Management Discussion and Analysis

BUSINESS REVIEW

For the year ended 31 December 2005, Genesis Energy Holdings Limited (the "Company") and its subsidiaries (collectively known as the "Group") recorded a turnover of RMB68.2 million (2004: RMB69.9 million) and loss attributable to shareholders of RMB262.9 million (2004: loss of RMB52.7 million). The turnover, as well as the result attributable to shareholders has substantially decreased as compared with that in 2004.

Oil Transportation Business

The oil pipeline in Xinjiang is operated by our subsidiary Xinjiang Xingmei Oil-pipeline Co. Ltd. ("Xingmei"), which the Group owns as to 80% of its equity interest. The oil pipeline stretches from Tahe Oil Field to Lun Tai railway station with total length of 70 km and a maximum annual transportation capacity of 3.5 million tones. As Tahe Oil Field has been gradually developed and more proven reserves have been found, competition of oil transportation business in Tahe Oil Field became keen. Xingmei used to be the only oil pipeline operator in Tahe Oil Field until late 2003 when China Petroleum and Chemical Corporation ("CPCC") has constructed and operated a new oil pipeline transporting crude oil extracted from Tahe Oil Field. Accordingly, the financial performance of the oil storage and transportation operation in Xinjiang and therefore the Group have been adversely affected. The Company was of the view that there has been a possible breach of the exclusivity agreement in relation to the oil transportation and storage entered into by both parties in 1999 and upon this issue, Xingmei has instituted legal proceeding against CPCC in the PRC seeking damages for the breach of the agreement. Even though possible favourable outcome is predicted by the Group's legal adviser as to PRC law, the Company is of the view that the business of oil transportation has been damaged and has to be restored. Given that CPCC is the sole operator of Tahe Oil Field and the major customer for Xingmei, the Company regards CPCC as a valuable strategic partner for its crude oil pipeline operation and has been trying to resolve the dispute and therefore restores the business relationship with CPCC. In order to stabilize the oil transportation business of the Group and therefore to safeguard the interest of the Company as well as its shareholders, Xingmei entered into a new transportation agreement with CPCC on 5 December 2005. By entering into a new transportation agreement, it will facilitate the settlement of the dispute and symbolize the Group's restoration of business relation with CPCC; further, this could ensure a stable source of revenue and cash flow to the Group. Subsequently, the approval for withdrawal from the pending litigation has been issued by the Supreme Court of China in December 2005. In view of the aforesaid, the Directors consider that the new transportation agreement with CPCC which collectively is in the interest of the Company and its shareholders as a whole.

Management Discussion and Analysis

Natural Gas Pipeline Network

The natural gas pipeline network was operated by our subsidiary Lejion Gas Co. Ltd. ("Lejion"), which the Group owns as to 72% of its equity interest. In view of the gas usage of the residential and commercial users, the operation of piped natural gas network was not expected to produce much contribution to the Group for the year. Therefore, in order to reduce the cashflow pressure and better utilization of limited resources, during the year, Lejion entered into a short term contracting agreement with the local government that the business of sale of piped natural gas were operated by the local government while Lejion could focus its resources to the business of refilling stations which supply natural gas and LPG for vehicle use. This reallocation of resources has brought a significant increase to the sales of natural gas at refilling stations. The sales of natural gas at refilling stations have increased by over 100% comparing with that of 2004. With the foreseeable mounting demand from the food and beverage industry for natural gas, a review of the above-mentioned contracting agreement is undergoing and Lejion is highly likely to cease the contracting agreement with the local government and picking up this operation by mid 2006.

Natural Gas Pipeline

In March 2004, the Group entered into an agreement to acquire effectively 51% equity interest of a jointly controlled entity in Ningxia, the PRC (the "Ningxia JEC"). Ningxia JEC will construct, operate and develop natural gas pipeline running from Qingbian, Shanxi Province to Yinchuan, Ningxia Hui Autonomous Region. The total length of the natural gas pipeline will be 275 kilometres with maximum annual transportation capacity of 2,000 million cubic metres. With reference to our feasibility study, there would be a demand of natural gas of not less than 1,300 million cubic metres to over 2,000 million cubic metres from a major industrial project in the same region which expected to be completed by 2006 or 2007. However, in October 2005, through reliable source from the local government, there could be significant change and uncertainty regarding the plan of the above-mentioned major industrial project. The Group was advised that due to the investors' withdrawal from that major industrial project, the local government may invite other investors to participate in the project or at the worst situation, terminate the entire project. Taking into account of the above factors, the Company, with the advice of an independent valuer, is of the view that it is prudent for the Group to make a full impairment on the Ningxia JEC. In the meantime, the Company will closely monitor the status of this investment, so as to ensure the interest of the Company is properly safeguarded and further, the Company is consulting our legal adviser as to the PRC law for recoverability of this investment.

FINANCIAL REVIEW

Turnover and Loss Attributable to Shareholders

As mentioned above, due to the unsatisfactory result of the oil transportation operation, turnover for the Group for the year ended 31 December 2005 decreased by 2.4% to RMB68.2 million (2004: RMB69.9 million). Turnover was mainly sourced from two different segments, oil transportation and natural gas pipeline network. Oil transportation operation recorded a turnover of RMB44.9 million for the year ended 31 December 2005 (2004: RMB43.7 million) while the natural gas pipeline network business in Korla registered a turnover of RMB23.2 million for the year ended 31 December 2005 (2004: RMB26.2 million).

Management Discussion and Analysis

The result has significantly declined, from a loss attributable to shareholders of RMB52.7 million in 2004 to that of RMB262.9 million. Apart from the loss from operation, this substantial loss was attributable to impairment of fixed assets, land lease prepayments, goodwill, interest in jointly controlled entity and receivables. Details please refer to note 8 to the financial statements.

Liquidity, Financial Resources and Capital Structure

As at 31 December 2005, the net assets of the Group have decreased to RMB141.3 million (31 December 2004: RMB403.2 million) while its total assets were RMB656.1 million (31 December 2004: RMB895.1 million). As at 31 December 2005, the Group's gross borrowings net of cash and bank balances amounted to RMB466.2 million as compared to RMB470.0 million as at 31 December 2004. Gearing ratio based on total assets was 71.1% (31 December 2004: 52.5%). Details of the Group's pledge of assets, the maturity profile of the Group's borrowings are shown in note 25 to the financial statements. The existing projects are financed partly by internal resources and partly by bank financing, with interest calculated by reference to prevailing market rate of Renminbi loan in the PRC. In view of the substantial liquidity problem faced by the Group, with the full support from our joint venture partners, the Group has already initiated discussion with bankers on restructuring the facility. The Board is also committed to reviewing all possible options to provide future cash flow to the Group and will consequently undertake a strategic review of our business. Further, the existing controlling shareholder will provide continuing financial support to the Group whenever it is necessary.

Foreign Exchange Fluctuation

As the business transactions as well as the bank borrowings of the Group are mainly denominated in Renminbi, the Directors consider that foreign exchange exposure does not pose a significant risk given that the exchange rates of these currencies are fairly stable and no hedging measure is currently necessary.

Contingent Liabilities

The contingent liability of the Group as at 31 December 2005 amounted to approximately RMB248 million (2004: Nil).

In accordance with the information available to the Group, this RMB248 million represents two alleged bank loans and interest from two PRC banks borrowed by a former director of the Group, in the name of a subsidiary of the Company, Xinjiang Xingmei Oil-Pipeline Co., Ltd., through alleged fraudulent actions.

The Group's PRC legal adviser is of the opinion that, with reference to the relevant PRC laws, the subsidiary, its immediate holding company and any existing member within the Group will not have any legal and financial obligations relating to these alleged bank loans and alleged interest thereon. The Group's legal adviser to Hong Kong law concurs to this view.

The executive board of directors has also performed a high level review on this PRC subsidiary and all active companies in the Group. Upon completion of this review, no material irregularity has been noted. The executive board of directors has submitted a report to the board of independent non-executive directors with the above finding, together with the legal opinion as to both the PRC and Hong Kong law.

After taking into account the above factors, the independent board of directors has appointed an independent professional firm to perform an overall review of the Group's internal financial control and compliance. Subject to recommendation from the independent board of directors, a special investigation on this isolated event will be performed, if necessary, to ensure the Group's assets and shareholders' interest are well safeguarded.

EMPLOYEES AND REMUNERATION POLICIES

As at 31 December 2005, the Group employed approximately 238 employees. The remuneration policies of the Group are based on the prevailing remuneration level in the market and the performance of respective companies and individual employees.

CHANGE OF CONTROLLING SHAREHOLDER

On 29 August 2005, Hong Chang Group Limited has become the new controlling shareholder of the Group, which own an aggregate of 1,662,795,650 issued shares of the Company, representing approximately 54.85% of total issue share capital of the Company. Details of the transaction have been disclosed in the joint announcement dated 8 September 2005.