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Industry Outlook

As the Chinese economy continues to experience substantial growth in the 21st century, so does the demand in energy, which has been growing year after year. Hence, energy supply has become a bottleneck to the economic development in China. The extensive mode of economic growth in China has caused excessive energy demand and poor energy utilization efficiency in the country, as well as serious environmental pollution problem. While energy import from overseas has been expanding in a higher pace, it still falls short of satisfying the needs from domestic economic development. Cases of oil shortage, electricity shortage and coal shortage are reported frequently. Facing the problem of energy bottleneck that could slow China's economic growth, The National Development and Reform Commission issued earlier this year The Eleventh Five-Year Plan in Energy Development, which outlines the national energy strategy of giving priority to energy conservation, relying on domestic resources, developing diverse energy resources, and driving for environmental protection, as well as putting in place a system that supplies stable, economical and clean energy, so that the sustainable development of the economy and society will be supported by the sustainable development of energy.

According to the Plan, by 2010, annual growth rate of primary energy consumption in China is expected to be 4%, among which coal, oil and natural gas will respectively account for 66.1%, 20.5% and 5.3% of the total primary energy consumption. Compared to 2005, the proportions of coal and petroleum in such consumption will decrease by 3.0 percentage points and 0.5 percentage point respectively, while natural gas will increase by 2.5 percentage points. According to the Plan, demand in natural gas in China is expected to reach approximately 110 billion m^3 per annum by 2010, and the annual consumption growth rate of natural gas will exceed 17%. Among the various types of natural gas consumptions, city gas is the fastest growing as households are shifting to use natural gas instead of coal gas.

In order to step up the development of domestic natural gas industry and to even out the imbalance between supply and demand, the PRC government has devoted greater effort in the upstream operation of natural gas exploration and exploitation as well as to speed up the construction of long distance pipelines. On the other hand, it has begun to rationalize the pricing mechanism of natural gas market, and to implement taxation and pricing policies that are favourable to production and utilization of clean energy.

Recently, Sulige Gas Field in Inner Mongolia and Puguang Gas Field in Sichuan have been discovered with total reserves of more than 500 billion m^3. These discoveries have driven the country's natural gas reserves and production volume to a new level. Moreover, the State Council has formally approved the "Sichuan-to-East Pipeline" project on the Puguang Gas Field, the total investment of which amounts to RMB 63.2 billion and commercial production is expected to commence in 2009. The gas field will provide 15 billion m^3 per year of natural gas to Hubei, Anhui, Jiangsu and Shanghai etc. In addition to its focus on domestic market, the PRC government also actively explores opportunities in the international natural gas supply market. While seeking to import LNG from overseas, the inland natural gas importation projects between China, Russia and Turkmenistan are progressing well. In the future, we can see tremendous opportunities in the city gas sector in China as natural gas supply is expected to increase significantly and because of its advantages of price and environmental protection.

Business Review
Development of New Projects

The Group is principally engaged in the investment in, and the operation and management of, gas pipeline and the sale and distribution of piped natural gas and compressed natural gas in China.

For the year ended March 31, 2007, turnover of the Group amounted to HK$1,236,469,000 (year ended March 31, 2006: HK$630,522,000), increased by 96.1% over the same period of last year. Profit for the year amounted to HK$225,563,000 (year ended March 31, 2006: HK$180,068,000), increased by 25.3%. Earnings per share was HK6.35cents (year ended March 31, 2006: HK6.15 cents).

New Project Expansion

Since the last financial year, the Group's project expansion has gradually shifted to large to medium-sized cities. As at June 30, 2007, the Group had secured 57 city piped gas projects (with exclusive concession rights) in 15 provinces, autonomous regions and directly-administered cities, owned one natural gas company with natural gas exploration right, five long distance natural gas pipeline projects and two LNG liquefaction companies.

The new projects include nine city piped gas projects in regions of Wuwei County in Anhui Province, Dezhou City and Qingdao City in Shandong Province, Jinzhou City Economic Hi-Tech Development Zone in Liaoning Province, Qishan County in Shaanxi Province, Hohhot City, Baotou City and Wushen Banner in Inner Mongolia Autonomous Region and Yubei district in Chongqing Municipality, two long distance gas pipeline projects in Inner Mongolia Region and one in Tianjin Municipality , two LNG liquefaction companies located in Kaixian, Chongqing Municipality and Xuanhan County, Sichuan Province and one natural gas company with natural gas exploration right in Dianjiang County, Chongqing Municipality.

Set out below is the nine new city piped gas projects secured by the Group by June 2007:

Province / Autonomous Region / Directly-Administered Cities	City / Districts
Anhui Province	Wuwei County
Inner Mongolia Autonomous Region	Hohhot City, Baotou City, Wushen Banner
Shandong Province	Dezhou City, Qingdao City
Chongqing Municipality	Yubei District
Liaoning Province	Jinzhou City Economic Hi-Tech Development Zone
Shaanxi Province	Qishan County

Left: Gas pipeline network in Baoji

Right: Dalian, Liaoning Province, city gas concession signing ceremony

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The above new projects cover a connectable city population of approximately 8,771,000 (approximately 2,741,000 households). The connectable city population covered by the Group's gas projects has increased to approximately 32,008,000 (approximately 10,009,000 households) as of June 2007, representing an increase by 39.0% compared to 2006.

In addition to the newly invested city piped gas projects, the Group also owns three long distance natural gas pipeline projects in Wushen Banner and Otog Banner, Ordos City, Inner Mongolia Autonomous Region and in Tianjin Municipality. Accordingly, the number of long distance gas pipeline projects owned by the Group has increased from last year's two (Dangyang and Xiaogan) to this year's five.

Last year, the Group actively sought for opportunities to invest in small scale natural gas liquefaction facilities close to natural gas source in the central and western region of China. In the last financial year, the Group decided to invest in two natural gas liquefaction factories in order to build up an independent gas supply system for the Group and to meet the demand of the downstream markets, thus further enhancing our competitiveness in tendering for new projects.

Looking into the next financial year, in the area of city gas distribution, the Group will continue to actively look for investment opportunities in large and medium-sized city gas projects with reasonable investment returns, expand its customer base and further integrate the existing city gas projects and increase the Group's overall project qualities and level of investment return. In the upstream exploration and transportation area, the Group will make preparation for participating in overseas natural gas exploration and transportation by collaborating with its strategic shareholders. At the end of 2006, the Ministry of Commerce of the PRC granted the Group a licence allowing the Group to operate gas fuel business such as the import, export and wholesale of natural gas, liquefied natural gas, liquefied petroleum gas, methanol and dimethyl ether, etc. This licence will provide further support to the future gas supply system of the Group.

Construction of Piped Gas Networks

Construction of city gas pipeline networks is one of the Group's principal businesses. The Group builds city main pipeline network and branch pipeline network to make gas connection to residential, industrial and commercial users, and charges them for such connection and gas usage.

During the financial year, the Group had completed 18 processing stations, two medium and high pressure regulating stations, high-pressure gas pipelines of 159 km, city medium and low-pressure gas pipeline of approximately 1,438 km and branch and customer pipeline network of 1,320 km.

As at March 31, 2007, the Group accomplished piped gas supply in 37 cities, and had built 43 processing stations, 22 medium to high pressure regulating stations, high-pressure gas pipelines of approximately 571 km, medium to low-pressure gas pipelines of approximately 4,466 km and branch and customer pipeline network of 4,798 km. Designed gas supply capacity of the processing stations reached 6,563,753 m^3 per day.

Left: Construction site of mid-range pressure natural gas network in Wuhu

Right: Liquidfied Natural Gas (LNG) tanks

Business Review
Residential Customers

During the financial year, the Group acquired a number of large city gas projects with urban population over a million each. These cities are economically prosperous and their citizens have high demand for real properties. This has enhanced the development of residential customer base of the Group. During the period, the Group completed natural gas connections for 164,544 domestic households, increased by approximately 16.3% over the same period of last year. The average connection fee of residential users was RMB2,092.

During the financial year, the Group acquired a total of 379,135 residential users who were primarily from Fushun and Hohhot projects. As at March 31, 2007, the Group had a total of 1,349,782 residential users, increased by 67.4% over the same period of last year, representing 16.7% of the total connectable domestic households.

Upper left: Customer service centre

Upper right: Natural gas transportation truck

Lower left: Electronic gas distribution monitoring system

Lower right: Gas pipelines for residential users

Business Review
Industrial and Commercial Customers

As versus residential users, industrial and commercial users, the focus of the Group's business direction, have much bigger demand for gas. During the financial year, the Group completed natural gas connections for 33 industrial customers and 369 commercial customers and acquired 5 industrial customers and 8,688 commercial customers. Industrial users are primarily in the building material productions, metallurgy and glass making industry.

As at March 31, 2007, the Group had a total of 111 industrial customers and 10,451 commercial customers, increased by 54.2% and 649.2% respectively compared with the last period. During the financial year, the connection fee for industrial fee for industrial users was calculated on the basis of the contracted daily gas volume at the average rate of RMB42.9 per m^3 and the average connection fee paid by commercial customers was RMB147,039 per customer.

Connection fee represented approximately 31.3% to the Group's total revenue for the financial year under review.

Sale of Piped Gas

Connection fee is a one-off income, whereas the Group's ultimate profit comes from the sales income of piped gas.

The Group sold a total of 357,726,000 m^3 of natural gas, a substantial increase of 107.6% as compared to the same period of last year, of which 62,028,000 m^3 was sold to residential users, 233,416,000 m^3 to industrial users and 33,240,000 m^3 to commercial users, 22,726,000 m^3 to CNG vehicle drivers and 6,317,000 m^3 to other users.

During the financial year, gas sold to industrial users represented 65.2% of the total natural gas volume sold, commercial users 9.3%, residential users 17.3% and CNG vehicles 6.4%. With a large proportion of industrial users in its customers mix, the Group enjoys a very big potential in its future gas sales. In addition, as local governments are generally more relaxed in controlling the tariffs for industrial users, it becomes much easier for the Group to transfer the risk of upstream natural gas price fluctuation to them.

During the financial year, the Group recorded natural gas sales income of HK$661,800,000, representing approximately 53.5% of the Group's total revenue for the year, an increase of approximately 142.4% over the same period of last year.

As at March 31, 2007, the daily natural gas supply capacity of the Group reached 1,618,160 m^3, increased by approximately 114.0% over the same period of last year, of which the actual domestic usage was approximately 342,460m^3/day, actual industrial usage approximately 758,566m^3/day, actual commercial usage approximately

Left: Natural gas-operated ceramics kilns in Dangyang

Right: Copper production factory in Wuhu

194,929 m^3/day, and actual CNG vehicles usage approximately 192,108 m^3/day. As of June 30, 2007, the total natural gas supply of the Group had exceeded 2,300,000 m^3 per day.

In the past financial year, average selling price (pre tax) was RMB1.75 per m^3 for residential users, RMB1.66 per m^3 for industrial users, RMB2.31 per m^3 for commercial users, and RMB2.23 per m^3 for CNG vehicles.

The core business of the Group is natural gas supply. Because of historical reasons, some of the projects are still selling piped coal gas and liquefied petroleum gas (LPG). Piped coal gas and LPG sales income from Fushun Zhongran, Liuzhou Zhongran and Yangzhou Zhongran was recorded. A total of 74,469,000 m^3 piped coal gas and LPG was sold during the financial year, of which 56,650,000 m^3 was sold to residential customers, 7,388,000 m^3 to industrial customers and 10,426,000 m^3 to commercial customers.

Natural Gas Joint Venture Companies

For the year ended March 31, 2007, revenue contribution of the Group's major subsidiaries and jointly-controlled companies to the Group's total revenue is as follows:

Joint venture company	Revenue (HK$'000)	As a percentage to the Group's total revenue (%)
Baoji Zhongran	188,043	15.21
Dangyang Zhongran	180,761	14.62
Wuhu Zhongran	167,963	13.58
Liuzhou Zhongran	108,776	8.80
Yichang Zhongran	73,149	5.92
Nanjing Zhongran	72,167	5.84
Yangzhou Zhongran	70,317	5.69
Beijing Zhongran Xiangke	53,603	4.34
Huainan Zhongran	49,166	3.97
Suzhou Zhongran	39,362	3.18
Fushun Zhongran	36,751	2.97
Xiaogan Zhongran	34,683	2.80
Yangzhong Zhongran	23,151	1.87
Total	**1,097,892**	**88.79**

CNG Refilling Stations for Vehicles

Compared to gasoline, compressed natural gas (CNG) can help reduce emissions of pollutant gases such as carbon monoxide, carbon dioxide and sulphur dioxide, and particular pollutants from motor vehicles on the roads. It is thus a more environmental-friendly fuel. Moreover, CNG only costs 60% as much as gasoline to produce the same amount of heat content. CNG is internationally recognized as a preferred alternative energy for motor vehicles.

During the period of the Eleventh Five-Year Plan, the PRC government has clearly defined its energy strategy as giving priority to conservation and environmental protection. As environmental protection ranks higher in the government's agenda, and with the increased exploitation of natural gas resource and its widened application, the promotion and use of CNG-fueled vehicles will give a strong assurance to reducing environmental pollution, alleviating pressure from oil shortage and realizing sustainable social and economic development. It is believed that CNG-fueled vehicles will enjoy strong support from and promotion by the government due to its outstanding economic and social cost-efficiency.

In this financial year, the Group entered into a cooperation agreement with 長沙市液化石油氣發展有限公司(Changsha City LPG Development Limited) for the establishment of Changsha Zhongran Natural Gas Company Ltd to operate natural gas refilling station for vehicles business in Changsha City, the provincial capital of Hunan Province. The joint venture company has already obtained its business registration licence which was issued by the People's Government of Changsha City. The Group also acquired 80% equity interest in 內蒙古包頭市申銀天然氣加氣有限公司(Inner Mongolia Baotou City Shenyin Natural Gas Station Limited) recently, which has already completed one natural gas refilling main station and three sub-stations for vehicles in Baotou City.

The Group currently owns 24 CNG refilling stations for vehicles, with a daily capacity in excess of 240,000 m^3. Sales income from CNG took up 6.4% of the Group's total sales income of natural gas in the period under review. In future, the Group will invest further in CNG refilling stations for vehicles with an aim to increasing its share of the market.

Furthermore, in order to develop the CNG refilling business for vehicles, the Group signed a joint venture agreement with GAIL, one of its existing shareholders, in June 2007 for the formation of a 50:50 joint venture company which is to invest in CNG projects, city gas supply projects and CNG refilling stations business in China, India and other countries.

Other Projects Development

In March 2007, the Group signed a joint venture agreement with SK E&S and SK Gas, subsidiaries of SK Group, the third largest corporation in Korea, for the establishment of a joint venture company to participate in such energy projects as exploitation, liquefaction, transportation of natural gas, distribution of city gas, and import and export of Liquefied Petroleum Gas (LPG) in China and overseas. According to the joint venture agreement, the new joint venture company will be incorporated in Hong Kong, China with a registered capital of US$20 million to be contributed by the two sides, in which China Gas will contribute US$10 million and hold 50% shares in the joint venture, and SK E&S and SK Gas will jointly contribute US$10 million and hold the remaining 50% in the joint venture. After the joint venture is set up, the two sides shall draw on their individual strengths in capital, technology and other resources to assist the joint venture in capturing investment opportunities and developing its core business. The joint venture aspires to become a major gas and energy operator in the Asia Pacific region.

Gross Profit Margin and Net Profit Margin

During the financial year, the Group realized revenue of HK$1,236,469,000 (2006: HK$630,522,000), an increase of 96.1% over the same period of last year; gross profit of HK$420,296,000 (2006:HK$305,354,000), representing 34.0% of the Group's overall gross profit margin (2006: 48.4%); net profit of HK$225,563,000 (2006: HK$180,068,000), representing an overall net profit margin of 18.2%(2006: 28.6%).

Strategic Shareholders

In addition to Hai Xai Finance Holdings Limited, a major shareholder of the Company, Asian Development Bank has become a strategic shareholder of the Company since last year. Besides Asian Development Bank, the Company also has strategic cooperation with two of its strategic shareholders.

In May 2007, the Company and Oman Oil Company, S.A.O.C. entered into a joint venture agreement for the establishment of a 50:50 joint venture company in Bermuda. The Bermuda joint venture company will primarily be engaged in the business of importing into the PRC energy products including liquefied natural gas, liquefied petroleum gas, crude oil and fuel oil from the Middle East or other parts of the world, and developing, acquiring, owning and operating energy projects including oil and gas field exploration and production (including coal bed methane fields), transportation infrastructure (such as pipelines and gas liquefaction and re-gasification facilities) in the Middle East, PRC or other parts of the world. It is an objective of the Company and Oman Oil Company, S.A.O.C. that the joint venture will become a major energy importer and producer in Asia.

In June 2007, the Company and GAIL entered into a joint venture agreement for the establishment of a 50:50 joint venture company in Bermuda. This joint venture company will primarily be engaged in the business of purchase, sale, distribution and transportation of natural gas, LNG and CNG, construction, operation and maintenance of gas pipeline and other systems, especially in relation to the coal bed methane, CNG supply to motor vehicles and construction of CNG refilling stations and their ancillary facilities and conversion equipments.

Human Resources

A team of excellent employees is vital to the success of a corporation. The Group remains faithful to "people come first" management concept. It has put in place a system of recruitment and internal training. The system provides mechanism for upgrading the professionalism and competence of its staff at all levels on an ongoing basis and also creates a platform for knowledge exchange and experience sharing among its staff. The Group recruits and retains capable people through enhancing job satisfaction and attractive remuneration package.

As at March 31, 2007, the Group has approximately 7,343 employees, an increase of approximately 64.5% over last year. More than 99.9% of the Group's employees are located in the PRC. Remuneration is determined by reference to their qualifications and experiences of the staff concerned and according to the prevailing industry practice in the respective regions in which it operates. Besides the basic salaries and pension fund contribution, some employees may be given discretionary bonuses, merit payment and share options depending on the financial results of the Group and the performances of these individual employees. The Group also provides extensive training including orientation tours for new employees and different levels of technical and management courses for the Group's management members and employees.

Excellence in Corporate Management

The Group's management team is committed to upgrading its corporate governance and transparency. In recognition of the effort of the Group's management, Capital Magazine once again awarded the Group with the "Capital's Outstanding PRC Natural Gas Supplier" title in May 2007. Capital Magazine is one of the best-selling and authoritative Chinese financial magazines in Hong Kong and the award panel was comprised of members from the editorial committee of Capital and 10 leading figures in the business community. This award demonstrates that the management standard of the Group is recognized by most of the investors.

Moreover, in June 2007, the Group was awarded first prize in "The Best Mid-Cap Company" and ranked seventh in both "The Best Managed Company" and "The Best Investor Relations" categories in the Mainland China section in the 2007 Asia's top companies poll organized by FinanceAsia, one of the leading financial magazines in Asia Pacific. This demonstrates that China Gas's effort in corporate management and investor relations are recognized by the investing community. The results of the poll were generated from the votes of some 200 securities analysts, fund managers and other figures in the Asian financial market who had been invited by FinanceAsia to pick their choices regarding the best companies in corporate management, leadership, corporate governance and investor relations etc. by a survey through email. China Gas stood out of the competition and was recognized by investors as an excellent Chinese business enterprise.

The Group was further elected by a dedicated gas industry portal in China –"博燃網" (Gasshow.com) as one of the "Top Ten Most Impressive Enterprises" in its "2006 Gasshow Performance Ranking" for three consecutive years, evidencing both industry and consumer recognition of the Group. The list was arrived at based on recommendations of members of the website and online ballots, and the election criteria included yearly performance, integrity, contribution to industry development, and technological and managerial innovation of an enterprise.


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Financial Review

Liquidity

As at March 31, 2007, the total assets of the Group was HK$7,293,402,000, increased by approximately 43.2% as compared to March 31, 2006.

As at March 31, 2007, the Group's cash on hand was HK$1,512,347,000 (March 31, 2006: HK$1,727,130,000). The Group's total bank and other borrowings amounted to approximately HK$2,929,233,000 (March 31, 2006: HK$2,011,452,000) of which approximately 23.5%, 8.4%, 38.6% and 29.5% would be due within one year, from first to second year, from second to fifth year and after the fifth year, respectively.

The Group has a current ratio of approximately 1.65 (March 31, 2006: 3.38) and the net gearing ratio was 0.75 (March 31, 2006: 0.38). The calculation of net gearing ratio was based on the net borrowings of HK$2,001,754,000 (total borrowings of HK$3,514,101,000 less bank balances and cash of HK$1,512,347,000) and the net assets of HK$2,681,220,000 as at March 31, 2007.

Capital Structure

The Company entered into a subscription agreement with Asian Development Bank during the financial year for the subscription of 150,000,000 shares of the Company, and the net proceeds received by the Company was approximately HK$186,700,000. These proceeds were mainly used for the development of new projects of the Group.

The Company entered into a subscription agreement with Asian Development Bank during the financial year for the subscription of 150,000,000 shares of the Company, and the net proceeds received by the Company was approximately HK$186,700,000. These proceeds were mainly used for the new projects development of the Group.

The Company issued convertible bonds with 1% per annum coupon due June 29, 2010 with an aggregate principal amount of US$40,000,000 (the "Bonds") in June 2005. The initial conversion price of the Bonds was HK$1.731 but the conversion will be adjusted in accordance to the initial agreement if any shareholding dilution event happens. The Bonds have been listed on The Hong Kong Stock Exchange since June 1, 2006. As at July 20, 2007, a total of US$23,000,000 of the Bond had been converted into a total of 103,639,506 ordinary shares of the Company.

Financial Resources

In October 2006, the Group obtained a 9-years development-related loan facility of US$50 million granted by Asian Development Bank. Such loan facility was used by the Group to invest in the infrastructures projects for the new natural gas transportation and distribution projects in China. Furthermore, the Group also obtained a total of US$75 million 7-years development-related loan facility from The Royal Bank of Scotland and other commercial banks in June 2007 under the arrangement of Asian Development Bank. Interest rate for the first loan facility is at USD LIBOR plus 2% per annum, while the second loan facility was charged at USD LIBOR plus 1.35% per annum.

The Group does not anticipate any material foreign exchange exposure since its cash, borrowings, revenue and expenses are denominated in Hong Kong dollars, RMB and US dollars. Besides, the Group believes that RMB appreciation will continue in the foreseeable future. Since all the operating income of the Group is denominated in RMB, the Group is expected to be benefited from repaying foreign currency debts by RMB funding.

As the interest charged on the commercial loans and development capital loan granted to the Group was calculated on a floating basis, in order to minimize the interest rate risk, the Group has entered into interest rate swap contracts to mitigate interest rate risk and reduce finance costs. There were two interest rate swap contracts outstanding during the financial year. For the US$60 million syndicated loan arranged by Societe Generale as the lead arranger, the Group is to pay floating interest charged at LIBOR+150Bps, but under the relevant interest swap contract, the Group only needs to pay interest at the fixed rate of 5.07% per annum. As to the US$50 million development-related loan provided by FMO and Proparco, interest is charged at the floating rate of LIBOR+235Bps. At present, the Group only needs to pay interest at the fixed annual rate of 5.73% pursuant to the interest rate swap. The development capital loans of US$50 million and US$75 million under the Asian Development Bank facilities have also been put into similar interest rate swap arrangements in order to mitigate interest rate risk and reduce finance costs.

The Group's operating and capital expenditures are funded by operating cash income, subscription monies from strategic investors, bank loans, the Bonds and development capital loan facility. The Group has sufficient sources of funds to meet future capital expenditure and working capital requirements.

Charge on Assets

As at March 31, 2007, the Group pledged part of the fixed assets and investment properties having a net book value of approximately HK$395,872,000 (March 31, 2006: HK$371,867,000) and certain investments in subsidiaries to banks to secure loan facilities granted to the Group.

Capital Commitments

The Group has a capital commitments in respect of the acquisition of property, plant and equipment and construction materials contracted for but not provided in the financial statements as at March 31, 2007 was HK$392,357,000 (March 31, 2006: HK$453,224,000) and HK$56,006,000 (March 31, 2006: HK$175,573,000), and such commitments would require a substantial part of the Group's present cash and external borrowings. The Group has also committed to acquire part of the PRC enterprise shares and to establish sino-foreign joint venture companies in the PRC.

Contingent Liabilities

As at March 31, 2007, the Group did not have any material contingent liabilities (as at March 31, 2006: Nil).

Liu Ming Hui
Managing Director

July 20, 2007