新奥燃气控股有限公司

XinAo Gas Holdings Limited

(incorporated in the Cayman Islands with limited liability)

(Stock Code: 2688)

(website: www.xinaogas.com)

RESULTS ANNOUNCEMENT FOR THE YEAR ENDED 31 DECEMBER 2004

The Board of Directors (the "Directors") of Xinao Gas Holdings Limited ("Xinao Gas" or the "Company" and together with its subsidiaries, the "Group") are pleased to announce the audited consolidated results of the Group for the year ended 31 December 2004 together with the comparative audited figures for the corresponding period in 2003.

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER

	Notes	**2004** *RMB'000*	**2003** *RMB'000*
Turnover	2	1,439,945	878,055
Cost of sales		(850,370)	(502,693)
Gross profit		589,575	375,362
Other operating income		47,596	30,734
Selling expenses		(29,488)	(21,524)
Administrative expenses		(230,567)	(137,704)
Other operating expenses		(18,519)	(14,239)
Profit from operations	3	358,597	232,629
Finance costs		(41,552)	(30,995)
Share of results of associates		(1,226)	(94)
Share of results of jointly controlled entities		(1,101)	(2,298)
Profit before taxation		314,718	199,242
Income tax expenses	4	(9,196)	(2,957)
Profit before minority interests		305,522	196,285
Minority interests		(53,265)	(13,195)
Profit for the year		252,257	183,090
Dividends	5	25,254	–
Earnings per share	6		
Basic		29.7 cents	24.8 cents
Diluted		29.1 cents	24.6 cents

Notes:

1. **Basis of preparation of financial statements**

   The Company is an exempt company incorporated in the Cayman Islands under the Companies Law and its shares are listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

   The financial statements have been prepared under the historical cost convention as modified for revaluation of properties.

   The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong.

2. **Segment information**

(a) ***Business segments***

For management purposes, the Group is currently divided into four divisions: gas connection, sales of piped gas, distributions of bottled liquefied petroleum gas and sales of gas appliances. These divisions are the basis on which the Group reports its primary segment information.

An analysis of the Group's turnover and contribution by business segment during the year is as follows:

	2004	**2003**
	RMB'000	*RMB'000*
Turnover		
Gas connection fees	822,697	516,468
Sales of piped gas	429,779	185,720
Distributions of bottled liquefied petroleum gas	149,185	161,402
Sales of gas appliances	38,284	14,465
	1,439,945	878,055
Profit from operations		
Gas connection fees	588,601	375,478
Sales of piped gas	74,939	28,085
Distributions of bottled liquefied petroleum gas	908	369
Sales of gas appliances	5,200	734
Unallocated other operating income	24,145	21,111
Unallocated expenses:		
– depreciation and amortisation *(Note)*	(56,622)	(20,962)
– corporate expenses	(278,574)	(172,186)
	358,597	232,629

Note: The amount represents principally depreciation and amortisation of property, plant and equipment relating to the gas connection, piped gas and bottled liquefied petroleum gas operation.

(b) ***Geographical segment***

More than 90% of the Group's assets are located in the PRC, including Hong Kong, as at the balance sheet date.

All of the Group's revenue are derived from activities in the PRC, including Hong Kong, in both years.

3. **Profit from operations**

	2004	**2003**
	RMB'000	*RMB'000*
Profit from operations has been arrived at after charging:		
Amortisation of intangible assets included in other operating expenses	4,903	3,706
Auditors' remuneration	2,879	2,317
Depreciation and amortisation of property, plant and equipment	77,434	52,371
Loss on disposal of property, plant and equipment	1,105	3,097
Minimum lease payments under operating leases in respect of land and buildings	6,442	3,769
Allowance for bad and doubtful debts	1,221	918
Allowance for inventories	6,740	1,260
Research and development expenses	4,163	2,889
Staff costs	155,896	87,506
Less: Amount capitalised under construction in progress	(21,066)	(5,427)
	134,830	82,079

4. **Income tax expenses**

	2004	**2003**
	RMB'000	*RMB'000*
Current tax	8,510	4,633
Under(over) provision in prior years	686	(1,676)
	9,196	2,957

The charge represents enterprise income tax in the PRC for the year.

Pursuant to the relevant laws and regulations in the PRC, all the Company's PRC subsidiaries are entitled to exemption from PRC enterprise income tax for the first two years commencing from their first profit-making year of operation and thereafter, these PRC subsidiaries will be entitled to a 50% relief from PRC enterprise income tax for the following three years. The reduced tax rate for the relief period is ranging from 7.5% to 16.5%. The charge of PRC enterprise income tax for the years has been provided for after taking these tax incentives into account.

No provision for Hong Kong Profits Tax has been made as the Group's income neither arises in, nor is derived from, Hong Kong.

The charge for the year can be reconciled to the profit per the income statement as follows:

	2004 *RMB'000*	2003 *RMB'000*
Profit before taxation	314,718	199,242
Tax at the domestic income tax rate of 33%	103,857	65,750
Tax effect of expenses not deductible for tax purpose	21,314	25,707
Tax effect of income not taxable for tax purpose	(6,122)	(6,312)
Tax effect of tax losses not recognised	16,125	10,477
Utilisation of tax losses previously not recognised	(640)	(209)
Under(over) provision in respect of prior year	686	(1,676)
Effect of tax concession granted to PRC subsidiaries	(111,543)	(82,018)
Effect of different tax rates of subsidiaries	(14,481)	(8,762)
Tax charge for the year	9,196	2,957

5. **Dividends**

	2004 *RMB'000*	2003 *RMB'000*
Final Dividend – Proposed HKD2.71 cents (equivalent to approximately RMB2.87 cents) per share (2003: Nil)	25,254	–

6. **Earnings per share**

The calculation of the basic and diluted earnings per share is based on the following data:

	2004 *RMB'000*	2003 *RMB'000*
Earnings for the purposes of basic earnings per share	252,257	183,090
Effect of dilutive potential shares:		
Interest on convertible bonds	1,307	–
Earnings for the purposes of diluted earnings per share	253,564	183,090

	2004 *Number of shares*	2003 *Number of shares*
Weighted average number of shares for the purpose of basic earnings per share	848,096,000	737,000,000
Effect of dilutive potential shares:		
Share options	10,961,000	8,075,000
Convertible bonds	12,989,000	–
Weighted average number of shares for the purpose of diluted earnings per share	872,046,000	745,075,000

Dividends and closing of register of members

The Directors now recommend a final dividend of HK2.71 cents (equivalent to approximately RMB2.87 cents) per share payable to shareholders of the Company whose names are on the register of members on 23 May 2005. **The register of members will be closed from Tuesday, 17 May 2005 to Monday, 23 May 2005, both days inclusive, during which period no share transfer will be effected. In order to qualify for the proposed final dividend, all transfers accompanied by the relevant share certificates must be lodged with the Company's Registrars, Computershare Hong Kong Investor Services Limited, at Room 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4.00 p.m. on Friday, 13 May 2005.**

MANAGEMENT DISCUSSION AND ANALYSIS

Industry Review

Energy Consumption Pattern in PRC

With the continuing strong economic growth in recent years, the demand from the People's Republic of China (the "PRC") for energy also increases tremendously. In 2004, the PRC imported a record of over 100 million tons of crude oil. The PRC is the second largest energy consumer in the world, and its major sources of energy are coal, crude oil and natural gas. The use of coal severely pollutes the environment, whereas 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 such as liquefied petroleum gas ("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 Research Institute, National Development and Reform Commission ("NDRC"), in 2004, the output of natural gas in the PRC increased by 18.5% to 40.8 billion cubic meters when compared to 2003.

As forecasted by the Energy Bureau, NDRC, the demand growth of natural gas will be well ahead of coal and oil in the PRC in the next 20 years. By 2010, natural gas consumption will make up 6% – 7% of the total energy consumption in the PRC and reach 93.8 billion cubic meters; by 2020, natural gas consumption will further increase to 10% of the total energy consumption and reach 203.7 billion cubic meters.

The highest growth in demand for natural gas comes from electricity generation and residential use, which also make up the largest proportion of natural gas demand. It is estimated that before 2020, the annual growth rates of natural gas demand for electricity generation, residential use, industrial use and chemical industry use will reach 17%, 14.7%, 8% and 6% respectively. With more rapid urbanization and higher standards for urban environmental protection in the PRC, the gas penetration rates in the PRC cities are also rising rapidly. At present, natural gas users only account for 10% of the total urban residential gas users in the PRC, and the ratio is expected to increase to 30% by 2010 and 40% by 2020. These statistics fully support the positive market prospects of natural gas industry in the PRC.

PRC Policies on City Piped Natural Gas Market

At the end of 2002, the Ministry of Construction of the PRC issued a memorandum on the "Opinion concerning the speeding up of the development of market economy in the public utilities sector" allowing local authorities to open up the market for the investment in construction and operation of public utilities, including city gas. Foreign investors are now allowed to participate in the market by various means, such as setting up wholly-owned enterprises, equity joint ventures or operation joint ventures. In February 2005, the State Council of the PRC also issued "Opinions on encouraging the development of non-state-owned economy", which also explicitly encourages private investors and foreign investors to enter urban public utilities sector.

The implementation of these PRC government policies will facilitate and accelerate the healthy development of city piped natural gas and further reduce the investment risks for gas operators. The market liberalization of city gas industry in the PRC has been speeded up with the support of relevant policies from the government. A number of city gas projects in the PRC have carried out corporate reform or invited outside investment.

The construction of various branch pipelines of the West-to-East Project, the linking up of Zhong-Wu Pipeline, the exploration of natural gas under seabed and imported liquefied natural gas ("LNG") projects in coastal areas have progressed smoothly. These developments, together with central and local governments' emphasis on using natural gas and higher popularity of natural gas among consumers, facilitate the rapid and continuous development of downstream natural gas business. As a result, the Group will have even greater business development prospects and higher ability to ensure reliable gas sources.

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, in order to have better marketing planning for and accelerate the development of connection business, the Group continued to carry out the marketing project launched last year to enhance the project companies' performance in connection business.

As the Group's piped gas users only accounted for 10% of the total connectable population, it is expected that connection fees will continue to form a significant portion of the total revenue of the Group. As more and more of the Group's projects are being connected to piped natural gas sources, such as the West-to-East Pipelines, we will rely more on piped gas sources rather than on truck-transmitted gas sources, and hence will be able to meet large-scale gas demand. As a result, not only the number of residential households and commercial/industrial ("C/I") users of our gas projects will increase rapidly, but also the Group's natural gas sales volume. It is expected that the proportion of connection fees to the Group's turnover will continue to increase steadily.

Residential Customers

Aiming at achieving a high natural gas penetration rate in every project city, the Group continued to devote lots of efforts to connecting more residential households during the year and consequently helped to protect the environment. The Group's piped gas business is a natural monopoly in nature. The main connection target of the Group will continue to be the residential households in new and existing buildings in the area covered by our pipeline network.

Throughout the PRC, local governments have tighter control in environmental protection, and existing coal-burning furnaces are being changed to gas-burning ones. These measures facilitate the development of the Group's business.

More and more residential households take the initiative to get connected to piped natural gas, and flats connected to piped natural gas have become popular and are preferred by new home buyers. These have boosted the connection business of the Group and lowered the Group's costs for developing new customers.

During the year, the government of PRC implemented macroeconomic measures, which affected the property industry, but its impact on the Group was trivial. As most of the Group's projects are medium-sized cities with real estates being economical residential housing, and the Group's operation strategy was to develop the whole city and made connections to not just new buildings, but also existing buildings and C/I customers, the macro-economic measures hardly affected the number of new connections made. With effective marketing strategies, the Group fulfilled its goal on the number of connections made. In addition, the completion of the West-to-East Pipelines Project creates favorable condition for the Group to develop new customers in massive scale. Therefore, the connection business growth for the year as a whole was still very good.

During the year, the Group made natural gas connections for 253,395 residential households, 66.5% more than last year. The average connection fee paid by households was RMB2,620, similar to that of last year.

As at the end of 2004, the Group provided natural gas connections to a total of 634,678 households, which accounted for 6.5% of the overall connectable population of the Group. Taken into account of the 116,961 acquired and converted natural gas users, the penetration rate would be 7.7%.

Commercial/Industrial Customers

During the year, the international oil price soared; the supply of electricity in the PRC was very tight, and 24 provinces in the PRC had restricted supply of electricity. On the contrary, piped natural gas is not just cheaper than other energy sources like electricity, coal gas and LPG, but also has stable selling price. Also, as the local governments in the PRC have put more efforts in controlling industrial pollution, many of them require coal to be replaced by clean energy sources, such as natural gas, and demand new commercial or industrial projects to use clean energy. In addition, gas sources commenced in projects along the West-to-East Pipelines in 2004, and the supply of natural gas is no longer restrained by the lack of gas sources. Therefore, many C/I enterprises that used to use electricity, oil, coal and other fuels switch to using natural gas. As always, the major C/I customers of the Group are factories, hotels, shopping malls, schools and hospitals, etc. Unlike LPG, natural gas is more difficult to transport and store, and as a result, customers can only access to natural gas through our pipeline network, which facilitates our connection business.

During the year, the Group provided natural gas connections for 733 C/I customers (connected to gas appliances of a total installed designed daily capacity of 525,321 cubic meters). The average connection fee was RMB302 per cubic meter, 40.9% lower than last year. The main reason for the decrease was that the Group offered discounts to large C/I customers to increase the future gas sales volume because they will consume huge volume of gas and become the major gas users, and the Group can also fully utilize the contracted gas volume from West-to-East Pipelines.

As at the end of 2004, the Group provided piped natural gas connections for a total of 1,515 C/I customers (connected to gas appliances of a total installed designed daily capacity of 1,058,114 cubic meters). If taken into account of the acquired and converted natural gas users, the Group would supply natural gas to a total of 2,023 C/I customers (connected to gas appliances of a total installed designed daily capacity of 1,214,314 cubic meters).

New Projects

In 2004, the Group continued to take an active role in the exploration of new projects. The Group's projects increased from 41 last year to 52 this year, and the connectable population grew tremendously by 55.7% to 29,128,000 (approximately 9,709,000 households) by the end of 2004 from 18,713,000 (approximately 6,238,000 households) last year. The growth in customer base was not only because of the acquisition of new projects, but also the growth in population size of our existing projects. This further stabilizes the Group's future income and makes the Group one of the professional city gas operators covering the largest population in the PRC.

New projects secured by the Group in 2004 are as follows:

Guangdong Province	Shantou, Zhanjiang
Guangxi Zhang Autonomous Region	Guigang, Guilin
Hebei Province	Luquan
Henan Province	Shangqiu
Inner Mongolia Autonomous Region	Tongliao
Shaanxi Province	Xianyang
Shandong Province	Yantai
Zhejiang Province	Huzhou, Longwan District in Wenzhou

After securing the provincial capital project Changsha last year, this year, the Group obtained Yantai, a million city with good C/I customer base. This has demonstrated once more the government's recognition of the Group's management ability, operation safety and financial strength, and it also enriches the Group's experience in managing large-scale city projects.

The Group continued to target at medium-to-large scale cities for its project development in 2004. The projects secured during the year were in general cities with strong economy, well-developed industries and large population, such as Guilin, Shantou, Yantai, Zhanjiang, etc, which enable the Group to make even more connections in the future. Also, the Group devoted more efforts in strategic development of project cities. Founded on the achievements in 2003, the Group keeps on enhancing its market position in Guangdong, Guangxi and Zhejiang and creating an environment for sharing resources and advantages. The outstanding performance, good safety track record, reliable gas supply and quality service of the project companies has increased Xinao Gas' brand recognition and influence in the regions.

Sale of Piped Gas

During the year, the Group sold 104,912,000 cubic meters and 142,798,000 cubic meters piped gas to residential households and C/I customers respectively, representing increases of 1.3 times and 99.4% respectively over last year. The volume of gas sales to C/I customers made up 57.6% of the total volume of gas sales, showing that the Group had large consumers as a solid foundation to support the Group's long-term revenue.

As the West-to-East Pipelines commenced gas supply in 2004, making gas sources more abundant, the Group expects the volume of gas sales to increase further in the future. The strong increase in natural gas sales during the year did not just come from quality new projects the Group had successfully obtained, but also from successful marketing in existing projects. The high growth in the sales volume of natural gas also reflects that the use of natural gas as a good energy source has been well-received by the public.

As the gas sales volume for C/I customers is much higher than residential households, the Group will continue to develop the markets of both residential households and C/I customers, so as to enhance the Group's revenue structure and provide stabilized cash flow.

Gas Source

During the year, the Group established formal strategic cooperation relations with China Huayou (Group) Corporation and CNOOC Nanhai Western Corporation for securing large projects. Developing good cooperation relations with upstream suppliers does not just ensure that the Group has support for gas supply, but also increases the Group's competitiveness in developing new projects.

The Group actively engaged in the construction of emergency system for ensuring gas sources and establishing our own gas source bases to guarantee gas supply of various means and types. During the year, the LNG Project in Weizhou Island, Beihai, Guangxi invested by the Group commenced construction and is expected to be finished by 2005. This project, once in operation, will mainly supply LNG to Zhanjiang Xinao Gas Company Limited, Guilin Xinao Gas Company Limited, Dongguan Xinao Gas Company Limited ("Dongguan Xinao") and other southern gas projects to be obtained by the Group. It can meet the gas demand of the projects and further reduce the purchase cost of gas.

After the long distance pipelines of the West-to-East Project commenced gas supply in 2003, more branch pipelines were built along the long distance pipelines in 2004. Currently, five project companies of the Group, namely, Xinxiang Xinao Gas Company Limited ("Xinxiang Xinao"), Chuzhou Xinao Gas Company Limited ("Chuzhou Xinao"), Changzhou Xinao Gas Company Limited ("Changzhou Xinao"), Bengbu Xinao Gas Company Limited ("Bengbu Xinao") and Huzhou Xinao Gas Company Limited ("Huzhou Xinao") have started to use the natural gas transmitted by the West-to-East Pipelines. With the completion of more branch pipelines of the West-to-East Pipelines and other pipeline constructions, more and more of the Group's projects will use natural gas transmitted by pipelines. It is expected that in 2005, projects in Hunan Province, namely, Changsha Xinao Gas Company Limited ("Changsha Xinao"), Xiangtan Xinao Gas Company Limited ("Xiangtan Xinao") and Zhuzhou Xinao Gas Company Limited ("Zhuzhou Xinao"), will use the natural gas transmitted by Zhong-Wu Pipeline. The Group expects that using natural gas transmitted by pipelines will minimize the purchase cost of gas, increase profit from piped gas sales and further enhance our ability for market development.

CNG Vehicle Gas Refuelling Station
The Group has started the operation of compressed natural gas ("CNG") vehicle refuelling stations ("CNG stations") in Shijiazhuang City and Langfang City, Hebei Province, and 1,736 taxis and 353 buses have been converted into CNG vehicles. As the price of natural gas is in average 30-50% lower than gasoline, it is highly welcome by public vehicle companies and vehicle owners.

As the Group anticipates that the prospects of CNG stations in the PRC will be very positive, the Group has set up a department for CNG stations and planned to launch this business in our existing project cities extensively in 2005. We intend to set up 50 – 100 CNG stations in Qingdao, Liaocheng, Bengbu, Xinxiang and Shijiazhuang to further increase the Group's profit source and long term revenue. The Group can fully utilize our existing resources, including gas stations, pipeline networks, gas sources, human resources, brand name, etc., when developing CNG stations in our operating locations, and hence can have good return of investment in a short period.

Since vehicle emission is now a major source of pollution in the large cities in the PRC, it is believed that the PRC government will promote policies of converting vehicles to using clean energy. This will further accelerate the development of CNG stations. The Group expects that CNG stations will become one of the major components in our gas sales business.

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 this year, some of the Group's project companies cooperated with banks to reach a win-win situation – our gas project companies use the widespread network resources of the banks for collecting gas usage charges, and the banks use the Group's customer resources for expanding their business. This cooperation makes it more convenient for our customers, reduces the Group's administrative costs and increases cost efficiency.

Sale of LPG
During the year, the Group sold 37,760 tons of LPG, decreased by 28.3% over last year. The Group has been principally engaged in the sale of piped natural gas, and LPG is only sold in certain project cities as a transitional gas source, as the gross profit margin and the net profit margin of LPG are relatively low. Bengbu Xinao, Huaian Xinao Gas Company Limited and Xinxiang Xinao are engaged in the wholesaling and/or retailing of LPG, and the sales volume of these three projects makes up 80% of the total volume of LPG sales.

Before being taken over by the Group, the principal business of these companies was the sale of LPG. They have all started to construct natural gas pipelines after the Group's acquisition, and LPG are only sold to customers not connected to piped natural gas or in peripheral towns. The Group expects that the sales of LPG of these projects will gradually be replaced by piped natural gas, and the average ratio of LPG sales volume to piped natural gas sales volume in these three projects changed from 80% to 20% last year to 65% to 35% this year, which shows that piped and bottled LPG are being replaced by piped natural gas.

The operating profit of LPG increase from RMB369,000 last year to RMB908,000 this year.

Sale of Gas Appliances
The Group sells cooking stoves, water boilers, heaters and stored-value card meters besides providing gas connections. During the year, the Group sold a total of 59,526 cooking stoves, 8,774 water boilers and 4,411 heaters. Most of the meters produced were used by the Group in its own connection business.

The production capacity of the stored-value card meter factory of the Group reached 600,000 in 2004. The factory mainly supplies the meters to be installed in residential households when the Group makes gas connections. Customers can have gas supply when they insert their prepaid stored-value cards into the meters. After the establishment of the production line, the average cost of stored-value card meters has dropped by 30%, and the connection costs of the Group has been substantially lowered.

Besides, among the stored-value card meters sold in 2004, 22,706 were sold to other gas distributors, meaning that the production of stored-value card meters not only reduces costs, but also generates additional income for the Group.

Gross Profit Margin and Net Profit Margin

The Group's overall gross profit margin was 40.9%, similar to that of last year, and net profit margin decreased from 20.9% last year to 17.5% this year. It was mainly because the projects the Group secured got larger, and the percentage of minority interests in net profit increased from 6.7% last year to 17.4% this year. The Group's operation efficiency remained at about the same level as last year if it was evaluated by profits before minority interests.

As LPG and coal gas will be replaced by natural gas gradually, and the gas supply of the branch pipelines of West-to-East Project and Zhong-Wu Pipeline will commence in the coming year, the Group expects that it will facilitate large sales volume of natural gas with lower cost and further increase the profits from piped gas sales.

To reduce the Group's operation costs and increase its profit, the Group cooperated with BearingPoint Management Consulting Limited during the year to conduct research on issues like cost control and budget management, and the Group introduced many advanced management ideas and management tools, such as reverse auction, point baseline scorecard, rolling budget, process cost and benchmark management. It paves the way for the Group for better cost control, budget management and financial management, and its effects are expected to become manifest in 2005.

Advanced Management System

The Group recognizes that safety is the essence of our business, and safe operation is of primary importance. The Group continued to maintain excellent safety track record last year, making a record of 12 years of continuous safe operation. The Group also puts many resources into safe operation technical team and equipment and uses advanced information technology system for daily operations and management. During the year, the Group made use of the advanced experience of the gas industry in the UK for reference and improved and perfected the Group's safety management handbook and emergency procedures, which further raise the safe operation standards.

In 2004, Liaocheng Xinao Gas Company Limited ("Liaocheng Xinao") and Beijing Xinao Jingchang Gas Company Limited finished the construction of information technology systems, and Liaocheng Xinao and Bengbu Xinao completed the construction of Geographic Information System. Apart from enhancing the operation and service efficiency and lowering the cost of operation of the Group, these systems also help the Group to ensure safe operation.

To increase the ability for safe operation, the Group brought in advanced gas safety training and recognition system from the UK, which will enhance the professional qualification and skills of the staff for providing better services to customers. The Group cooperated with Utilise Training & Development Solutions Limited to establish a gas professional training center, which was launched in March 2004. This cooperation project has been supported by the British Consulate, Ministry of Construction of the PRC and Energy Bureau, NDRC. During the year, the training center conducted 27 sessions of training courses, and 360 of our staff members passed the Operational Qualification and Recognition Examination (Level 1). This lays a solid foundation for the Group to operate more safely and professionally. In 2005, the Group will introduce Level 2 and Level 3 Examination for the staff and foster more qualified personnel to enhance further safety and operational efficiency.

During the year, we continued to use various means, such as setting up social service monitoring network and service complaint hotlines and organizing customer opinion campaign, to collect from the customers useful opinions on installation works and after-sales services. By enhancing the service quality of the Group, we can further boost our brand recognition and image and facilitate the development of connection service.

Outstanding Management

Because of the excellent management, the Company continued to receive many awards from various prominent international financial magazines during the year: "Overall Best Managed Company in China (Medium Cap)" by *AsiaMoney* for the first time, and five other individual awards, namely, "Clearest Corporate Strategy", "Best Financial Management", "Best Investor Relations", "Best Annual Reports" and "Most Improved Website"; "Chinese Business 500" for four consecutive years and "Top 20 Chinese Enterprises of Highest Total Asset Growth" for two consecutive years by *Yazhou Zhoukan*.

The above awards, voted by international institutional investors and analysts, prove that Xinao Gas is highly regarded by investors for its high management quality and transparency. It was not easy to obtain such achievements, but the Group's management will endeavour to maintain our outstanding performance and continue to achieve even better results and reputation.

Customer Service

Quality customer service is the key for maintaining good and long term relations between the Company and customers. 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 many of the project companies were awarded "Unit with High Consumer Satisfaction" by local consumer councils during the year.

In 2004, Dongguan Xinao, Kaifeng Xinao Gas Company Limited, Lianyungang Xinao Gas Company Limited and Beijing Xinao Gas Company Limited also launched the "95158" national 24-hour hotline, which means that 11 project companies have launched such service. Our customers can simply dial 95158 to access their local 24- hour customer service centre and communicate with us conveniently. In case of emergency, we uphold our promise to arrive at the site within 20 minutes to carry out repair work. Our emergency-repair vehicles are approved by the local governments to be equipped with sirens similar to those on police cars, and we are also hooked-up in the 110 network, so that we will be able to handle any emergency situations immediately and efficiently.

In addition, the project companies of the Group follow the Group's unified requirements 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. As prevention is always better than cure, 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 are rooted at our human resources. Therefore, we uphold the principle of "based on people" and put great emphasis on recruitment and internal training.

During the year, we recruited 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. Each new staff member was given internal training and deployed to different departments and subsidiaries to have a good understanding of the Group's culture and operations, so that they could provide quality customer services and the smooth operation of the Company could be ensured.

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, such as Tsinghua University, so as to enhance their competence, professional skills and quality.

The Group also arranges two days of training every month to all employees to broaden their horizons and increase their ability, and the lecturers are mainly university professors or local and overseas management experts. We set up mailbox to the general manager, staff forums, staff representative meetings and other platforms to give opportunities for staff to communicate with the management, so that the management can understand the frontline problems and make appropriate adjustments.

In addition, the Company regularly invites family members of the employees to attend various functions, such as seminars or dinner parties, etc., to strengthen communications and affections between staff and the Company, and to enhance the sense of belonging of staff towards the Group.

As at 31 December 2004, the Group had 7,820 employees, of which five based in Hong Kong and the others based in the PRC. They were remunerated at market level with benefits like bonus, retirement benefits, professional training, share option scheme, etc.

Financial Resources Review

Liquidity and Financial Resources

As at 31 December 2004, the Group's cash on hand was RMB911,537,000 (2003: 487,129,000), and its total bank and other borrowings amounted to RMB1,917,160,000 (2003: 1,111,926,000). Its net gearing ratio, i.e. the ratio of net debt to equity, was 52.6% (2003: 54.9%).

Share Placement

To meet the capital demand for development and obtaining new projects, the Company placed 122,000,000 shares to international asset management companies and professional investors at the price of HK$3.84 per share, and the net proceeds were HK$456,000,000 (equivalent to RMB483,360,000). As planned, the proceeds were used for new gas project companies, CNG vehicle refuelling station business and general working capital. The market response for the placement was very positive. Apart from providing the capital the Group required, this placement has also enlarged the Group's shareholder base and capital base and hence enhanced the Group's strength.

Loans from IFC, Who also Becomes Long Term Shareholder of the Company

In the first half of the year, the Group successfully brought in International Finance Corporation ("IFC"), the private sector arm of the World Bank Group, as our long term shareholder. IFC also agreed to provide five-year loans for a total of US$25,000,000 (equivalent to RMB206,700,000) to the project companies of the Group, and the loans were drawn in the second half of the year as part of their working capital. The fact of IFC becoming the Group's shareholder and lender does not just illustrate the Group's distinctive status, ability and positive prospects, but also shows IFC's recognition of the Group's importance and contribution in the environmental industry.

Under the above US$25,000,000 Loan Agreements, the Company, Mr. Wang Yusuo ("Mr. Wang") and the Borrowers (i.e. Bengbu Xinao, Shijiazhuang Xinao Gas Company Limited and Xiangtan Xinao, which are all 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 in the capital of Easywin Enterprises Limited ("Easywin"), indirectly through Easywin, at least 35% of the issued share capital of the Company. Mr. Wang and Ms. Zhao are the beneficial and legal owners of Easywin, which is owned as to 50% by Mr. Wang and 50% by Ms. Zhao. As at 31 December 2004, Easywin and Mr. Wang together held 44.67% interests of the Company.

Five-Year Zero Coupon Convertible Bonds

Planning to obtain more new projects for development, the Company seized the chance of the record-low interest rate in the USA in 40 years and issued five-year convertible bonds in an aggregate principal amount of HK$550,000,000 on 15 November 2004. The bonds 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 bonds 2.5 years after the issue date. If the bondholders do not exercise the option of redemption, then they have to hold the bonds 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 bonds 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 bonds was HK$5.4375, which is subject to adjustment for events, if any, which may have diluting effects after the issue. If all the bonds are converted into shares, 101,145,000 ordinary shares of the Company will be issued, equivalent to 11.66% of the total issued capital of the Company as at 31 December 2004. No one exercised conversion right as of 31 December 2004. The net proceeds of HK$534,205,000 from this bond issue are mainly used for repaying the syndication loan of the Company due in 2005 and for developing gas markets in the PRC. The bond issue has brought long term capital at low cost to the Group, met the Group's demand for development and fully utilized low-cost capital to increase shareholders' wealth.

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

Borrowings Structure

As at 31 December 2004, the Group's total bank and other borrowings amounted to RMB1,917,160,000 (2003: RMB1,111,926,000), including zero coupon convertible bonds of HK$535,438,000 (equivalent to RMB567,564,000), loans of US$90,000,000 (equivalent to RMB744,120,000) and a secured loan of HK$11,240,000 (equivalent to RMB11,914,000). Apart from the zero coupon convertible 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 RMB45,734,000 that has to be secured by assets with the net asset value of approximately RMB116,168,000, all of the other loans are unsecured. Short-term loans amounted to RMB643,441,000 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 currency and interest rate swap contracts for all US dollar loans in order to fix the exchange rates and reduce the interest rates.

Contingent Liabilities

As at 31 December 2004, the Group did not have any contingent liabilities (2003: Nil).

Capital Commitments

As at 31 December 2004, the Group's capital expenditure in respect of the acquisition of property, plant and equipment contracted but not provided for was RMB22,673,000 (2003: RMB25,561,000) and authorised but not contracted for was RMB14,200,000 (2003: RMB14,200,000).

Prospects

Under all the favorable conditions, we believe that the Group will have better development prospects, more chances for exploring new projects and higher ability to ensure reliable gas sources. It is expected that the Group will, as always, be able to secure new quality projects in large and medium cities in 2005. Despite the huge market opportunities, we will remain prudent and conduct cautious feasibility study on each project before making any investment decision, so as to minimize investment risks and maximize shareholders' wealth.

Purchases, Sale or Redemption of Listed Securities

During the year, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

Audit Committee

The Company established an Audit Committee on 28 March 2001. The Audit Committee has reviewed with management the accounting principles and practices adopted by the Group and discussed auditing, internal controls and financial reporting matters. Members of the Audit Committee are Mr. Wang Guangtian, Ms. Yien Yu Yu, Catherine and Mr. Kong Chung Kau, who are all independent non-executive Directors. Mr. Xu Liang was a member of the Audit Committee in 2004 and ceased to act as a member on 31 March 2005. The Audit Committee has reviewed the unaudited interim accounts and the audited annual accounts for 2004. Two Audit Committee meetings were held during the financial year.

Corporate Governance

The Group recognises the importance of corporate governance and shares the view that to maintain a highly transparent management system is critical to our shareholders, investors, customers, employees as well as the industry watchdog. The Group has the Executive Committee to review major investment projects of the Group, give decisive advice, draw up annual operation plans, financial budgets and large financing packages, review proposals on appointments and removals, etc. The Group also has the Strategic Committee to analyse and study the macro economy and industry policies, establish strategies and long term goals for the Group. Both Executive Committee and Strategic Committee are the decision making cores of the Group, they review the proposals raised by each other to ensure that the proposals are tactical and executable. The Group also has the Supervisory Committee, an internal supervisory division, responsible for risks management and stringent internal audit on decision and regulation systems, operations, management and performance of the Group to ensure that the Group operates on the right track.

It is part of our strategy to stay open and responsive to any queries that our shareholders and investors may have from time to time. Since listing, we have obtained numerous awards from the investment community regarding our financial and operation management practice. It is also our aim to continue to enhance our management quality.

The Company has complied with the Code of Best Practice as was then set out in Appendix 14 of the Rules Governing the Listing of Securities of the Stock Exchange of Hong Kong Limited throughout the year.

Publication of Detailed Annual Results on The Stock Exchange's Website

A detailed results announcement containing all the information required by paragraphs 45(1) to 45(3) of Appendix 16 to the Listing Rules of The Stock Exchange (in force prior to 31 March 2004 which remains applicable to results announcement in respect of accounting periods commencing before 1 July 2004 under transitional arrangement) will be published on the Stock Exchange's Website in due course.

By order of the Board
Xinao Gas Holdings Limited
WANG YUSUO
Chairman

Hong Kong, 20 April 2005

As at the date of this announcement, the Board comprises nine executive Directors, namely Mr. Wang Yusuo (Chairman), Mr. Yang Yu (Chief Executive Officer), Mr. Chen Jiacheng, Mr. Zhao Jinfeng, Mr. Qiao Limin, Mr. Jin Yongsheng, Mr. Yu Jianchao, Mr. Cheung Yip Sang and Mr. Cheng Chak Ngok; one non-executive Director, namely Ms. Zhao Baoju, and three independent non-executive Directors, namely Mr. Wang Guangtian, Ms. Yien Yu Yu, Catherine and Mr. Kong Chung Kau.