Management Discussion and Analysis

BUSINESS REVIEW

For the year ended 31 December 2006, Genesis Energy Holdings Limited (the "Company") and its subsidiaries (collectively known as the "Group") recorded an increase of turnover by 6% to RMB72.2 million (2005: RMB68.2 million) and loss attributable to shareholders was substantially narrowed down by 68% to RMB85.2 million (2005: loss of RMB262.9 million).

There has been a growth of 6% in respect of revenue as compared with that in 2005 while it is encouraging to see that the loss attributable to shareholders has been substantially decreased by 68% to RMB85.2 million. We must pay tribute to the hard work of the management, particular in the improved management and control of both operations, namely, crude oil transportation and natural gas network, have been strengthened. The Group has continued to consolidate its existing businesses in crude oil transportation and natural gas pipelined network in Xinjiang, the PRC, and has taken positive steps to explore oil and gas exploitation and extraction business overseas and within the PRC as well.

Oil Transportation Business

The oil pipeline in Xinjiang is operated by our subsidiary Xinjiang Xingmei Oil-pipeline Co. Ltd. ("Xingmei"), which the Group owns as to 80% of its equity interest and the remaining 20% of equity interest is held by China Petroleum and Chemical Corporation ("CPCC"). The oil pipeline stretches from Tahe Oil Field to Lun Tai railway station with total length of 70 km and a maximum annual transportation capacity of 3.5 million tones. As already disclosed in the 2005 Annual Report, the litigation between Xingmei and CPCC had been satisfactorily settled after entering into a new transportation agreement with CPCC in December 2005. This new transportation agreement has ensured a stable source of revenue and cash flow to the Group. With the support from CPCC, a new board of directors for Xingmei was introduced by end of 2005. The new board has imposed more stringent control over internal management, in particular detailed segregation of duties among different divisions and senior management team. In view of the stable source of cash flow and improved management and control over the operation, Xingmei's board is confident that the high gearing of Xingmei will be contained with a prudent funding and treasury policy.

Natural Gas Pipeline Network

The natural gas pipeline network has been operated by our subsidiary Lejion Gas Co. Ltd. ("Lejion"), which the Group owns as to 72% of its equity interest. The performance of the natural gas pipeline network has shown improvement for the year of 2006. Last year, Lejion entered into a short term contracting agreement with the local government that the business of sale of piped natural gas would be operated by the local government while Lejion could focus its resources to the business of refilling stations which supply natural gas and LPG for vehicle use. This reallocation of resources has brought improvement to the sales of natural gas at refilling stations. With the foreseeable mounting demand from the food and beverage industry for natural gas, a review of the above-mentioned contracting agreement is undergoing and Lejion is considering to cease the contracting agreement with the local government and picking up this operation in the near future.

Management Discussion and Analysis

FINANCIAL REVIEW

Turnover and Loss Attributable to Shareholders

Turnover for the Group for the year ended 31 December 2006 increased by 6% to RMB72.2 million (2005: RMB68.2 million). Turnover was mainly sourced from two different segments, oil transportation and natural gas pipeline network. Oil transportation operation recorded a turnover of RMB44.7 million for the year ended 31 December 2006 (2005: RMB44.9 million) while the natural gas pipeline network business in Korla registered a turnover of RMB27.5 million for the year ended 31 December 2006 (2005: RMB23.2 million). These two business segments represent approximately 62% and 38% of the Group's total turnover respectively.

The loss attributable to shareholders has been substantially narrowed down to RMB85.2 million in this year comparing with RMB262.9 million in 2005. Apart from the operating loss, the loss was composed of finance expenses, impairment of a long outstanding receivable and loss on exchange. Details please refer to note 8 to the financial statements.

Liquidity, Financial Resources and Capital Structure

As at 31 December 2006, the net assets of the Group have decreased to RMB104.1 million (31 December 2005: RMB141.3 million) while its total assets were RMB627.7 million (31 December 2005: RMB656.1 million). As at 31 December 2006, the Group's gross borrowings net of cash and bank balances amounted to RMB411.6 million as compared to RMB466.2 million as at 31 December 2005. Gearing ratio based on total assets was 65.5% (31 December 2005: 71.1%). Details of the Group's pledge of assets of maturity profile of the Group's borrowings are shown in note 25 to the financial statements. The existing projects are financed partly by internal resources and partly by bank financing, with interest calculated by reference to prevailing market rate of Renminbi loan in the PRC. With the full support from our joint venture partners, the Group has already initiated discussion with bankers on restructuring the facility.

Further during the year under review, the Group has raised approximately HK$59 million, net of related expenses, from issue of 404,250,000 new shares of the Company which is intended to be used for general working capital and possible investment in energy sector. Subsequently to year end, for the same purpose, an additional amount of approximately HK$120 million, net of related expenses, has been raised from issue of 374,000,000 new shares of the Company. The Board is also committed to review all other possible options to provide future cash flow to the Group and will consequently undertake a strategic review of our business. Further, the existing controlling shareholder will provide continuing financial support to the Group whenever it is necessary.

Foreign Exchange Fluctuation

The business transactions as well as the bank borrowings of the Group are mainly denominated in Renminbi while cash outflow mainly comprises administration expenses in Hong Kong. Renminbi appreciated by approximately 3% in 2006. The Directors consider that in short run, the exchange rate fluctuation of Renminbi and Hong Kong dollars do not pose a significant risk to the Group and the Group will review and monitor from time to time the risk in relation to foreign exchange.

Contingent Liabilities

The contingent liability of the Group as at 31 December 2006 amounted to approximately RMB264 million (2005: RMB248 million).

In accordance with the information available to the Group, this RMB264 million represents two alleged bank loans and interest from two PRC banks borrowed by a former director of the Group, in the name of a subsidiary of the Company, Xinjiang Xingmei Oil-Pipeline Co., Ltd., through alleged fraudulent actions.

The Group's PRC legal adviser is of the opinion that, with reference to the relevant PRC laws, the subsidiary, its immediate holding company and any existing member within the Group will not have any legal and financial obligations relating to these alleged bank loans and alleged interest thereon. The Group's legal adviser to Hong Kong law concurs to this view.

As mentioned in last year annual report, the executive board of directors also performed a high level review on this PRC subsidiary and all active companies in the Group. Upon completion of this review, no material irregularity was noted. The executive board of directors submitted a report to the board of independent non-executive directors with the above finding, together with the legal opinion as to both the PRC and Hong Kong law.

After taking into account the above factors, the independent board of directors has appointed an independent professional firm to perform an overall review of the Group's internal financial control and compliance to improve the level of corporate governance and safeguard the Group's assets and shareholders' interest are well. Test and assessment on the internal control systems of principal subsidiaries have been performed so as to determine whether these internal control systems meet the expected objectives, and made advice on improving the weakness of the control system and proactively provided corresponding assistance. With the adoption and execution of the internal control policy, the Board considers that these improved systems of internal controls are effective and sufficient to guarantee the Group in achieving its operation and governance objectives. Since then, the Group will constantly improve and strengthen its corporate control with reference to changes in the operating environment in order to enhance its corporate governance and safeguard the interests of the shareholders.

EMPLOYEES AND REMUNERATION POLICIES

As at 31 December 2006, the Group employed approximately 229 employees. The remuneration policies of the Group are based on the prevailing remuneration level in the market and the performance of respective companies and individual employees.