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)

ANNUAL RESULTS ANNOUNCEMENT FOR THE YEAR ENDED 31 DECEMBER 2005

The Board of Directors (the "Directors") of Xinao Gas Holdings Limited (the "Company") and together with its subsidiaries, the "Group") is pleased to announce the audited consolidated results of the Company and its subsidiaries (collectively the "Group") for the year ended 31 December 2005 together with the comparative audited and restated figures for the corresponding period in 2004. The audited consolidated financial statements have been reviewed by the Company's audit committee.

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	**2005** *RMB'000*	**2004** *RMB'000* (Restated)
Revenue	*4*	2,056,826	1,439,945
Cost of sales		(1,285,172)	(850,370)
Gross profit		771,654	589,575
Other income		120,271	47,596
Selling expenses		(37,392)	(29,488)
Administrative expenses		(294,737)	(230,983)
Other expenses		(25,592)	(18,519)
Share of results of associates		1,136	(1,226)
Share of results of jointly controlled entities		20,936	(1,101)
Finance costs		(127,289)	(42,746)
Profit before taxation	*5*	428,987	313,108
Taxation	*6*	(38,719)	(9,196)
Profit for the year		390,268	303,912
Attributable to:			
Equity holders of the Company		303,118	250,648
Minority interests		87,150	53,264
		390,268	303,912
Dividends	*7*		
– Paid		25,254	–
– Proposed		45,440	25,254
Earnings per share	*8*		
Basic		34.1 cents	29.6 cents
Diluted		32.4 cents	29.0 cents

CONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2005

	Notes	**2005** *RMB'000*	**2004** *RMB'000* (Restated)
Non-current assets			
Property, plant and equipment		3,534,973	2,649,933
Prepaid lease payments		269,882	221,717
Investment properties		71,602	–
Goodwill		147,996	79,552
Exclusive rights of operation		14,620	15,147
Negative goodwill		–	(4,351)
Interests in associates		128,661	61,025
Interests in jointly controlled entities		235,432	170,499
Available-for-sale investment		2,600	–
Investments in securities		–	1,439
Deposit paid for investments		264,602	49,640
		4,670,368	3,244,601
Current assets			
Inventories		115,713	106,899
Trade and other receivables	*9*	579,423	331,355
Prepaid lease payments		5,776	5,326
Derivative financial instruments		5,504	–
Amounts due from customers for contract work		216,286	162,035
Amounts due from associates		52,731	15,361
Amounts due from jointly controlled entities		40,119	25,092
Amounts due from related companies		52,118	51,224
Pledged bank deposits		162,963	–
Bank balances and cash		1,621,092	911,537
		2,851,725	1,608,829
Current liabilities			
Trade and other payables	*10*	729,904	482,909
Derivative financial instruments		49,662	–
Amounts due to customers for contract work		183,078	86,437
Amounts due to associates		90,826	13,474
Amounts due to jointly controlled entities		4,920	20,575
Amounts due to related companies		19,796	8,745
Taxation payable		37,439	6,249
Bank and other loans – due within one year		566,457	643,441
		1,682,082	1,261,830
Net current assets		1,169,643	346,999
		5,840,011	3,591,600
Capital and reserves			
Share capital		95,819	91,954
Reserves		2,236,270	1,830,610
Equity attributable to equity holders of the Company		2,332,089	1,922,564
Minority interests		518,779	438,288
		2,850,868	2,360,852
Non-current liabilities			
Bank and other loans – due after one year		961,083	706,155
Convertible bonds		448,933	514,862
Guaranteed notes		1,570,729	–
Deferred taxation		8,398	9,731
		2,989,143	1,230,748
		5,840,011	3,591,600

Notes

1. BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants. In addition, the financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited and by the Companies Ordinance.

The consolidated financial statements have been prepared on the historical cost basis, except for certain properties and financial instruments, which are measured at revalued amounts or fair values, as appropriate.

2. PRINCIPAL ACCOUNTING POLICIES

The accounting policies used in the financial statements are consistent with those followed in the preparation of the Group's annual financial statements for the year ended 31 December 2004 except as described below.

In the current year, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards (HKFRSs), Hong Kong Accounting Standards (HKASs) and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants that are effective for accounting periods beginning on or after 1 January 2005. The application of the new HKFRSs has resulted in a change in the presentation of the consolidated income statement, consolidated balance sheet and consolidated statement of changes in equity. In particular, the presentation of minority interests and share of tax of associates/jointly controlled entities have been changed. The changes in presentation have been applied retrospectively. The adoption of the new HKFRSs has resulted in changes to the Group's accounting policies in the following areas that have an effect on how the results for the current and/or prior accounting years are prepared and presented:

- Business combinations (HKFRS 3);
- Financial instruments (HKAS 32 and HKAS 39); and
- Leases (HKAS 17): and

The impact of these changes in accounting policies is discussed below. The impact on basic and diluted earnings per share is discussed in note 3.

HKFRS 3 Business Combinations

In the current period, the Group has applied HKFRS 3, "Business Combinations", which is for business combinations for which the agreement date is on or after 1 January 2005. The principal effects of the application of HKFRS 3 to the Group are summarised below:

Goodwill

In previous periods, goodwill arising on acquisitions prior to 1 January 2001 was held in reserves, and goodwill arising on acquisitions after 1 January 2001 was capitalised and amortised over its estimated useful life. The Group has applied the relevant transitional provisions in HKFRS 3. Goodwill previously recognised in reserves (included in goodwill reserve) of RMB1,650,000 has been transferred to the Group's accumulated profits on 1 January 2005. With respect to goodwill previously capitalised on the balance sheet, the Group has discontinued amortising such goodwill from 1 January 2005 onwards and goodwill will be tested for impairment at least annually and in the financial year in which the acquisition takes place. Goodwill arising on acquisitions after 1 January 2005 is measured at cost less accumulated impairment losses (if any) after initial recognition. As a result of this change in accounting policy, no amortisation of goodwill has been charged in the current year. Comparative figures for 2004 have not been restated.

Excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost (previously known as "negative goodwill")

In accordance with HKFRS 3, any excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over the cost of acquisition ("discount on acquisition") is recognised immediately in profit or loss in the period in which the acquisition takes place. In previous periods, negative goodwill arising on acquisitions prior to 1 January 2001 was held in reserves, and negative goodwill arising on acquisitions after 1 January 2001 was presented as a deduction from assets and released to income based on an analysis of the circumstances from which the balance resulted. In accordance with the relevant transitional provisions in HKFRS 3, the Group has derecognised all negative goodwill at 1 January 2005 (of which negative goodwill of RMB7,240,000 (included in goodwill reserve) was previously recorded in reserves and of RMB4,351,000 was previously presented as a deduction from assets), with a corresponding increase to accumulated profits.

HKAS 32 Financial Instruments: Disclosure and Presentation & HKAS 39 Financial Instruments: Recognition and Measurement.

In the current year, the Group has applied HKAS 32 "Financial Instruments: Disclosure and Presentation" and HKAS 39 "Financial Instruments: Recognition and Measurement". HKAS 32 requires retrospective application. HKAS 39, which is effective for annual periods beginning on or after 1 January 2005, generally does not permit to recognise, derecognise or measure financial assets and liabilities on a retrospective basis. The principal effects resulting from the implementation of HKAS 32 and HKAS 39 are summarised below:

Convertible bonds

HKAS 32 requires an issuer of a compound financial instrument (that contains both financial liability and equity components) to separate the compound financial instrument into its liability and equity components on its initial recognition and to account for these components separately. Direct issue costs are allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds. In subsequent periods, the liability component, including the allocated direct issue costs, is carried at amortised cost using the effective interest method. The principle impact of HKAS 32 on the Group is in relation to convertible bonds issued by the Company that contain both liability and equity components. Previously, convertible bonds were classified as liabilities and recorded at the proceeds received, net of direct issue costs on the balance sheet. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accrual basis and charged to the income statement using effective interest method over the period of the bond and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise. Because HKAS 32 requires retrospective application, comparative figures have been restated. Comparative profit for 2004 has been restated in order to reflect the increase in effective interest on the liability component for the convertible bonds issued in 2004 (see Note 3 for the financial impact).

Classification and measurement of financial assets and financial liabilities

The Group has applied the relevant transitional provisions in HKAS 39 with respect of classification and measurement of financial assets and financial liabilities that are within the scope of HKAS 39.

Until 31 December 2004, the Group classified and measured its investments in securities in accordance with the benchmark treatment of Statement of Standard Accounting Practice 24 ("SSAP 24"). In 2004, investment in securities comprise insurance fund and unlisted equity securities and were classified as investment securities under SSAP 24. Investment securities were measured at subsequent reporting dates at cost, as reduced by any impairment loss that is other than temporary. From 1 January 2005 onwards, the Group classifies and measures insurance fund in accordance with HKAS 39 as loans and receivables.

Derivatives

By 31 December 2004, the cross currency interest rate swap contracts had not been recognised on the balance sheet. The net interest expense or income arisen from the cross currency interest rate swap arrangements is included in net profit or loss for the period on an accrual basis and accounted for as finance costs.

From 1 January 2005 onwards, all derivatives that are within the scope of HKAS 39 are required to be carried at fair value at each balance sheet date regardless of whether they are deemed as held for trading or designated as effective hedging instruments. Under HKAS 39, derivatives (including embedded derivatives separately accounted for from the host contracts) are deemed as held-for-trading financial assets or financial liabilities, unless they qualify and are designated as effective hedging instruments. The corresponding adjustments on changes in fair values would depend on whether the derivatives are designated as effective hedging instruments, and if so, the nature of the item being hedged. For derivatives that are deemed as held for trading, changes in fair values of such derivatives are recognised in profit or loss for the period in which they arise.

The Group has applied the relevant transitional provisions in HKAS 39. For cross currency interest rate swap contracts that are not qualify for hedging accounting, on 1 January 2005, the Group recognised the cross currency interest rate swaps at fair value. The fair value on 1 January 2005 of RMB7,119,000, has been recognised in the Group's accumulated profits (see Note 3 for the financial impact).

HKAS 17 Leases

In previous periods, owner-occupied leasehold land and buildings were included in property, plant and equipment and measured using the revaluation model. In the current year, the Group has applied HKAS 17 "Leases". Under HKAS 17, the land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification, unless the lease payments cannot be allocated reliably between the land and buildings elements, in which case, the entire lease is generally treated as a finance lease. To the extent that the allocation of the lease payments between the land and buildings elements can be made reliably, the leasehold interests in land are reclassified to prepaid lease payments under operating leases, which are carried at cost and amortised over the lease term on a straight-line basis. This change in accounting policy has been applied retrospectively (see Note 3 for the financial impact). Alternatively, where the allocation between the land and buildings elements cannot be made reliably, the leasehold interests in land continue to be accounted for as property, plant and equipment.

3. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

The effects of the changes in the accounting policies described above on the results for the current and prior year are as follows:

	2005 *RMB'000*	**2004** *RMB'000*
Increase in revaluation deficit	(370)	(4,369)
Decrease in depreciation of property, plant and equipment	13,403	7,549
Amortisation of prepaid lease payments	(4,967)	(3,598)
Decrease in amortisation of goodwill	5,610	–
Decrease in amortisation of goodwill (included in share of results of associates)	362	–
Decrease in release of negative goodwill	(251)	–
Increase in effective interest on the liability component of convertible bonds	(6,861)	(1,194)
Losses arising from changes in fair value of derivative financial instruments	(44,158)	–
Decrease in profit for the year	(37,232)	(1,612)
Attributable to:		
Equity holders of the Company	(34,832)	(1,193)
Minority interests	(2,400)	(419)
	(37,232)	(1,612)
Decrease in basic earnings per share	3.9 cents	0.2 cents
Decrease in diluted earnings per share	3.6 cents	0.2 cents

Analysis of decrease in profit for the year by line items presented according to their function:

	2005 *RMB'000*	2004 *RMB'000*
Decrease in cost of sales	8,436	3,951
Decrease in other income	(251)	–
Decrease in other expenses	5,240	(4,369)
Increase in share of results of associates	362	–
Decrease in share of results of jointly controlled entities	(3)	–
Increase in finance costs	(51,019)	(1,194)
Decrease in taxation	3	–
	(37,232)	(1,612)

The cumulative effects of the application of the new HKFRSs as at 31 December 2004 and 1 January 2005 are summarised below:

	As at 31 December 2004 (originally stated) *RMB'000*	Effect of HKAS 1 and HKAS 27 *RMB'000*	Effect of HKAS 17 *RMB'000*	Effect of HKAS 32 *RMB'000*	As at 31 December 2004 (restated) *RMB'000*	Effect of HKFRS 3 *RMB'000*	Effect of HKAS 39 *RMB'000*	As at 1 January 2005 (restated) *RMB'000*
Balance sheet items								
Property, plant and equipment	2,941,594	–	(291,661)	–	2,649,933	–	–	2,649,933
Negative goodwill	(4,351)	–	–	–	(4,351)	4,351	–	–
Investments in securities	1,439	–	–	–	1,439	–	(1,439)	–
Trade and other receivables	380,995	–	–	(49,640)	331,355	–	1,439	332,794
Deposit paid for investments	–	–	–	49,640	49,640	–	–	49,640
Prepaid lease payments	–	–	227,043	–	227,043	–	–	227,043
Derivative financial instruments	–	–	–	–	–	–	(7,119)	(7,119)
Convertible bonds	(567,564)	–	–	52,702	(514,862)	–	–	(514,862)
Deferred taxation	(24,205)	–	14,474	–	(9,731)	–	–	(9,731)
Total effects on assets and liabilities	2,727,908	–	(50,144)	52,702	2,730,466	4,351	(7,119)	2,727,698
Capital reserve-equity component of convertible bonds	–	–	–	53,896	53,896	–	–	53,896
Goodwill reserve	5,590	–	–	–	5,590	(5,590)	–	–
Property revaluation reserve	57,879	–	(36,826)	–	21,053	–	–	21,053
Accumulated profits	641,089	–	(5,650)	(1,194)	634,245	9,941	(7,119)	637,067
Minority interests	–	445,956	(7,668)	–	438,288	–	–	438,288
Total effects on equity	704,558	445,956	(50,144)	52,702	1,153,072	4,351	(7,119)	1,150,304
Minority interests	445,956	(445,956)	–	–	–	–	–	–

The Group has not early applied the following new standards and interpretations that have been issued but are not yet effective:

HKAS 1 (Amendment)	Capital disclosures[1]
HKAS 19 (Amendment)	Actuarial gains and losses, group plans and disclosures[2]
HKAS 21 (Amendment)	Net investment in a foreign operation[2]
HKAS 39 (Amendment)	Cash flow hedge accounting of forecast intragroup transactions[2]
HKAS 39 (Amendment)	The fair value option[2]
HKAS 39 & HKFRS 4 (Amendments)	Financial guarantee contracts[2]
HKFRS 6	Exploration for and evaluation of mineral resources[2]
HKFRS 7	Financial instruments: Disclosures[1]
HK(IFRIC) – INT 4	Determining whether an arrangement contains a lease[2]
HK(IFRIC) – INT 5	Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds[2]
HK(IFRIC) – INT 6	Liabilities arising from participating in a specific market – waste electrical and electronic equipment[3]
HK(IFRIC) – INT 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies[4]

[1] Effective for annual periods beginning on or after 1 January 2007.
[2] Effective for annual periods beginning on or after 1 January 2006.
[3] Effective for annual periods beginning on or after 1 December 2005.
[4] Effective for annual periods beginning on or after 1 March 2006.

The directors of the Company anticipate that the application of these Standards or Interpretations will have no material impact on the financial statements of the Group.

4. 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 revenue and contribution by business segment during the year is as follows:

2005

	Gas connection fees *RMB'000*	Sales of piped gas *RMB'000*	Distributions of bottled liquefied petroleum gas *RMB'000*	Sales of gas appliances *RMB'000*	Unallocated segment *RMB'000*	Consolidation *RMB'000*
Revenue	1,033,260	767,552	191,463	64,551	–	2,056,826
Result	765,176	138,810	3,960	14,132	–	922,078
Unallocated other income						120,271
Unallocated corporate expenses						(508,145)
						534,204
Share of results of associates	896	240	–	–	–	1,136
Share of results of jointly controlled entities	20,648	288	–	–	–	20,936
Finance costs						(127,289)
Profit before taxation						428,987
Taxation						(38,719)
Profit for the year						390,268

2004

	Gas connection fees *RMB'000*	Sales of piped gas *RMB'000*	Distributions of bottled liquefied petroleum gas *RMB'000*	Sales of gas appliances *RMB'000*	Unallocated segment *RMB'000*	Consolidation *RMB'000*
Revenue	822,697	429,779	149,185	38,284	–	1,439,945
Result	588,601	74,939	908	5,200	–	669,648
Unallocated other income						47,596
Unallocated corporate expenses						(359,063)
						358,181
Share of results of associates	3	(866)	–	–	(363)	(1,226)
Share of results of jointly controlled entities	(1,103)	2	–	–	–	(1,101)
Finance costs						(42,746)
Profit before taxation						313,108
Taxation						(9,196)
Profit for the year						303,912

(b) Geographical segment

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

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

5. PROFIT BEFORE TAXATION

	2005 RMB'000	2004 RMB'000
Profit before taxation has been arrived at after (crediting) charging:		
Allowance for bad and doubtful debts	15,314	1,221
Allowance for inventories	–	6,740
Amortisation of exclusive rights of operation included in other expenses	527	464
Amortisation of goodwill included in other expenses	–	4,439
Amortisation of prepaid lease payments	4,967	3,598
Auditors' remuneration	3,080	2,879
Depreciation of property, plant and equipment	110,032	70,329
Deficit on revaluation of property, plant and equipment	370	4,369
Loss on disposal of property, plant and equipment	2,557	1,105
Minimum lease payments under operating leases in respect of land and buildings	8,550	6,442
Research and development expenses	485	4,163
Staff costs	193,964	155,896
Less: Amount capitalised under construction in progress	(13,747)	(21,066)
	180,217	134,830

6. TAXATION

	2005 RMB'000	2004 RMB'000
Current tax	43,125	8,510
(Over) underprovision in prior years	(4,406)	686
	38,719	9,196

The charge represents PRC enterprise income tax for the year.

Pursuant to the relevant laws and regulations in the PRC, certain PRC subsidiaries of the Group 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.

Tax charge for the year can be reconciled to the profit before taxation per the consolidated income statement as follows:

	2005 RMB'000	2004 RMB'000
Profit before taxation	428,987	313,108
Tax at the PRC enterprise income tax rate of 33%	141,566	103,326
Tax effect of share of results of associates	(375)	405
Tax effect of share of results of jointly controlled entities	(6,909)	363
Tax effect of expenses not deductible for tax purpose	58,067	21,077
Tax effect of income not taxable for tax purpose	(14,353)	(6,122)
Tax effect of tax losses not recognised	23,428	16,125
Utilisation of tax losses previously not recognised	(2,296)	(640)
(Over)under provision in respect of prior year	(4,406)	686
Effect of tax concession granted to PRC subsidiaries	(139,668)	(111,543)
Effect of different tax rates of subsidiaries	(16,335)	(14,481)
Tax charge for the year	38,719	9,196

In addition to the income tax expense charged to consolidated income statement, a deferred tax credit of RMB1,333,000 (2004: deferred tax charge of RMB3,323,000) has been recognised in equity in the year.

7. DIVIDEND

	2005 RMB'000	2004 RMB'000
Final dividend paid in respect of 2004 of HKD2.71 cents (in respect of 2003: Nil) per share (equivalent to approximately RMB2.87 cents per share)	25,254	–
Final dividend, proposed in respect of 2005 of HKD4.81 cents (2004: HKD2.71 cents) per share (equivalent to approximately RMB5.00 cents per share) (2004: RMB2.87 cents per share))	45,440	25,254

The final dividend in respect of 2005 of HKD4.81 cents (2004: HKD2.71 cents) (equivalent to approximately RMB5.00 cents (2004: RMB2.87 cents)) per share on 908,371,488 shares (2004: 879,125,000 shares) has been proposed by the directors and is subject to approval by the shareholders in the forthcoming annual general meeting.

8. **EARNINGS PER SHARE**

The calculation of the basic and diluted earnings per share attributable to the ordinary equity holders of the Company is based on the following data:

	2005 *RMB'000*	2004 *RMB'000*
Earnings		
Earnings for the purposes of basic earnings per share	303,118	250,648
Effect of dilutive potential ordinary shares:		
Interest on convertible bonds	16,867	2,501
Earnings for the purposes of diluted earnings per share	319,985	253,149

	2005 **Number of shares**	2004 **Number of shares**
Number of shares		
Weighted average number of ordinary shares for the purposes of basic earnings per share	888,491,000	848,096,000
Effect of dilutive potential ordinary shares:		
– share options	4,177,000	10,961,000
– convertible bonds	95,687,000	12,989,000
Weighted average number of ordinary shares for the purposes of diluted earnings per share	988,355,000	872,046,000

9. **TRADE AND OTHER RECEIVABLES**

The Group allows an average credit period ranges from 60 to 90 days to its trade customers.

	2005 *RMB'000*	2004 *RMB'000*
The following is an aged analysis of trade receivable:		
0 – 3 months	179,424	170,664
4 – 6 months	32,788	37,398
7 – 9 months	53,359	28,906
10 – 12 months	18,287	9,370
More than 1 year	3,618	–
Trade receivable	287,476	246,338
Prepayments, deposits and other receivables	291,947	85,017
	579,423	331,355

Included under trade receivables are retentions held by customers for contract work amounted to RMB2,090,973 (2004: Nil).

The directors consider that the carrying amount of trade and other receivables approximates their fair values.

10. **TRADE AND OTHER PAYABLES**

	2005 *RMB'000*	2004 *RMB'000*
The following is an aged analysis of trade payable:		
0 – 3 months	213,772	161,640
4 – 6 months	64,340	33,759
7 – 9 months	17,364	20,175
10 – 12 months	16,378	8,731
More than 1 year	35,838	28,155
Trade payable	347,692	252,460
Advances received from customers	216,381	108,925
Accrued charges and other payables	165,831	121,524
	729,904	482,909

The directors consider that the carrying amount of trade and other payables approximates their fair value.

MANAGEMENT DISCUSSION AND ANALYSIS

INDUSTRY REVIEW

PRC Policies on City Piped Natural Gas Market

Since the issue of "Opinion concerning the speeding up of the development of market economy in the public utilities sector" by the Ministry of Construction of the PRC at the end of 2002 and "Opinions on encouraging the development of non-state-owned economy" by the State Council of the PRC at the beginning of 2005, the market liberalisation of urban gas industry in the PRC has been accelerated. Private and foreign investors have actively participated in the investment in, and the construction and operation of, city gas business in the PRC.

According to "Circular on reforming natural gas wellhead price to establish a pricing mechanism and making appropriate increase in natural gas wellhead price in the recent period" issued by the National Development and Reform Commission on 23 December 2005, the price of natural gas will change from being stable in the past to being pegged with the prices of oil, coal and LPG. The natural gas industry will greatly benefit from this new policy. Firstly, in the PRC, natural gas is in average 30% - 50% cheaper than coal gas, electricity and LPG; when natural gas wellhead price is pegged with these energy sources, natural gas will always maintain its price competitiveness over those major substitute energy sources in the PRC, and so more users will switch to using natural gas. Secondly, the current natural gas price in the PRC is only about 40% of the international prices. As the prices of the pegged energy sources are expected to rise, the natural gas price will also be pushed up, which will facilitate large volume import of liquefied natural gas ("LNG"). The availability of natural gas sources is the key for the development of the whole natural gas industry. Sufficient gas sources can help enhance the sustainable development of the industry, and the market liberalisation of the city piped natural gas industry will become more comprehensive and mature.

According to the 11th Five-Year Plan, the PRC government will strengthen the development of basic industries and infrastructures, emphasise both oil and gas, reinforce the exploration and exploitation of oil and gas, extend the cooperation with other countries, increase strategic oil reserve capacity and develop oil substitutes steadily.

The construction of various branch pipelines of the West-East Pipeline, the commencement of gas supply of Zhongxian-Wuhan Pipeline, the exploration of offshore natural gas and the smooth progress of the LNG import projects in coastal areas, together with the central and local governments' emphasis on using natural gas, all facilitate the rapid and continuous development of downstream natural gas business. As a result, the Group will have even greater business development prospects.

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, the Group had strategic adjustments to slow down the acquisition of new projects and boost connections in existing projects. As the Group's piped gas users only accounted for 16.6% of the total connectable population, it is expected that the Group will continue to have huge revenue from connection, and connection will still be the major revenue source of the Group. With the rapid growth in the number of residential households and C/I customers in the piped gas projects, the Group's natural gas sales volume also increased remarkably. As the proportion of gas sales will increase year by year, in spite of the strong growth in connection fees, the Group expects that the proportion of connection fees to total turnover will decline gradually.

Residential Customers

During the year, the Group continued to devote lots of efforts to connecting more residential households in the project cities. Flats connected to piped natural gas are in general preferred by new home buyers. Also, the continuous upsurge of international oil prices drove up the price of LPG, the main substitute of natural gas, and enlarged the price difference between LPG and natural gas. These boosted the connection business of the Group and lowered the costs for developing new customers.

During the year, the Group made natural gas connections for 334,637 residential households, 32.1% more than last year. The average connection fee paid by households was RMB2,647. As at the end of 2005, the Group provided natural gas connections to a total of 969,315 households, which accounted for 9.0% of the overall connectable population of the Group. If the 302,495 acquired/converted natural gas users were added, the penetration rate would be 11.8%. And if the other piped gas users were also added, the total number of residential users was 1,793,216, and the penetration rate would be 16.6%. Such penetration rates also show that the Group still has a large pool of potential customers for new connections.

Commercial/Industrial Customers

As the local governments in the PRC have implemented more stringent measures for environmental protection and put more efforts in controlling industrial pollution, more and more cities restrict the use of coal and require new commercial or industrial projects to use clean energy. However, other clean energy sources, such as electricity and LPG, are much more expensive than natural gas. Hence, it facilitates the promotion of natural gas among C/I customers. In addition, more large projects of the Group have been or will be connected to piped natural gas sources, such as West-East Pipeline and Zhongxian-Wuhan Pipeline, as well as the Guangdong LNG terminal to be completed in 2006; it facilitates the Group to make massive connections to C/I customers in an organised manner.

C/I customers are the Group's major gas users, and over 60% of natural gas sales comes from them. To accelerate the market development of C/I customers, the Group has strengthened the technological support for sales and marketing. Besides, the Group has established 54 demonstration sites of connected C/I customers, which consist of 27 industries and spread out in 13 project locations. It can increase the potential customers' confidence in using natural and promote C/I business effectively.

During the year, the Group provided natural gas connections for 1,140 C/I customers (connected to gas appliances of a total installed designed daily capacity of 1,045,466 cubic meters), 98.8% more over last year, which clearly illustrates the Group's effective marketing strategy and the competitive advantages of natural gas over other fuel substitutes. The average connection fee was RMB268 per cubic meter, 11.3% lower than last year. As C/I customers are the major gas users and consume huge volume of gas, the Group offered discounts to large C/I customers in projects with piped natural gas sources in order to increase future gas sales volume.

As at the end of 2005, the Group provided piped natural gas connections for a total of 2,655 C/I customers (connected to gas appliances of a total installed designed daily capacity of 2,103,580 cubic meters). If the acquired and converted natural gas users were added, the Group would supply natural gas to a total of 3,439 C/I customers (connected to gas appliances of a total installed designed daily capacity of 2,286,861 cubic meters). If the other piped gas users were also added, the Group would supply natural gas to a total of 4,041 C/I customers (connected to gas appliances of a total installed designed daily capacity of 2,495,479 cubic meters).

New Projects

In 2005, the Group started its strategic adjustments. The Group has slowed down the acquisition of new projects and switched focus from obtaining many new piped gas projects to boosting penetration rates in existing projects and developing CNG vehicle refuelling stations ("CNG stations"), which will increase long term natural gas sales. The Group considers that most of the rich cities with piped natural gas sources have been taken up by the existing gas operators, and the Group will not invest in projects that do not meet our stringent required rates of return. However, as there will be more piped natural gas sources in the future, such as the LNG import terminals to be completed in the coming years, the Group will continue to obtain some quality projects. The strategic adjustments also enable the Group to concentrate resources and have more effective management of the 59 projects across 14 provinces, municipalities and autonomous regions.

Currently, the Group has an overall penetration rate of 16.6% only, and from the Group's past experience, the penetration rates can reach as high as 70% - 80%. Even if the Group slows down its acquisition and secures fewer new projects, the Group expects to maintain its high growth, as the gas penetration rates of residential households and the sales volume of C/I customers will grow rapidly in the coming three to four years impelled by the strong economic growth in the PRC. In addition, the Group has reached critical mass in terms of connectable population coverage, and the long term revenue is guaranteed with growing penetration rate and more CNG refuelling stations. Therefore, in the future, the Group will have higher flexibility to select projects with high quality, high return or strategic significance.

In 2005, the Group secured seven new piped gas projects, more than the Group's target of securing four to six new projects set at the beginning of the year, and the Group's number of projects increased from 52 last year to 59 this year, and the connectable population grew by 11.2 % to 32,387,000 (approximately 10,796,000 households) by the end of 2005 from 29,128,000 (approximately 9,709,000 households) last year. This makes the Group one of the largest professional city gas operators interms of population coverage in the PRC.

New projects secured by the Group during the year are as follows:

Province	**Project**	**Connectable population**
Anhui Province	Fengyang	110,000
Fujian Province	Quanzhou	991,000
Guangdong Province	Zhaoqing High New Development Zone	63,000
Henan Province	Luoyang	1,474,000
Zhanjiang Province	Hangzhou Xiaoshan	259,000
Zhanjiang Province	Taizhou Huangyan	285,000
Zhanjiang Province	Yongkang	229,000

As always, the Group emphasises strategic development of project cities. In general, the projects secured this year are cities with strong economy, well-developed industries, large population and good development potentials. For instance, Quanzhou has well-developed industrial and commercial sectors; Luoyang, with its prosperous industrial/commercial activities and high income per capital, is a pivotal city in Henan Province in terms of economy. In addition, the Group has project development in new regions: Quanzhou, the first piped gas project the Group secured in Fujian Province, signifies the Group's breakthrough in Fujian, a lucrative region. Furthermore, the Group has further expanded its strategic cooperation. The Group established strategic cooperation relations with Daqing Petroleum Administration Bureau during the year for jointly developing downstream business. Also, the Group secured Luoyang project together with China Huayou Group Company in 2005 and established Luoyang Xinao Huayou Gas Company Limited, which is our first successful joint acquisition after entering into the strategic cooperation agreement with China Huayou Group Company in 2004. Moreover, the Group has built up a successful development model from the experience of Fengyang project: the expansion from a core project to periphery cities and towns. As Fengyang is only 8 km away from the pipeline network of the Group's existing Bengbu project, which has direct access to natural gas from West-East Pipeline, the Group can make better use and increase the value of resources with relatively low cost, and hence maximise the value by fully utilising gas and other resources.

Sale of Piped Gas

During the year, the Group sold 198,488,000 cubic meters and 273,051,000 cubic meters piped gas to residential households and C/I customers respectively, representing increases of 89.2% and 91.2% respectively over last year. The sales volume of gas to C/I customers made up 57.9% of the total volume of gas sales, showing that the Group has large volume consumers, who lay a solid foundation to support the Group's long-term revenue.

With the Group's strategic adjustments to boost penetration rates in the coming years, and more piped natural gas sources available, which enables the Group to connect more large volume C/I customers, it is expected that the Group will continue to have considerable growth in gas sales in the coming years. It will further consolidate the Group's long term revenue and provide large and stable cash flow.

During the year, the Group and the joint venture partner in Shijiazhuang, the capital of Hebei Province, made further investment in the project, and acquired about 270,000 residential households using coal gas into Shijiazhuang Xinao Gas Company Limited, the Group's subsidiary. The Group will convert those coal gas users into piped natural gas users gradually. Apart from contributing to environmental protection, it can also increase the Group's gas sales revenue in the long run.

Gas Source

Natural gas source is the critical factor for the development of the Group as well as the whole natural gas industry. Therefore, with more projects and higher gas sales volume, the Group has also further increased its non-pipeline transmission capacity in addition to the Group's existing piped natural gas sources. The Group has one of the largest non-pipeline transmission systems in the PRC and possesses 114 LNG/CNG trucks, with a total one-time transmission capacity of up to 18,800,000 cubic meters. LNG/CNG can be used when necessary, so as to ensure gas supply. The Group has devoted great efforts in developing a contingency system that ensures gas sources and has set up a designated team. If any projects have tight supply of gas sources, the systems, together with the gas supply control center, can enhance the guarantee of gas supply.

The construction of the LNG project in Weizhou Island, Beihai, Guangxi was completed in 2005, and the project is now undergoing shakedown tests before commencing operation. It will be the fourth LNG plant in the PRC when put into production. It will mainly supply LNG to the Group's project in the south to meet the gas demand of the projects and further reduce the purchase cost of gas.

To further ensure gas sources, reduce purchase cost of gas and support the Group's policy of boosting penetration rates, the Group will participate in the establishment of a company engaged in coal conversion business in 2006. The business is to convert coal into DME, which can enhance the supply of backup gas sources and support the Group's development. DME is a clean fuel and can directly substitute natural gas and LPG without any alternation to the existing piped gas facilities. It is expected that the coal conversion project will commence construction in 2006 and be put into production in 2009. The coal conversion project will guarantee future gas sources, stabilise gas cost and bring in additional long term revenue. Besides, it is in line with the PRC government's policies of environmental protection and development of oil and gas substitutes, so it is strongly supported by the PRC government. After years of research on coal conversion projects, the Group completed the construction of a production line with an annual production capacity of 10,000 tons of DME in Bengbu City, Anhui Province, and it commenced production by the end of the year. Besides, the Group has started the research on the technology for replacing natural gas by DEM.

Apart from the Group's five projects that has used natural gas from West-East Pipeline since 2005, the Groups projects in Changsha, Zhuzhou and Xiangtan in Hunan Province also started to use the natural gas from Zhongxian-Wuhan Pipeline, and Yantai project used the offshore natural gas. After having access to piped natural sources, Changsha, Zhuzhou, Xiangtan and Yantai projects had more than 100,000 coal gas residential users converted into natural gas users. With the completion of more long distance pipelines, more and more of the Group's large projects use natural gas transmitted by pipelines. It facilitates new connections and minimises the additional cost of using CNG/LNG.

Because of the significant increase in international energy prices in 2005, the PRC government also adjusted the domestic energy pricing policy and further promoted market liberalisation of the natural gas industry. The government made adjustments to the policy on natural gas wellhead price at the end of 2005, and it is expected that natural gas price may follow other major energy prices to rise in the coming years. The PRC government also consents that natural gas downstream distributors should be allowed to make adjusts to gas tariffs according to the regulations. The Group has reinforced the communication with upstream suppliers like PetroChina to ensure gas supply. At the same time, the Group has also made application to local governments for gas tariff adjustments, so as to shift the adjusted costs to customers to protect the earning of the Group.

CNG Vehicle Gas Refuelling Station

Since vehicle emission is one of the major source of pollution in the large cities in the PRC, the PRC governments promotes the policies on converting vehicles to using clean energy. This will further accelerate the CNG station business. Besides, as the price of natural gas is on average 30-50% lower than gasoline, it is highly welcome by public vehicle companies and vehicle owners.

The Group has taken active measures to develop CNG stations business in its existing projects. By the end of 2005, the Group has obtained approval from governments to build 60 CNG stations, of which 10 have been completed and are in operation. It is expected that CNG station will become one of the major sources for increasing gas sales in the long term.

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 last year, some of the Group's project companies started to cooperate with local banks. They use the widespread network resources of the banks for collecting gas usage charges. This cooperation makes it more convenient for our customers, reduces the Group's administrative costs and increases cost efficiency.

Sale of Bottled LPG

During the year, the Group sold 45,179 tons of bottled LPG, increased by 19.6% over last year's 37,760 tons. The sales of bottled LPG increased because that the some of the new projects the Group acquired during the year had bottled LPG business. The operating profit of LPG increased from RMB908,000 last year to RMB3,960,000 this year.

The Group has been principally engaged in the sale of piped natural gas. However, some of the projects were mainly engaged in the sale of bottled LPG before being acquired by the Group. Bottled LPG is now only sold to customers not connected to piped natural gas or in peripheral towns, and it is expected to be replaced by piped natural gas gradually.

Sale of Gas Appliances

The Group sells cooking stoves, water boilers, heaters and stored-value card meters, which are relating to gas connections. The Group produces stored-value card meters, most of which are used by the Group in its own connection business. The Group lowers the average cost of meters by 30% by producing them itself. Besides, in 2005, the Group continued to sell meters to other gas distributors, which generated additional income for the Group.

Gross and Net Profit Margins

The Group's overall gross and net profit margins (after minority interests) were 37.5% and 14.7% respectively, and the margins dropped when compared to last year. One of the major causes for the drop was the change in the Group's revenue structure. As the penetration rates of the gas projects gets higher, although the overall penetration rate of the Group remains at 16.6% and leaves plenty of room for connection fee revenue growth, the proportion of connection fee revenue to total turnover will decline steadily: its ratio decreased from 57.1% in 2004 to 50.4% in 2005. The proportion of piped gas sales to total turnover will grow steadily with the rise of the penetration rates: its ratio increased from 29.8% in 2004 to 37.3% in 2005. As the margins of connection fee revenue are higher than piped gas sales, the change in the revenue structure will make the Group's future gross and net profit margins to be on a decreasing trend, until the revenue structure becomes relatively stable. On the other hand, this trend also reflects the enhancement in the Group's revenue structure, which shifts gradually from relying on one-off connection fee revenue to recurring and steady piped gas sales.

The other cause for the drop in the margins was the increase in minority shareholders' interests in the gas project companies, which was a result of the Group shifting from securing small-to-medium projects to medium-to-large projects. The percentage of minority interests in net profit increased from 17.4% last year to 22.3% this year. The Group still has high operation efficiency after taking into account of the change in revenue structure and profits before minority interests.

To reduce the Group's operation costs and enhance its operation efficiency, in 2005, the Group continued to strengthen the implementation of the measures from the consultation project by BearingPoint Management Consulting (Shanghai) Limited, especially on enhancing internal control and cost and expenses management. As a result, the Group has good control over selling expenses and administrative expenses and achieves more efficient operation management.

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 depend on human resources. Therefore, we put great emphasis on recruitment and internal training.

During the year, we continued to recruit 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. The Group has comprehensive induction training for new employees to ensure that they can become qualified employees quickly and be able to provide quality service to customers, so as to maintain smooth operations of the Group.

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, so as to enhance their competence, professional skills and quality. The Group also emphasises internal training and arranges two days of training every month to all employees. During the year, the Group organised 40 training sessions and seminars on informatisation, sustainable growth, good leadership, financial systems, process streamlining, sales techniques, project management, operation and management of gas stations, knowledge on safety check, etc.

As at 31 December 2005, the Group had 10,331 employees, of which seven based in Hong Kong and the others based in the PRC. They were remunerated at market level with benefits like bonus, retirement benefits, insurance, professional training, share option scheme, etc.

FINANCIAL RESOURCES REVIEW

Liquidity and Financial Resources

As at 31 December 2005, the Group's cash on hand (included pledged bank deposits) was RMB1,784,055,000 (2004: RMB911,537,000), and its total debts amounted to RMB3,547,202,000 (2004: RMB1,864,458,00). Its net gearing ratio, i.e. the ratio of net debt to equity (excluded minority interests), was 75.6% (2004: 49.6%).

Under the US$25,000,000 Loan Agreements with International Finance Corporation ("IFC"), the private sector arm of the World Bank Group, the Company, Mr. Wang Yusuo ("Mr. Wang") and the Borrowers (i.e. Bengbu Xinao Gas Company Limited, Shijiazhuang Xinao Gas Company Limited and Xiangtan Xinao Gas Company Limited, 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 of Xinao Group International Investment Limited (formerly known as Easywin Enterprises Limited) ("XGII"), indirectly through XGII, at least 35% of the issued share capital of the Company. Mr. Wang and Ms. Zhao are the beneficial and legal owners of XGII, which is owned as to 50% by Mr. Wang and 50% by Ms. Zhao. As at 31 December 2005, XGII and Mr. Wang together held 42.88% interests of the Company.

Five-year Zero Coupon Convertible Bonds

The Company issued five-year convertible bonds ("CB" or "CBs") in an aggregate principal amount of HK$550,000,000 on 15 November 2004. The CBs 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 CBs 2.5 years after the issue date. If the bondholders do not exercise the option of redemption, then they have to hold the CBs 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 CBs 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 CBs was HK$5.4375, which is subject to adjustment for events, if any, which may have diluting effects after the issue.

As at 31 December 2005, HK$79,570,000 (equivalent to RMB82,753,000) of CBs was converted into 14,633,560 ordinary shares of the Company. There were HK$470,430,000 (equivalent to RMB489,247,000) of CBs outstanding. If all the outstanding CBs are converted into shares, approximately 86,515,862 ordinary shares of the Company will be issued, equivalent to 9.57% of the total issued share capital of the Company.

Seven-year 7.375% Fixed Rate Bonds

On 5 August 2005, the Company issued 7-year bonds in the aggregate principle amount of US$200,000,000 (equivalent to RMB1,614,040,000) with issue price and redemption price of 100%, which are unconditionally and irrevocably guaranteed by the guarantor subsidiaries. The guarantor subsidiaries are wholly-owned subsidiaries of the Company and are primarily holding companies that operate through subsidiaries. The coupon of the bonds is 7.375%, and interests are paid semi-annually. The net proceeds after deducting all expanses are US$194,000,000 (equivalent to RMB1,565,619,000). The net proceeds of the bonds will be used for business expansion, including construction of CNG stations and acquisition of new projects, and for general corporate purposes of the Group, including refinancing of existing debts. The major terms and conditions of the bonds were disclosed in the Company's announcement dated 29 July 2005.

The Group captured the chance of record-low interest rate in the USA to finance business expansion. As the Group's acquisition strategy will focus on large sized cities, the 7 year term of the Bonds can match the payback period of the investment in large sized cities. With the rising US interest rate cycle, the costs of financing with floating rates are getting higher and higher. Therefore, the Group believed that fixed rates for 7 years could facilitate the Group to have even better cost control. Also, the bonds had 5 times subscription and a lowest-ever coupon rate among Chinese bonds in similar nature at the time of issue. The bonds were also awarded "Best Asian High Yield Bond Issue for 2005" by the renowned financial magazine EuroWeek. These showed that the bondholders and investors gave strong credit to the Group and recognized the prospect of the Group's business. The issue of the bonds also facilitated the Group to enlarge investor base and enhance its financing ability.

The Group believed that the appreciation of RMB would continue in the future. As all the operations of the Group are in the PRC, the Group will benefit from earning RMB and repaying foreign currency debts.

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

Borrowings Structure

As at 31 December 2005, the Group's total debts amounted to RMB3,547,202,000 (2004: RMB1,864,458,000), including bonds of US$200,000,000 (equivalent to RMB1,614,040,000), zero coupon CBs of HK$470,430,000 (equivalent to RMB489,247,000), loans of US$25,000,000 (equivalent to RMB201,755,000) and a secured loan of HK$10,088,000 (equivalent to RMB10,492,000). Apart from the zero coupon CBs and the fixed rate US dollar 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 RMB109,947,000 that has to be secured by assets with the carrying amount of approximately RMB88,209,000, all of the other loans are unsecured. Short-term loans amounted to RMB566,457,000 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 interest rate swap contracts for the US dollar bonds. The Group will monitor the market trends of interest and exchange rates closely and make appropriate adjustments when necessary.

Contingent Liabilities

As at 31 December 2005, the Group had contingent liabilities of RMB77,000,000 (2004: Nil).

Capital Commitments

As at 31 December 2005, the Group had contracted but not provided for capital commitments of RMB15,227,000 (2004: RMB22,673,000), and authorised but not contracted for capital commitments of RMB Nil (2004: RMB14,200,000) for the purchase of property, plant and equipment.

As at 31 December 2005, the Group had contracted but not provided for capital commitments of RMB161,390,000 (2004: RMB114,125,000) for the Group's share in joint ventures.

Pledge of Assets

At the balance sheet date, the Group pledged certain assets as securities for bank loans granted to the Group, associates and jointly controlled entities as follows:

	2005	**2004**
	RMB'000	*RMB'000*
Carrying amount of:		
Property, plant and equipment	60,605	116,168
Investment properties	27,604	–
	88,209	116,168

In addition to the above, the Group has also pledged its rights to fee income of certain subsidiaries in favour of banks to secure banking facilities granted to the Group.

PROSPECTS

The Group has also prepared itself for long term development. The Group has strategic adjustments on its development plans from 2005 onwards: instead of focusing on obtaining a large number of new piped gas projects, we shifts our emphasis to boosting gas penetration rates in our existing projects and developing compressed natural gas (CNG) vehicle refuelling stations, which can increase the long term natural gas sales. The strategic adjustments are based on the Group's consideration that most of the rich cities with piped natural gas sources have been taken up by the existing gas operators, and the Group will not invest in projects that do not meet our stringent required rates of return. However, as there will be more piped natural gas sources in the future, such as the LNG import terminals to be completed in the coming years, the Group will continue to obtain some quality projects.

As at the end of 2005, the Group had a connectable population of 32,387,000, equivalent to approximately 10,796,000 households, and the penetration rate was only 16.6%. According to the Group's past experience, the penetration rates can reach as high as 70% - 80%. Even if the Group slows down its acquisition and secures fewer new projects, the Group expects to maintain its high growth, as the gas penetration rates of residential households and the sales volume of C/I customers will grow rapidly in the coming three to four years impelled by the strong economic growth in the PRC. In addition, the Group has reached critical mass in terms of connectable population coverage, and the long term revenue is guaranteed by growing penetration rates and more CNG refuelling stations. Therefore, in the future, the Group will have higher flexibility to select projects with high quality, high return or strategic significance.

Natural gas source is the key factor for the development of the Group as well as the whole natural gas industry. Therefore, not only the three oil and gas giants continue the exploration of new oil and gas fields and the construction of more long distance pipelines and LNG import terminals, the Group also has started to develop upstream business. Apart from the development of the LNG project in Weizhou Island, Guangxi since 2004, the Group will also participate in the establishment of a company engaged in coal conversion business in 2006. The business is to convert coal into dimethyl ether ("DME") to enhance the supply of backup gas sources and support the Group's development. DME is a clean fuel and can directly substitute natural gas and LPG without any alternation to the existing piped gas facilities. It is expected that the coal conversion project will commence construction in 2006 and be put into production in 2009. It will guarantee future gas sources, stabilise gas cost and bring in additional long term revenue. Besides, it is in line with the PRC government's policies of environmental protection and development of oil and gas substitutes, so it is strongly supported by the PRC government.

The Group believes that the city piped gas market in the PRC, after its rapid development in the past years, may enter into the stage of merges and acquisitions in the coming years. This will offer good opportunities for further development and expansion to the Group, a large and renowned gas operator.

With the Group's well-developed brand recognition in the industry, which is a result of our quality customer service and safe and efficient operation management, the Group has started to explore and develop value-added services based on our customer resources and brand name. We will try to develop other value added businesses in project cities with high penetration rates, so as to generate more revenue from diversifies services and create new profit without putting in additional resources.

Under all the favorable conditions, we believe that the Group will have better development prospects, higher ability to ensure reliable gas sources and higher flexibility in selecting new projects for business expansion. It is expected that with the Group's strategic adjustment, informatisation and streamlining of business processes, the Group can make more efficient use of resources and take full advantage of the Group's leading edges in the industry. We will gradually turn from a high growth company into a public utilities company in the future years, so as to minimise investment risks and maximise shareholders' wealth.

PURCHASE, 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 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 2005. Four Audit Committee meetings were held during the financial year.

REMUNERATION COMMITTEE

The Company's Remuneration Committee was established on 31 December 2004 and is composed of Mr. Yang Yu, an executive Director and Chief Executive Officer, and three independent non-executive Directors, namely, Mr. Wang Guangtian, Ms. Yien Yu Yu, Catherine and Mr. Kong Chung Kau. The Remuneration Committee's responsibilities includes the review of the Company's policy for remuneration of Directors and senior management and determination the remuneration packages of executive Directors and senior management including benefits in kind, pension rights and compensation payments.

THE CODE ON CORPORATE GOVERNANCE PRACTICES

To the knowledge of the Board, the Company has complied with the Code on Corporate Governance Practices ("Code") as set out in Appendix 14 of the Listing Rules throughout the year, and there have been no material deviations from the code. Details of compliance will be set out in the Corporate Governance Report in the 2005 Annual Report.

DIVIDENDS AND CLOSING OF REGISTER OF MEMBERS

The Directors now recommend a final dividend of HKD4.81 cents (equivalent to approximately RMB5.00 cents) (2004: RMB2.87 cents) per share payable to shareholders of the Company whose names are on the register of members on 23 May 2005. The final dividend is subject to approval by the shareholders in the forthcoming annual general meeting. The register of members will be closed from Monday, 8 May 2006 to Tuesday, 23 May 2006, 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 Branch Share Registrar in Hong Kong, 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 Thursday, 4 May 2006.

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

Hong Kong, 20 April 2006

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.