Reuters, Xinao Gas targets policy-led sales surge, 27th February, 2007

Reporter: Ruth Wong / Judy Hua

HONG KONG, Feb 27 (Reuters) - **Xinao** Gas Holdings Ltd. , China's top urban gas distributor, is shooting for 50 percent annual sales growth over two to three years as the coal-reliant country turns to cleaner energy, and plans to return more cash to shareholders in coming years.

Xinao, which vies with Hong Kong and China Gas and China Gas Holdings Ltd. to pipe gas across the world's second-largest energy consumer, plans to spend 1 billion yuan (US$130 million) this year alone expanding its distribution web, finance director Yu Jianchao told Reuters on Tuesday.

Gas demand is expanding at a double-digit percentage clip as Beijing, which relies on coal to fire three-quarters of its energy but hopes to reduce emissions of pollutants by a 10th by the end of the decade, pushes more environmentally friendly fuel.

The world's fourth-largest economy is expected to consume 60 billion cubic metres of gas annually by 2010, versus 47 bcm in 2004. In contrast, biggest European market Britain consumes a 100 bcm yearly, the International Energy Agency reckons.

"Growth in the domestic natural gas market is very ideal, creating big room for our development," the 38-year-old Yu said in an interview.

"Beijing is pushing the use of natural gas. That balances the interests of users and operators," the easy-going finance veteran of 17 years said at his Hong Kong offices.

Explosive demand growth helped **Xinao**'s net profit rise 21 percent to 303.12 million yuan ($38 million) in 2005, when it also posted 2.06 billion yuan in revenue.

Now, the firm aims to raise its dividend payout ratio -- steadily -- to between 30 to 35 percent in coming years, from 15 percent now.

Based in the northern province of Hebei, the firm is active in coastal cities and expects its connectable population to rise to 50 million in three to five years, from 33.6 million in mid-2006. It expects to raise its penetration rate to 50 percent -- in those addressable markets -- from 20 percent now.

Yu hopes penetration would rise eventually to 80 to 90 percent of the connectable market, he added.

THE GAS CONNECTION

Yu waved off a decision by southern Guangdong province banning piped-gas firms from collecting connection fees, saying that policy would not spread to the rest of the country -- a potential that has investors worried.

"It's impossible ... because the pricing reform for urban utilities has not been included in the government's work plan," he said.

Connection fees make up nearly half of turnover now, but Yu expects that proportion to sink to about 30 percent in two to three years.

Shares in **Xinao** have plunged more than 20 percent since December, after the Guangdong ruling. They rose 2.54 percent on Tuesday, outperforming a 1.76 percent drop in the benchmark Hang Seng Index <.HSI>.

The wealthy province contributes a 10th of the company's revenue.

Xinao is now looking abroad for further growth. It got a government green light last year to import LNG, joining China's oil triumvirate of PetroChina , Sinopec Corp. and CNOOC Ltd. .

It's hunting for gas resources in places from Australia and Malaysia to the Middle East. Yu did not rule out cooperating with the top three oil companies or foreign firms on LNG projects.

"Our strengths lie in downstream distribution," he said.

"Hopefully, we will give a clear outline of where to build an LNG terminal and on opportunities for cooperation in 2008, and start providing LNG in 2010."

Further downstream, **Xinao** has the government's blessing to set up more than 200 gas stations, of which it has built 65.

The firm plans to raise the volume of gas sold at stations to 15-20 percent of total gas sales by 2010, from 3 percent now.

On the outlook for mergers and acquisitions, Yu declined to comment.

"One thing that is for sure: our company will not be acquired." ($1=7.744 Yuan)