新奧燃气控股有限公司
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 2006

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 Group for the year ended 31 December 2006 together with the comparative audited restated figures for the corresponding period in 2005. The audited consolidated financial statements have been reviewed by the Company's Audit Committee.

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 RMB'000	2005 RMB'000 (Restated)
Revenue	4	3,396,536	2,056,826
Cost of sales		(2,203,313)	(1,285,172)
Gross profit		1,193,223	771,654
Other income		201,358	132,249
Selling expenses		(59,154)	(37,392)
Administrative expenses		(545,585)	(294,737)
Fair value changes on derivative financial instruments		(1,854)	(37,039)
Fair value changes on convertible bonds		(4,392)	(56,153)
Share-based payment expenses		(57,370)	–
Other expenses		(59,981)	(26,731)
Share of results of associates		4,685	1,136
Share of results of jointly controlled entities		66,126	20,936
Finance costs		(203,424)	(73,383)
Profit before taxation		533,632	400,540
Taxation	5	(49,772)	(38,343)
Profit for the year		483,860	362,197
Attributable to:			
Equity holders of the Company		379,617	270,549
Minority interests		104,243	91,648
		483,860	362,197
Dividend	6		
– Paid		46,333	25,254
– Proposed		75,923	45,440
Earnings per share	7		
Basic		40.5 cents	30.5 cents
Diluted		38.7 cents	30.3 cents

CONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2006

	Notes	2006 RMB'000	2005 RMB'000 (Restated)
Non-current assets			
Property, plant and equipment		5,191,837	3,534,973
Prepaid lease payments		375,200	269,882
Investment properties		70,885	71,602
Goodwill		184,267	133,046
Other intangible assets		267,386	57,271
Interests in associates		340,173	76,571
Interests in jointly controlled entities		295,530	235,432
Available-for-sale investments		18,420	2,600
Amount due from an associate		83,000	57,000
Amount due from a jointly controlled entity		69,000	–
Deposits paid for investments in joint ventures		54,725	264,602
Deposits paid for acquisition of property, plant and equipment		14,491	–
		6,964,914	4,702,979
Current assets			
Inventories		171,218	115,713
Trade and other receivables		797,895	579,423
Prepaid lease payments		6,587	5,776
Derivative financial instruments		–	5,504
Amounts due from customers for contract work		311,243	216,286
Amounts due from associates		67,558	52,731
Amounts due from jointly controlled entities		46,255	40,119
Amounts due from related companies		101,784	52,118
Pledged bank deposits		–	162,963
Bank balances and cash		1,567,552	1,621,092
		3,070,092	2,851,725
Current liabilities			
Trade and other payables		1,625,959	729,904
Derivative financial instruments		46,012	49,662
Amounts due to customers for contract work		279,902	183,078
Amounts due to associates		56,320	90,826
Amounts due to jointly controlled entities		16,484	4,920
Amounts due to related companies		18,032	19,796
Taxation payable		36,088	37,439
Bank and other loans – due within one year		619,140	566,457
Financial guarantee liability		1,502	1,228
		2,699,439	1,683,310
Net current assets		370,653	1,168,415
Total assets less current liabilities		7,335,567	5,871,394

	Notes	2006 RMB'000	2005 RMB'000 (Restated)
Capital and reserves			
Share capital		102,825	95,819
Reserves		2,953,835	2,135,667
Equity attributable to equity holders of the Company		3,056,660	2,231,486
Minority interests		811,768	527,663
		3,868,428	2,759,149
Non-current liabilities			
Bank and other loans – due after one year		1,750,738	961,083
Financial guarantee liability		1,228	2,455
Convertible bonds		127,597	556,400
Guaranteed notes		1,525,461	1,570,729
Deferred taxation		62,115	21,578
		3,467,139	3,112,245
		7,335,567	5,871,394

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 ("HKICPA"). In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Main Board of the Stock Exchange of Hong Kong Limited and by the Hong Kong 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. APPLICATION OF NEW HONG KONG FINANCIAL REPORTING STANDARDS

In the current year, the Group has applied, for the first time, a number of new standard, amendments, and interpretations ("new HKFRSs") issued by the HKICPA that are either effective for accounting periods beginning on or after 1 December 2005 or 1 January 2006. 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 or prior accounting periods have been prepared and presented.

Financial guarantee contracts

In the current year, the Group has applied Hong Kong Accounting Standard ("HKAS") 39 and HKFRS 4 (Amendments) *Financial guarantee contracts* which is effective for annual periods beginning on or after 1 January 2006.

A financial guarantee contract is defined by HKAS 39 *Financial Instruments: Recognition and Measurement* as "a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument".

The Group acts as the issuer of the financial guarantee contracts

Prior to 1 January 2006, financial guarantee contracts were not accounted for in accordance with HKFRS 4 *Insurance Contract* and those contracts were disclosed as contingent liabilities. A provision for financial guarantee was only recognised when it was probable that an outflow of resources would be required to settle the financial guarantee obligation and the amount can be estimated reliably.

Upon the application of these amendments, a financial guarantee contract issued by the Group and not designated as at fair value through profit or loss is recognised initially at its fair value less transaction costs that are directly attributable to the issue of the financial guarantee contract. Subsequent to initial recognition, the Group measures the financial guarantee contract at the higher of: (i) the amount determined in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 *Revenue*.

In relation to a financial guarantee granted to a bank over the repayment of a loan by an associate, the Group has applied the transitional provisions in HKAS 39. The fair value of the financial guarantee contract at the date of grant of RMB4,910,000, representing a deemed capital contribution to the associate, has been adjusted to the carrying amount of interests in associates. The unamortised amount of RMB4,910,000 at 1 January 2005 has been recognised as a financial liability for the financial guarantee contract. This change in accounting policy has resulted in an increase in profit for the year (see note 3 for the financial impact).

3. RESTATEMENTS

In the current year, the Group has made the following restatements:

(a) During the year ended 31 December 2005, the Group acquired certain subsidiaries and business of which the fair values of the identifiable assets, liabilities and contingent liabilities acquired were determined provisionally. During the year, the Group made certain fair value adjustments with reference to the valuation report to the carrying amounts of the identifiable assets and liabilities of the subsidiaries and business acquired as a result of completing the initial accounting. The adjustments to the fair values at the acquisition date of the identifiable assets, liabilities and contingent liabilities were made as if initial accounting had been incorporated from acquisition date.

(b) As mentioned in note 2, the Group has applied HKAS 39 and HKFRS 4 (Amendments) *Financial guarantee contracts* in the current year for financial guarantees granted to a bank over the repayment of a loan by an associate. The fair value of the financial guarantee contract at the date of grant, representing a deemed capital contributions to the associate, has been adjusted to the carrying amount of interests in associates and recognised as a financial liability for the financial guarantee contract at 1 January 2005.

(c) In the current year, the management has performed a reassessment of the functional currency of the Company and considered RMB to be the Company's functional currency. As a result, the conversion option of the convertible bonds issued by the Company in prior years which is settled other than by the exchange of a fixed amount of cash for a fixed number of shares is a conversion option derivative instead of an equity instrument. The Group accounted for the convertible bonds as financial liability at fair value through profit or loss. The adjustments are made retrospectively.

The cumulative effects of the above restatements on the consolidated balance sheet as at 31 December 2005 are summarised as below:

	As at 31 December 2005 (originally stated) *RMB'000*	Subsequent fair value adjustments *RMB'000*	Financial guarantee *RMB'000*	Functional currency *RMB'000*	Reclassification *RMB'000*	As at 31 December 2005 (restated) *RMB'000*
Balance sheet items						
Goodwill	147,996	(14,950)	–	–	–	133,046
Other intangible assets	14,620	42,651	–	–	–	57,271
Interests in associates	128,661	–	4,910	–	(57,000)	76,571
Amount due from an associate						
– non-current	–	–	–	–	57,000	57,000
Financial guarantee liability						
– current	–	–	(1,228)	–	–	(1,228)
– non-current	–	–	(2,455)	–	–	(2,455)
Convertible bonds	(448,933)	–	–	(107,467)	–	(556,400)
Deferred taxation	(8,398)	(13,180)	–	–	–	(21,578)
Other assets and liabilities	3,016,922	–	–	–	–	3,016,922
Total effects on assets and liabilities	2,850,868	14,521	1,227	(107,467)	–	2,759,149
Share premium	1,200,265	–	–	2,022	–	1,202,287
Translation reserve	9,566	–	–	(9,566)	–	–
Convertible bond-equity reserve	46,099	–	–	(46,099)	–	–
Accumulated profits	888,747	5,637	1,227	(53,824)	–	841,787
Minority interests	518,779	8,884	–	–	–	527,663
Other reserve items	187,412	–	–	–	–	187,412
Total effects on equity	2,850,868	14,521	1,227	(107,467)	–	2,759,149

The effects of the restatements on the Group's equity at 1 January 2005 are summarised below:

	As at 1 January 2005 (originally stated) *RMB'000*	Functional currency *RMB'000*	As at 1 January 2005 (restated) *RMB'000*
Convertible bond-equity reserve	53,896	(53,896)	–
Accumulated profits	637,067	(14,244)	622,823
Total effects on equity	690,963	(68,140)	622,823

The effects of the above restatements on the results for the current and prior year are as follows:

	2006 *RMB'000*	2005 *RMB'000*
(i) HKAS 39 and HKFRS 4 (Amendments)		
Income from financial guarantee	1,793	1,227
(ii) Other adjustments		
Discount on acquisition of a subsidiary	–	10,898
Amortisation of intangible assets	(2,371)	(1,139)
Decrease in taxation	709	376
Loss on fair value change of convertible bonds	(4,392)	(56,153)
Decrease in interest expense on convertible bonds	3,286	16,867
Decrease in exchange gain	–	(147)
	(2,768)	(29,298)
Decrease in profit for the year	(975)	(28,071)
Attributable to:		
Equity holders of the Company	(975)	(32,569)
Minority interests	–	4,498
	(975)	(28,071)
Decrease in basic earnings per share	(0.1 cents)	(3.6 cents)
Decrease in diluted earnings per share	(0.1 cents)	(3.6 cents)

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

	2006 *RMB'000*	2005 *RMB'000*
Increase in other income	1,793	11,978
Fair value changes on convertible bonds	(4,392)	(56,153)
Increase in other expenses	(2,371)	(1,139)
Decrease in finance costs	3,286	16,867
Decrease in taxation	709	376
Decrease in profit for the year	(975)	(28,071)

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:

2006

	Gas connection *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*	Consolidated *RMB'000*
Revenue	1,354,892	1,623,510	282,606	135,528	–	3,396,536
Result	1,004,061	300,977	10,769	25,067	–	1,340,874
Unallocated other income						184,410
Unallocated corporate expenses						(859,039)
						666,245
Share of results of associates	1,492	(4,558)	–	9,891	(2,140)	4,685
Share of results of jointly controlled entities	65,463	663	–	–	–	66,126
Finance costs						(203,424)
Profit before taxation						533,632
Taxation						(49,772)
Profit for the year						483,860

2005

	Gas connection *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*	Consolidated *RMB'000* (restated)
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						126,732
Unallocated corporate expenses						(596,959)
						451,851
Share of results of associates	896	240	–	–	–	1,136
Share of results of jointly controlled entities	20,648	288	–	–	–	20,936
Finance costs						(73,383)
Profit before taxation						400,540
Taxation						(38,343)
Profit for the year						362,197

(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. TAXATION

	2006	2005
	RMB'000	*RMB'000* (restated)
Current tax	58,360	43,125
Overprovision in prior years	(5,747)	(4,406)
	52,613	38,719
Deferred tax	(2,841)	(376)
	49,772	38,343

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:

	2006	2005
	RMB'000	*RMB'000* (Restated)
Profit before taxation	533,632	400,540
Tax at the PRC enterprise income tax rate of 33%	176,099	132,178
Tax effect of share of results of associates	(1,546)	(375)
Tax effect of share of results of jointly controlled entities	(21,822)	(6,909)
Tax effect of expenses not deductible for tax purpose	54,729	74,662
Tax effect of income not taxable for tax purpose	(18,217)	(21,936)
Tax effect of tax losses not recognised	56,321	23,428
Utilisation of tax losses previously not recognised	(896)	(2,296)
Tax effect of deductible temporary differences not recognised	7,860	–
Overprovision in respect of prior year	(5,747)	(4,406)
Effect of tax concession granted to PRC subsidiaries	(178,979)	(139,668)
Effect of different tax rates of subsidiaries	(18,030)	(16,335)
Tax charge for the year	49,772	38,343

In addition to the income tax expense charged to consolidated income statement, a deferred tax charge of RMB2,449,000 (2005: deferred tax credit of RMB1,333,000) has been recognised in equity in the year.

6. DIVIDENDS

	2006	2005
	RMB'000	*RMB'000*
Final dividend paid 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))	46,333	25,254
Final dividend proposed in respect of 2006 of HKD7.75 cents (2005: HKD4.81 cents) per share (equivalent to approximately RMB7.79 cents per share (2005: RMB5.00 cents per share))	75,923	45,440

The final dividend in respect of 2006 of HKD7.75 cents (2005: HKD4.81 cents) (equivalent to approximately RMB7.79 cents (2005: RMB5.00 cents) per share on 973,958,599 shares (2005: 908,371,488 shares) has been proposed by the directors and is subject to approval by the shareholders in the forthcoming annual general meeting.

7. **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:

	2006	2005
	RMB'000	*RMB'000* (Restated)
Earnings		
Earnings for the purposes of basic earnings per share	379,617	270,549
Effect of dilutive potential ordinary shares:		
Fair value changes on convertible bonds	4,392	–
Earnings for the purposes of diluted earnings per share	384,009	270,549

	2006 Number of shares	2005 Number of shares
Number of shares		
Weighted average number of ordinary shares for the purposes of basic earnings per share	936,924,000	888,491,000
Effect of dilutive potential ordinary shares:		
– share options	2,344,500	4,177,000
– convertible bonds	53,826,000	–
Weighted average number of ordinary shares for the purposes of diluted earnings per share	993,094,500	892,668,000

FINANCIAL AND OPERATIONAL HIGHLIGHTS

	For the year ended 31 December		
	2006	**2005** (Restated)	**Increase (Decrease)**
Turnover *(RMB)*	3,396,536,000	2,056,826,000	65.1%
Gross profit *(RMB)*	1,193,223,000	771,654,000	54.6%
Profit attributable to equity holders of the Company *(RMB)*	379,617,000	270,549,000	40.3%
Earnings per share – Basic *(RMB)*	40.5 cents	30.5 cents	32.8%
Connectable urban population	39,073,000	32,387,000	20.6%
Connectable residential households	13,024,000	10,796,000	20.6%
New natural gas connections made during the year:			
– residential households	451,072	334,637	34.8%
– commercial/industrial ("C/I") customers (sites)	1,493	1,140	353 sites
– installed designed daily capacity for C/I customers (m^3)	1,481,611	1,045,466	41.7%
Accumulated number of natural gas customers:			
– residential households	2,069,783	1,271,810	62.7%
– C/I customers (sites)	5,778	3,439	2,339 sites
– installed designed daily capacity for C/I customers (m^3)	4,372,540	2,286,861	91.2%
Accumulated number of piped gas (including natural gas) customers:			
– residential households	2,458,735	1,793,216	37.1%
– C/I customers (sites)	6,290	4,041	2,249 sites
– installed designed daily capacity for C/I customers (m^3)	5,023,652	2,495,479	1.01 times
Natural gas penetration rate	15.9%	11.8%	–
Piped gas (including natural gas) penetration rate	18.9%	16.6%	–
Unit of piped gas sold to residential households (m^3)	299,806,000	198,488,000	51%
Unit of piped gas sold to C/I customers (m^3)	852,513,000	255,859,000	2.3 times
Unit of bottled liquefied petroleum gas ("LPG") sold (ton)	58,136	45,179	28.7%
Number of vehicle refuelling stations	57	10	47 stations
Number of natural gas processing stations	74	64	10 stations
Total length of existing intermediate and main pipelines (km)	9,234	7,268	27.1%

CHAIRMAN'S STATEMENT

Results of the Year

The Group continued to record substantial growth in its results for 2006. The revenue and profit attributable to shareholders for the year reached RMB3,396,536,000 and RMB379,617,000 respectively, representing increases of 65.1% and 40.3% over last year respectively. Earnings per share — basic increased by 32.8% to RMB40.5 cents.

During the year, the Group secured five new gas projects, which were located in Nanan City, Huian City, Shishi City and Jinjiang City in Fujian Province and Laian City in Anhui Province. As of the end of 2006, there were 64 city piped gas projects, and the connectable urban population increased by 20.6% to 39,073,000. Reaping from the advantage of possessed resources, the Group has instigated to develop compressed natural gas ("CNG") vehicle refuelling station ("refuelling station") business from 2002. Apart from acquiring large-scaled refuelling station business in Shanghai, the Group has also built up 15 refuelling stations in eight cities during the year. Consequently, the aggregate number of refuelling stations has been increased to 57, which fortifies the Group's gas sales volume and revenue in the long run.

During the year, the Group made piped natural gas connections to 451,072 residential households and 1,493 commercial/industrial ("C/I") customers (connected to gas appliances of a total installed designed daily capacity of 1,481,611 cubic meters). As of the end of 2006, the accumulated number of residential households and C/I customers of natural gas were 2,069,783 and 5,778 (connected to gas appliances of a total installed designed daily capacity of 4,372,540 cubic meters) respectively, and the accumulated number of residential households and C/I customers of other piped gas were 388,952 and 512 (connected to gas appliances of a total installed designed daily capacity of 651,112 cubic meters) respectively. The sales volume of gas for the year also grew tremendously by 1.82 times whilst the share of piped gas revenue over total revenue was raised drastically to 47.8%, revealing an economy of scale and the prosperous development of the Group, which consolidated the Group's long term recurring revenue in the future.

Corporate Management

With a view to drawing on the best practical management experience of the corporations in the industry worldwide, so as to bring the Group's management quality in line with the state-of-the-art corporations in this field, the Group has joined force with IBM Global Services (China) Company Limited ("IBM") in 2006 to launch a consultation project on process streamlining and information system management. In June 2006, the total IT solutions project was commenced officially. Four subsidiaries were selected as the trial run units. The Group was the pioneer enterprise with parallel implementation of the enterprise management software SAP utilities solution, oil and natural gas industry solution and enterprise resource planning. The total IT solutions project was put into practice on 8 January 2007 as scheduled.

As of the end of 2006, the Group has gas projects across 14 provinces, municipalities and autonomous regions in the People's Republic of China ("PRC"). Therefore, the Group has established eight regional management centers (merging the nine centers in 2005 for reducing operation costs) to facilitate management of gas projects. To ensure achievement of the Group's targets and effective communication of the Group's strategy, the Group instigated a strategic performance management project effectively during the year. The project divides the Group's strategic target into strata for execution at each company and employee, enabling the transformation of targets into actions and enhancing the ability of strategy implementation in all aspects. During the instigation process, the Group's strategy has been reviewed with the stance and approach of strategic communication clarified. The strategic division of labour for each organisation level has also been confirmed. All these have strengthened the strategic co-ordination among functional departments and have provided a fundamental solution for transplanting strategic execution.

International Awards

The Company was awarded "Chinese Business 500" by *Yazhou Zhoukan* again during the year, making it the sixth consecutive year the Company gained this award. The Company's annual report 2005 was also awarded "Honourable Mention, Best Annual Report Awards" by The Hong Kong Management Association, which revealed that the Company's annual report has provided clear and accurate disclosure and has served the function of shareholder communication effectively. These awards also reflected the recognition of investors and professional institutions towards the Company's management quality and high degree of transparency. In future, management of the Group will endeavor to maintain and achieve beyond this outstanding performance and reputation that have been gained by the Company through challenging course.

Human Resources

As at the end of 2006, the Group had 13,355 employees (2005: 10,331), providing sufficient human resources to cater the need of the Group's development.

The Group endorses the principle of "based on people" and believes that healthy employee development is the key to the provision of satisfactory services to customers. Therefore, the Group offers learning and studying opportunities to employees as a kind of benefits and rewards, so as to encourage lifelong learning among employees.

The Group also tailor-makes practical career development plans for employees, creates open career paths for them and allows them to fully utilise their potential. With a view to facilitating the progress and growth of young employees, the Group provides competition for promotion, job rotation, on-the-job training and promotion channel development to young employees, which in turn ensure adequate human resources for the Group's sustainable and healthy development.

In light of ensuring clear understanding of the Group's development strategy and vision among employees, concerning employees' personal growth as well as encouraging employees' action on realisation of personal and corporate value, in 2007, the Group will implement employee satisfaction project in full force, aiming to swell both the degree of employees' satisfaction and the Group's benefits.

Prospects

Energy, being the important strategic resources for national economy and national security, acts an indispensable role in the course of modernisation. The use of clean energy and development of natural gas industry is an essential trend under the continuous development and energy structural adjustment in China economy. Natural gas is deployed by the PRC government as a major tool for energy structure enhancement and environmental protection. In 2004, the PRC government established a new energy strategy, which required a raise of natural gas ratio in energy structure. Whilst the demand of energy grows with time in association with the continuous rapid economic development in PRC, there will be stringent energy supply in all kinds continuously. The consumption structure of natural gas has been undergoing changes since 2005, with the percentage of natural gas used in chemical industry and urban areas against total natural gas usage above 60%. This consumption structure will be further improved under the rapid demand growth of natural gas in PRC. In future, natural gas will become the major fuel in the urban gas market in PRC. The urbanisation ratio will be raised from the existing level of 43%, to 55% – 60% by 2020. Natural gas industry in PRC has already come into its rapid development phase.

With the rapid development of the Group in the past few years, the Group has established its pioneering role and market position in the PRC gas industry. In view of facilitating the Group's development in the long run, the Group has conducted a scientific and rational adjustment on its development strategy timely in prudent manner. Instead of focusing on obtaining a large number of new gas projects, we shift our emphasis to boosting gas penetration rates in our existing projects, and exploring channels to provide bottled liquefied petroleum gas ("LPG") and other clean energy alternatives to the sub-urban areas around the existing project areas, transforming the Company from a high-growth company into a public utilities company gradually. The average gas penetration rate of the Group is 18.9%, and there is still a considerable room for growth before reaching the peak gas penetration rate of 70% to 80%. With the Group's coverage of 39,073,000 urban population as well as prosperous C/I customers base, it is expected that the Group is able to maintain high growing momentum even when the Group decreases the number of new project acquisitions immensely. In this regards, the Group's strategic adjustment is supported by concrete fundamentals, which facilitate the Group's continuous business development in the long run.

In recent years, apart from promoting connection service, the Group has also been actively developing C/I customers and refuelling stations, which involve users with much higher usage volume than residential users. The revenue structure of the Group has been enhanced accordingly with the proportion of one-off connection fee to the Group's total revenue falling continuously, in particular, from 76.8% in 2001 to 39.9% in 2006. Gas sales revenue has also increased drastically from 21.0% in 2001 to 47.8% in 2006. In the long run, gas sales and gas profit contributions will take over connection fee and become the major revenue and profit contributions to the Group. By the time, gas sales will also provide more stable revenue to the Group.

Stable and reliable natural gas source is essential to the Group's development strategy realisation. On top of full utilisation of long distance pipeline in PRC, the Group has also actively explored gas source by self production and has seek to merchandise international gas source. During the year, the Group has invested in the coal chemical project in Erdos, Inner Mongolia and utilises the rich coal resources there for dimethyl ether ("DME") production. Being a kind of gas fuels, DME is regarded as another clean energy apart from natural gas, which can be used as direct substitute for natural gas and LPG. The project of DME has received great support and encouragement from the PRC government. In the meantime, the early-stage construction work for this project is well in progress. It is expected that phase one of this project will come into operation in 2009 with an annual production capacity of 400,000 tons of DME. As a supplementary source for natural gas, DME can meet part of the Group's demand of gas source in future. At the same time, the liquefied natural gas ("LNG") processing factory located in Weizhou Island, Beihai, Guangxi invested by the Group has come into production in 2006. This factory is the fourth LNG processing factory in PRC. The factory has started to provide natural gas to the Group's projects in Guangdong province and Guangxi in light of providing additional natural gas source to these projects and lowering the purchasing cost.

Moreover, the Group has established Xinao Energy Sales Company Limited during the year and obtained the import and export right of natural gas, LPG, methanol, DME and various kinds of gas materials, making the Group the fourth company having the import/export right of natural gas after the PRC's three oil and gas giants (PetroChina Company Limited, China Petroleum & Chemical Corporation, CNOOC Limited). It turns a new leaf for the Group's future international energy trading business and strengthens the gas source security for the Group's gas projects.

In 2007, the Group will enhance management and lower operational cost through the promotion and implementation of strategic development, total IT solutions and balanced score card. In addition, the Group will continue to stick to the customer-oriented principle, and to enhance customers' satisfaction. In association with the rapid development of the Group's business, Xinao Gas has already established its market position. The industry has entered the stage of mergers and acquisitions, which provides opportunities to the Group. Whilst encountering these market opportunities, the Group would evaluate every investment decision with the most prudent attitude. In light of minimising investment risk, every project will undergo the most prudent and stringent feasibility study before an investment decision is made. In future, the Group will actively implement the distribution strategy of clean energy and raise the operational results in all aspects. In addition to contributing to the environmental protection business in PRC, the Group shall endeavour to maximise the benefits of shareholders, customers, employees, society and the corporation.

FINANCIAL RESOURCES REVIEW

Liquidity and financial resources

As at 31 December 2006, the Group's cash on hand was equivalent to RMB1,567,552,000 (2005: RMB1,784,055,000), and its total debts was equivalent to RMB4,022,936,000 (2005: RMB3,654,669,000). Its net gearing ratio, i.e. the ratio of net debt to equity (excluding minority interests), was 80.3% (2005: 83.8%).

Under the US$25,000,000 Loan Agreements with IFC, 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, according to the Loan Agreement and the subsequent amendment thereto, 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 Xinao Group International Investment Limited (formerly known as Easywin Enterprises Limited) ("XGII"), indirectly through XGII, at least 27% 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 2006, XGII and Mr. Wang together held 35.13% 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 2006, HK$458,700,000 (equivalent to RMB460,850,000) of CBs was converted into 84,358,594 ordinary shares of the Company. There were HK$91,300,000 (equivalent to RMB91,729,000) of CBs outstanding. If all the outstanding CBs are converted into shares, around 16,790,826 ordinary shares of the Company will be issued, equivalent to 1.72% of the total issued share capital of the Company as at 31 December 2006.

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.

As all the operations of the Group are in the PRC, if the appreciation of RMB would continue in the future, the Group will benefit from earning RMB and repaying foreign currency debts, the finance charges for foreign currency debt will be lowered indirectly.

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 2006, the Group's total bank and other borrowings amounted to RMB4,022,936,000 (2005: RMB3,654,669,000), including zero coupon CBs at fair value of HK$127,000,000 (equivalent to RMB127,597,000), loans and bonds of US$222,500,000 (equivalent to RMB1,737,436,000) and mortgage loans of HK$8,974,000 (equivalent to RMB9,016,000). Apart from the zero coupon CBs and the fixed rate US$200,000,000 bonds, other US dollar loans and HK dollar mortgage loans bear interest at floating rates, and the remaining bank and other borrowings are denominated in Renminbi at fixed interest rates or the interest rates released by the People's Bank of China. The project companies used the Renminbi loans as their working capital and operational expenditure. Except for the loan amount of RMB1,504,258,000 equivalent that has to be secured by assets with the net asset value of approximately RMB119,613,000 equivalent, all of the other loans are unsecured. Short-term loans amounted to RMB619,140,000 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 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.

Capital commitments

	As at 31 December 2006 *RMB'000*	**As at 31 December 2005** *RMB'000*
Capital expenditure in respect of acquisition of property, plant and equipment		
– contracted for but not provided for	32,716	15,227
Group's share of capital commitments contracted but not provide for:		
– in joint ventures	–	161,390
– in an associate	919	–
	33,635	176,617

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. The Audit Committee has reviewed the unaudited interim accounts and the audited annual accounts for 2006. Three Audit Committee meetings were held during the financial year.

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 2006 Annual Report.

DIVIDENDS AND CLOSING OF REGISTER OF MEMBERS

The Directors now recommend a final dividend of HK$7.75 cents (2005: HK$4.81 cents) (equivalent to approximately RMB7.79 cents (2005: RMB5.00 cents)) per share payable to shareholders of the Company whose names are on the register of members on Tuesday, 29 May 2007. The final dividend is subject to approval by the shareholders in the forthcoming annual general meeting. The register of members will be closed from Friday, 25 May 2007 to Tuesday, 29 May 2007, 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 4:30 p.m. on Wednesday, 23 May 2007.

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

Hong Kong, 19 April 2007

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

"Please also refer to the published version of this announcement in The Standard."