) to facilitate management of gas projects. To ensure achievement of the Group's targets and effective communication of the Group's strategy, the Group instigated a strategic performance management project effectively during the year. The project divides the Group's strategic target into strata for execution at each company and employee, enabling the transformation of targets into actions and enhancing the ability of strategy implementation in all aspects. During the instigation process, the Group's strategy has been reviewed with the stance and approach of strategic communication clarified. The strategic division of labour for each organisation level has also been confirmed. All these have strengthened the strategic co-ordination among functional departments and have provided a fundamental solution for transplanting strategic execution.

International Awards

The Company was awarded "Chinese Business 500" by Yazhou Zhoukan again during the year, making it the sixth consecutive year the Company gained this award. The Company's annual report 2005 was also awarded "Honourable Mention, Best Annual Report Awards" by The Hong Kong Management Association, which revealed that the Company's annual report has provided clear and accurate disclosure and has served the function of shareholder communication effectively. These awards also reflected the recognition of investors and professional institutions towards the Company's management quality and high degree of transparency. In future, management of the Group will endeavor to maintain and achieve beyond this outstanding performance and reputation that have been gained by the Company through challenging course.

Human Resources

As at the end of 2006, the Group had 13,355 employees (2005: 10,331), providing sufficient human resources to cater the need of the Group's development.

The Group endorses the principle of "based on people" and believes that healthy employee development is the key to the provision of satisfactory services to customers. Therefore, the Group offers learning and studying opportunities to employees as a kind of benefits and rewards, so as to encourage lifelong learning among employees.

The Group also tailor-makes practical career development plans for employees, creates open career paths for them and allows them to fully utilise their potential. With a view to facilitating the progress and growth of young employees, the Group provides competition for promotion, job rotation, on-the-job training and promotion channel development to young employees, which in turn ensure

adequate human resources for the Group's sustainable and healthy development.

In light of ensuring clear understanding of the Group's development strategy and vision among employees, concerning employees' personal growth as well as encouraging employees' action on realisation of personal and corporate value, in 2007, the Group will implement employee satisfaction project in full force, aiming to swell both the degree of employees' satisfaction and the Group's benefits.

Prospects

Energy, being the important strategic resources for national economy and national security, acts an indispensable role in the course of modernisation. The use of clean energy and development of natural gas industry is an essential trend under the continuous development and energy structural adjustment in China economy. Natural gas is deployed by the PRC government as a major tool for energy structure enhancement and environmental protection. In 2004, the PRC government established a new energy strategy, which required a raise of natural gas ratio in energy structure. Whilst the demand of energy grows with time in association with the continuous rapid economic development in PRC, there will be stringent energy supply in all kinds continuously. The consumption structure of natural gas has been undergoing changes since 2005, with the percentage of natural gas used in chemical industry and urban areas against total natural gas usage above 60%. This consumption structure will be further improved under the rapid demand growth of natural gas in PRC. In future, natural gas will become the major fuel in the urban gas market in PRC. The urbanisation ratio will be raised from the existing level of 43%, to 55% – 60% by 2020. Natural gas industry in PRC has already come into its rapid development phase.

With the rapid development of the Group in the past few years, the Group has established its pioneering role and market position in the PRC gas industry. In view of facilitating the Group's development in the long run, the Group has conducted a scientific and rational adjustment on its development strategy timely in prudent manner. Instead of focusing on obtaining a large number of new gas projects, we shift our emphasis to boosting gas penetration rates in our existing projects, and exploring channels to provide bottled liquefied petroleum gas ("LPG") and other clean energy alternatives to the sub-urban areas around the existing project areas, transforming the Company from a high-growth company into a public utilities company gradually. The average gas penetration rate of the Group is 18.9%, and there is still a considerable room for growth before reaching the peak gas penetration rate of 70% to 80%. With the Group's coverage of 39,073,000 urban population as well as prosperous C/I customers base, it is expected that the Group is able to maintain high growing momentum even when the Group decreases the number of new project acquisitions immensely. In this regards, the Group's strategic adjustment is supported by concrete fundamentals, which facilitate the Group's continuous business development in the long run.

In recent years, apart from promoting connection service, the Group has also been actively developing C/I customers and refuelling stations, which involve users with much higher usage volume than residential users. The revenue structure of the Group has been enhanced accordingly with the proportion of one-off connection fee to the Group's total revenue falling continuously, in particular, from 76.8% in 2001 to 39.9% in 2006. Gas sales revenue has also increased drastically from 21.0% in 2001 to 47.8% in 2006. In the long run, gas sales and gas profit contributions will take over connection fee and become the

major revenue and profit contributions to the Group. By the time, gas sales will also provide more stable revenue to the Group.

Stable and reliable natural gas source is essential to the Group's development strategy realisation. On top of full utilisation of long distance pipeline in PRC, the Group has also actively explored gas source by self production and has seek to merchandise international gas source. During the year, the Group has invested in the coal chemical project in Erdos, Inner Mongolia and utilises the rich coal resources there for dimethyl ether ("DME") production. Being a kind of gas fuels, DME is regarded as another clean energy apart from natural gas, which can be used as direct substitute for natural gas and LPG. The project of DME has received great support and encouragement from the PRC government. In the meantime, the early-stage construction work for this project is well in progress. It is expected that phase one of this project will come into operation in 2009 with an annual production capacity of 400,000 tons of DME. As a supplementary source for natural gas, DME can meet part of the Group's demand of gas source in future. At the same time, the liquefied natural gas ("LNG") processing factory located in Weizhou Island, Beihai, Guangxi invested by the Group has come into production in 2006. This factory is the fourth LNG processing factory in PRC. The factory has started to provide natural gas to the Group's projects in Guangdong province and Guangxi in light of providing additional natural gas source to these projects and lowering the purchasing cost.

Moreover, the Group has established Xinao Energy Sales Company Limited during the year and obtained the import and export right of natural gas, LPG, methanol, DME and various kinds of gas materials, making the Group the fourth

company having the import/export right of natural gas after the PRC's three oil and gas giants (PetroChina Company Limited, China Petroleum & Chemical Corporation, CNOOC Limited). It turns a new leaf for the Group's future international energy trading business and strengthens the gas source security for the Group's gas projects.

In 2007, the Group will enhance management and lower operational cost through the promotion and implementation of strategic development, total IT solutions and balanced score card. In addition, the Group will continue to stick to the customer-oriented principle, and to enhance customers' satisfaction. In association with the rapid development of the Group's business, Xinao Gas has already established its market position. The industry has entered the stage of mergers and acquisitions, which provides opportunities to the Group. Whilst encountering these market opportunities, the Group would evaluate every investment decision with the most prudent attitude. In light of minimising investment risk, every project will undergo the most prudent and stringent feasibility study before an investment decision is made. In future, the Group will actively implement the distribution strategy of clean energy and raise the operational results in all aspects. In addition to contributing to the environmental protection business in PRC, the Group shall endeavour to maximise the benefits of shareholders, customers, employees, society and the corporation.

Wang Yusuo
Chairman

19 April 2007