

The following is the text of a report, prepared for the purpose of incorporation in this prospectus, from the auditors and reporting accountants of Xinao Gas Holdings Limited, Deloitte Touche Tohmatsu.

德勤·關黃陳方會計師行

Certified Public Accountants
26/F, Wing On Centre
111 Connaught Road Central
Hong Kong

香港中環干諾道中111號
永安中心26樓

**Deloitte
Touche
Tohmatsu**

27 April 2001

The Directors
Xinao Gas Holdings Limited
N M Rothschild & Sons (Hong Kong) Limited

Dear Sirs,

We set out below our report on the financial information regarding Xinao Gas Holdings Limited (the “Company”) and its subsidiaries (hereinafter collectively referred to as the “Group”) for each of the three years ended 31 December 2000 (the “Relevant Periods”) for inclusion in the prospectus of the Company dated 27 April 2001 (the “prospectus”).

The Company was incorporated and registered as an exempted company with limited liability in the Cayman Islands under the Companies Law (2001 Revision) Chapter 22 of the Cayman Islands on 20 July 2000. Through a group reorganisation, as more fully explained in the paragraph headed “Corporate reorganisation” in Appendix V of the prospectus (the “Group Reorganisation”), the Company has since 28 March 2001 become the holding company of the Group which is principally engaged in the investment in, and the operation and management of, gas pipeline infrastructure and the sale and distribution of piped natural gas in the People’s Republic of China (the “PRC”).

As at the date of this report, the particulars of the Company’s subsidiaries, all of which are indirectly held by the Company except for Xinao Gas Investment Group Limited, which is directly held by the Company, are as follows:

Name of company	Place and date of incorporation/ establishment	Issued and fully paid share capital/ registered capital	Proportion of nominal value of issued capital/ registered capital held by the Company	Principal activities
北京新奧燃氣有限公司 (“Beijing Xinao Gas Company Limited”) (Note a)	The PRC 10 September 1999	Registered capital US\$1,195,600	80%	Investment in gas pipeline infrastructure and provision of piped natural gas

Name of company	Place and date of incorporation/ establishment	Issued and fully paid share capital/ registered capital	Proportion of nominal value of issued capital/ registered capital held by the Company	Principal activities
葫蘆島新奧燃氣有限公司 ("Huludao Xinao Gas Company Limited") (Note b)	The PRC 24 December 1999	Registered capital US\$1,207,700	90%	Investment in gas pipeline infrastructure and provision of piped natural gas
廊坊新奧燃氣有限公司 ("Langfang Xinao Gas Company Limited")	The PRC 28 March 1993	Registered capital US\$9,333,900	95%	Investment in gas pipeline infrastructure and provision of piped natural gas
聊城新奧燃氣有限公司 ("Liaocheng Xinao Gas Company Limited") (Note a)	The PRC 11 June 1999	Registered capital RMB16,000,000	90%	Investment in gas pipeline infrastructure and provision of piped natural gas
Xinao Changping Investment Limited	British Virgin Islands 19 December 2000	Share capital US\$1	100%	Investment holding
Xinao Chengyang Investment Limited	British Virgin Islands 15 August 2000	Share capital US\$1	100%	Investment holding
Xinao Gas Investment Group Limited	British Virgin Islands 4 January 2000	Share capital US\$1,000	100%	Investment holding
Xinao Huangdao Investment Limited	British Virgin Islands 19 December 2000	Share capital US\$1	100%	Investment holding
Xinao Huludao Investment Limited	British Virgin Islands 25 May 2000	Share capital US\$1	100%	Investment holding
Xinao Jingzhou Investment Limited	British Virgin Islands 15 August 2000	Share capital US\$1	100%	Investment holding
Xinao Langfang Investment Limited	British Virgin Islands 21 February 2000	Share capital US\$1,000	100%	Investment holding
Xinao Liaocheng Investment Limited	British Virgin Islands 26 April 2000	Share capital US\$1	100%	Investment holding

Name of company	Place and date of incorporation/ establishment	Issued and fully paid share capital/ registered capital	Proportion of nominal value of issued capital/ registered capital held by the Company	Principal activities
Xinao Miyun Investment Limited	British Virgin Islands 26 April 2000	Share capital US\$1	100%	Investment holding
Xinao Pinggu Investment Limited	British Virgin Islands 19 December 2000	Share capital US\$1	100%	Investment holding
Xinao Zhucheng Investment Limited	British Virgin Islands 10 August 2000	Share capital US\$1	100%	Investment holding

Notes:

- (a) Beijing Xinao Gas Company Limited and Liaocheng Xinao Gas Company Limited were converted into Sino-foreign equity joint ventures on 8 August 2000 with terms of 30 years.
- (b) Huludao Xinao Gas Company Limited was converted into a Sino-foreign equity joint venture on 7 August 2000 with a term of 30 years.

Langfang Xinao Gas Company Limited is a Sino-foreign equity joint venture established in the PRC on 28 March 1993. Prior to the Group Reorganisation, it was owned as to approximately 19.63 per cent. by 廊坊市天然氣有限公司 (“Langfang City Natural Gas Company Limited”), approximately 30.37 per cent. by Newstar Australia Pty. Ltd. and 50 per cent. by 新奧集團股份有限公司 (“Xinao Group Company Limited”), all of which are companies controlled by Mr. Wang Yusuo (“Mr. Wang”) or Ms. Zhao Baoju (“Ms. Zhao”). Since Mr. Wang indirectly owned an approximate 93.2 per cent. and an approximate 50.7 per cent. equity interests in Langfang City Natural Gas Company Limited and Xinao Group Company Limited respectively and Ms. Zhao owned the entire equity interest in Newstar Australia Pty. Ltd., Mr. Wang and Ms. Zhao jointly owned an approximate 74 per cent. effective equity interest in Langfang Xinao Gas Company Limited. Upon completion of the Group Reorganisation, Langfang Xinao Gas Company Limited became a 95 per cent. owned subsidiary of the Company, of which an approximate 69 per cent. effective equity interest was contributed by Mr. Wang and Ms. Zhao and the balance of an approximate 26 per cent. equity interest was acquired by the Group.

On 30 July 2000, the Group acquired an 80 per cent. equity interest in Beijing Xinao Gas Company Limited from Xinao Group Company Limited. On 3 August 2000, the Group acquired a 90 per cent. equity interest in Huludao Xinao Gas Company Limited from Xinao Group Company Limited. On 7 August 2000, the Group acquired a 90 per cent. equity interest in Liaocheng Xinao Company Limited from Xinao Group Company Limited.

The Company, Xinao Changping Investment Limited, Xinao Chengyang Investment Limited, Xinao Huangdao Investment Limited, Xinao Jingzhou Investment Limited, Xinao Pinggu Investment Limited and Xinao Zhucheng Investment Limited have not produced any audited financial statements since their respective dates of incorporation as these companies have not carried on any business, except for the transactions relating to the Group Reorganisation.

For the companies registered and operating in the PRC, statutory financial statements were prepared in accordance with the relevant accounting principles and financial regulations applicable to enterprises established in the PRC. The statutory auditors of Langfang Xinao Gas Company Limited are 廊坊會計師事務所 for the year ended 31 December 1998 and 廊坊益華會計師事務所有限公司 for the years ended 31 December 1999 and 2000. The statutory auditors of Beijing Xinao Gas Company Limited, Huludao Xinao Gas Company Limited and Liaocheng Xinao Gas Company Limited are 北京達州會計師事務所, 葫蘆島渤海會計師事務所 and 聊城正坤有限責任會計師事務所 for the year ended 31 December 2000, respectively. For all other companies incorporated in the British Virgin Islands, they were not required to have their financial statements audited by independent auditors. For the purpose of this report, we have undertaken our own independent audit of the management accounts of these companies for each of the three years ended 31 December 2000 (the "Relevant Periods"), or since their respective dates of incorporation/establishment where this is a shorter period, which are prepared under accounting principles generally accepted in Hong Kong, in accordance with the Auditing Standards issued by the Hong Kong Society of Accountants, and we have carried out such additional procedures as we consider necessary in accordance with the Auditing Guideline "Prospectuses and the Reporting Accountant" as recommended by the Hong Kong Society of Accountants.

The summaries of the combined results of the Group for the Relevant Periods and of the combined net tangible assets of the Group as at 31 December 2000 (the "Summaries") set out in this report have been prepared based on the audited financial statements or, where appropriate, management accounts of the companies now comprising the Group, on the basis set out in section 1 below. The directors of the respective companies of the Group are responsible for the preparation of these financial statements and management accounts which give a true and fair view.

The directors of the Company are responsible for the contents of the prospectus in which this report is included. It is our responsibility to form an independent opinion on the Summaries and to report our opinion to you.

In our opinion, on the basis of presentation set out in section 1 below, the Summaries together with the notes thereon give, for the purpose of this report, a true and fair view of the combined results of the Group for each of the three years ended 31 December 2000 and of the combined net tangible assets of the Group as at 31 December 2000.

1. BASIS OF PRESENTATION

The summary of the combined results of the Group for each of the three years ended 31 December 2000 includes the results of the companies comprising the Group for the periods under review as if the Group's equity interest in Langfang Xinao Gas Company Limited contributed by Mr. Wang and Ms. Zhao had been in existence since 1 January 1998 and throughout the Relevant Periods. Although the transfer of the 69 per cent. interest in Langfang Xinao Gas Company Limited indirectly owned by Mr. Wang and Ms. Zhao involved cash consideration, the consideration was funded by an advance from a company owned by Mr. Wang and Ms. Zhao and subsequently the advance was capitalised for shares of the Company. Accordingly, the transfer is in substance a share for share exchange. For the additional approximate 26 per cent. equity interest in Langfang Xinao Gas Company Limited and the equity interests in Beijing Xinao Gas Company Limited, Huludao Xinao Gas Company Limited and Liaocheng Xinao Gas Company Limited acquired by the Group during the Relevant Periods, these acquisitions have been accounted for using the acquisition method of accounting and their results are included from the effective dates of acquisition.

The summary of the combined net tangible assets of the Group as at 31 December 2000 has been prepared to present the assets and liabilities of the Group at that date.

The financial information is based on the audited financial statements and management accounts of each company in the Group.

The financial information has been prepared on a going concern basis as an amount due to Easywin Enterprises Limited, the Company's ultimate holding company, of RMB81,374,000 had been fully capitalised and the Group had obtained confirmations from certain of its bankers for the renewal of its existing banking facilities amounting to RMB74,800,000 subsequent to 31 December 2000. Details of the capitalisation are set out in section 9 below.

All significant intra-group transactions and balances have been eliminated on combination.

2. PRINCIPAL ACCOUNTING POLICIES

The financial information set out in this report has been prepared under the historical cost convention. The principal accounting policies adopted, which are in accordance with accounting principles generally accepted in Hong Kong, are as follows:

Goodwill

Goodwill arising on acquisition of a subsidiary or business which represents the excess of the purchase consideration over the Group's share of the fair value ascribed to the separable net assets at the date of acquisition of a subsidiary or business is written off to reserves immediately on acquisition. Negative goodwill, which represents the excess of the Group's share of the fair value ascribed to the separable net assets at the date of acquisition over the purchase consideration, is credited to reserves.

On disposal of a subsidiary or business, the attributable amount of goodwill previously eliminated against or credited to reserves is included in the determination of the profit or loss on disposal of the subsidiary or business.

Revenue recognition

Gas connection revenue is recognised when the outcome of a gas connection contract can be estimated reliably and the stage of completion at the balance sheet date can be measured reliably. Revenue from gas connection contracts is recognised on the percentage of completion method, measured by reference to the value of work carried out during the period. When the outcome of a gas connection contract cannot be estimated reliably, revenue is recognised only to the extent of contract cost incurred that it is probable to be recoverable.

Sales of piped natural gas and gas appliances are recognised when goods are delivered and title has been passed.

Interest income is accrued on a time basis by reference to the principal outstanding and at the interest rate applicable.

Property, plant and equipment

Property, plant and equipment other than construction in progress are stated at cost less depreciation and amortisation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its present working condition and location for its intended use. Expenditure incurred after the asset has been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the

expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalised as an additional cost of the asset.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the income statement.

Where the recoverable amount of an asset has declined below its carrying amount, the carrying amount is reduced to reflect the decline in value. In determining the recoverable amount of assets, expected future cash flows are not discounted to their present values.

Depreciation and amortisation are provided to write off the cost of each asset other than construction in progress, over its estimated useful life, and after taking into account its estimated residual value, using the straight line method, as follows:

Land use rights	Over the shorter of the term of the lease or the operation period of the relevant company
Buildings	Over the shorter of 30 years or the operation period of the relevant company
Pipelines	Over the shorter of 30 years or the operation period of the relevant company
Machinery and equipment	10 years
Motor vehicles	6 years
Office equipment	6 years

Construction in progress

Construction in progress represents machinery and pipelines under construction and is stated at cost. Cost comprises direct and indirect costs of acquisition or construction. Completed items are transferred from construction in progress to proper categories of property, plant and equipment when they are ready for their intended use.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of those assets which necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the assets. Capitalisation of such borrowing costs ceases when these qualifying assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalised.

All other borrowing costs are recognised as an expense in the period in which they are incurred.

Inventories

Inventories, including construction materials, gas appliances and piped natural gas for sales, consumables and spare parts are stated at the lower of cost and net realisable value. Cost which comprises all costs of purchase and, where applicable, costs of conversion and other costs that have been incurred in bringing the inventories to their present location and condition is calculated using the weighted average method. Net realisable value is based on estimated selling prices in the ordinary course of business less estimated costs to completion and the estimated costs necessary to make the sale.

Construction contracts

When the outcome of a construction contract can be estimated reliably and the stage of contract completion at the balance sheet date can be measured reliably, contract costs are charged to the income statement by reference to the stage of completion of the contract activity at the balance sheet date on the same basis as contract revenue is recognised.

When the outcome of a construction contract cannot be estimated reliably, contract costs are recognised as an expense in the period in which they are incurred. When it is probable that total contract costs will exceed contract revenue, the expected loss is recognised as an expense immediately.

Research and development costs

Research costs are recognised as an expense in the year in which they are incurred. Expenditure on development is charged to the income statement in the year in which it is incurred except where a clearly defined project is undertaken and it is reasonably anticipated that development costs will generate future economic benefits. Such development costs are deferred and written off over the life of the project from the date of commencement of commercial operations.

Taxation

The charge for taxation is based on the results for the year after adjusting for items which are non-assessable or disallowed. Certain items of income and expense are recognised for tax purposes in a different accounting period from that in which they are recognised in the financial statements. The tax effect of the resulting timing differences, computed under the liability method, is recognised as deferred taxation in the financial statements to the extent that it is probable that a liability or asset will crystallise in the foreseeable future.

Foreign currencies

The subsidiaries in the PRC and the British Virgin Islands maintain their books and records in Renminbi ("RMB"). Transactions denominated in currencies other than RMB are translated into RMB at the applicable rates of exchange quoted by The People's Bank of China ("PBOC") prevailing at the dates of the transactions. Monetary assets and liabilities denominated in other currencies are re-translated into RMB at the applicable PBOC rates in effect at the year end dates. Gains and losses arising on exchange are dealt with in the income statement.

Retirement benefit scheme contribution

The retirement benefit scheme contribution charged to the income statement represents the Group's contribution payable to the retirement funds scheme managed by the local social security bureau in accordance with the PRC Government regulations.

Operating leases

Rentals payable under operating leases are charged to the income statement on a straight line basis over the relevant lease terms.

3. RESULTS

The following is a summary of the combined results of the Group for the Relevant Periods prepared on the basis set out in section 1 above:

	<i>Notes</i>	1998 <i>RMB'000</i>	1999 <i>RMB'000</i>	2000 <i>RMB'000</i>
Turnover	(a)	41,109	52,923	122,270
Cost of sales		<u>(18,327)</u>	<u>(23,492)</u>	<u>(58,362)</u>
Gross profit		22,782	29,431	63,908
Other revenues		324	793	945
Tax refund	(b)	–	2,656	5,180
Selling expenses		(222)	(273)	(2,041)
Administrative expenses		(3,449)	(3,690)	(9,153)
Other operating expenses		<u>(656)</u>	<u>(45)</u>	<u>(357)</u>
Profit from operations	(c)	18,779	28,872	58,482
Interest expense	(d)	<u>(2,957)</u>	<u>(3,300)</u>	<u>(8,112)</u>
Profit before taxation		15,822	25,572	50,370
Taxation	(e)	<u>(2,373)</u>	<u>(3,836)</u>	<u>(6,976)</u>
Profit before minority interests		13,449	21,736	43,394
Minority interests		<u>(4,117)</u>	<u>(6,653)</u>	<u>(6,018)</u>
Profit for the year		<u>9,332</u>	<u>15,083</u>	<u>37,376</u>
Dividends	(f)	<u>–</u>	<u>–</u>	<u>30,529</u>

Notes:

(a) Turnover

Turnover comprises the following:

	1998 RMB'000	1999 RMB'000	2000 RMB'000
Gas connection fees	31,941	38,508	101,282
Sales of piped natural gas	9,045	14,342	20,517
Sales of gas appliances	123	73	471
	<u>41,109</u>	<u>52,923</u>	<u>122,270</u>

(b) Tax refund

The amount for the year ended 31 December 1999 represented a refund of sales tax. On 1 January 1994, the PRC Government abolished the Commercial and Industrial Consolidated Tax ("CICT") and introduced a new system of indirect taxes including value-added tax, business tax and consumption tax. Pursuant to relevant tax regulations, foreign enterprises established before 31 December 1993 may, upon approval by tax authorities, be entitled to a refund of the excess sales tax paid under the new tax legislation over the amount calculated under CICT rules for a period of five years from 1 January 1994 to 31 December 1998 (the "Eligible Periods"). Under the new tax legislation, Langfang Xinao Gas Company Limited, a subsidiary of the Company, was subject to higher net sales tax payable when compared with sales tax calculated under CICT rules for the Eligible Periods. The tax refunds obtained by Langfang Xinao Gas Company Limited of the excess sales tax paid over the CICT that would otherwise be payable under the relevant tax rules were recorded in the year when the approval by tax authorities was obtained.

During the year ended 31 December 2000, Langfang Xinao Gas Company Limited applied for a refund of part of the income tax paid for the two years ended 31 December 1999 as an incentive for investment in Langfang, amounting to approximately RMB5,180,000. The application was approved by 廊坊經濟技術開發區財政局 ("Finance Department of Langfang Economic and Technical Development Zone") in December 2000 and was recorded in the year when the approval was obtained. The amount of refund was received in January 2001. In the opinion of the directors, this refund was non-recurring and the amount was determined on a negotiation basis.

(c) Profit from operations

	1998 RMB'000	1999 RMB'000	2000 RMB'000
Profit from operations has been arrived at after charging:			
Auditors' remuneration	10	20	15
Depreciation and amortisation of property, plant and equipment	2,932	3,977	10,367
Loss on disposal of property, plant and equipment	542	34	2,159
Operating lease rentals in respect of land and buildings	107	93	481
Research and development expenses	-	-	762
Retirement benefits scheme contributions	149	275	377
Other staff costs	919	1,676	4,880
	<u>1,068</u>	<u>1,951</u>	<u>5,257</u>
Total staff costs	1,068	1,951	5,257
Less: Amount capitalised under construction in progress	<u>-</u>	<u>(490)</u>	<u>(451)</u>
	<u>1,068</u>	<u>1,461</u>	<u>4,806</u>
and after crediting:			
Interest income	<u>36</u>	<u>28</u>	<u>202</u>

(d) Interest expense

	1998 <i>RMB'000</i>	1999 <i>RMB'000</i>	2000 <i>RMB'000</i>
Interest on bank loans wholly repayable within five years	3,033	3,358	8,386
<i>Less: Amount capitalised under construction in progress</i>	<u>(76)</u>	<u>(58)</u>	<u>(274)</u>
	<u><u>2,957</u></u>	<u><u>3,300</u></u>	<u><u>8,112</u></u>

The annual capitalisation rates used to determine the amount of borrowing costs eligible for capitalisation are 7.42 per cent., 9.40 per cent. and 6.34 per cent. for the years ended 31 December 1998, 1999 and 2000, respectively.

(e) Taxation

The charge represents PRC enterprise income tax for the Relevant Periods.

Pursuant to the relevant laws and regulations in the PRC, all the Group's PRC subsidiaries are entitled to exemption from PRC enterprise income tax for the first two years commencing from their first profit-making year of operation and thereafter, these PRC subsidiaries will be entitled to a 50% relief from PRC enterprise income tax for the following three years. The reduced tax rate for the relief period is 15%. The charge of PRC enterprise income tax for the Relevant Periods has been provided for after taking these tax incentives into account.

There was no significant unprovided deferred taxation during the Relevant Periods.

(f) Dividends

No dividends have been paid or declared by the Company since the date of its incorporation. However, during the year ended 31 December 2000, Langfang Xinao Gas Company Limited declared a dividend of RMB44,000,000 to its then shareholders, of which approximately RMB30,529,000 was paid in respect of the approximate 69 per cent. equity interest contributed by Mr. Wang and Ms. Zhao.

The rates of dividend and the number of shares ranking for dividends are not presented as such information is not considered meaningful having regard to the purpose of this report.

(g) Earnings per share

No earnings per share is presented as its inclusion, for the purpose of this report, is not considered meaningful.

(h) Remuneration of directors and highest paid employees

No remuneration was paid or payable to any directors of the Company during the Relevant Periods.

The emoluments of the five highest paid employees of the Group for the Relevant Periods were as follows:

	1998 <i>RMB'000</i>	1999 <i>RMB'000</i>	2000 <i>RMB'000</i>
Basic salaries and allowances	78	86	141
Retirement benefits scheme contributions	<u>3</u>	<u>6</u>	<u>6</u>
	<u><u>81</u></u>	<u><u>92</u></u>	<u><u>147</u></u>

The emoluments of each of the above employees did not exceed RMB1,000,000 during the Relevant Periods.

During the Relevant Periods, no emoluments were paid by the Group to the five highest paid individuals (including directors and employees) as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors waived any emoluments during the Relevant Periods.

(i) Retirement benefits schemes

According to the relevant laws and regulations in the PRC, the PRC subsidiaries are required to contribute a certain percentage of the payroll of their employees to the retirement benefits schemes to fund the retirement benefits of their employees. The only obligation of the Group with respect to the retirement benefits schemes is to make the required contributions under the respective schemes. During the Relevant Periods, there were no forfeited contributions, which arose upon employees leaving the retirement benefits schemes, available to reduce the contribution payable in the future periods.

(j) Transfer to or from reserves

	1998 RMB'000	1999 RMB'000	2000 RMB'000
Goodwill reserve			
Balance brought forward	–	–	–
Negative goodwill arising on acquisition of businesses and subsidiaries	–	–	5,590
	<u>–</u>	<u>–</u>	<u>5,590</u>
Balance carried forward	<u>–</u>	<u>–</u>	<u>5,590</u>

Other than the above, there were no movements in reserves during the Relevant Periods.

(k) Related party transactions

During the Relevant Periods, the Group had the following significant transactions with the following related parties in which Mr. Wang has an interest.

Name of related party	Nature of transaction	1998 RMB'000	1999 RMB'000	2000 RMB'000
廊坊新城房地產開發有限公司 ("Langfang Xincheng Property Development Company Limited")	Provision of gas connection services by the Group (Notes i and iv)	2,038	3,440	11,360
	Acquisition of land and buildings by the Group (Note iii)	–	–	7,600
廊坊新奧酒店管理有限公司 ("Langfang Xinao Hotel Management Company Limited")	Provision of gas connection services by the Group (Notes i and iv)	–	–	453
	Sales of piped natural gas by the Group (Notes ii and iv)	–	–	125
廊坊新奧物業管理有限公司 ("Langfang Xinao Property Management Company Limited")	Provision of gas connection services by the Group (Notes i and iv)	–	–	82
	Sales of piped natural gas by the Group (Notes ii and iv)	2,220	4,909	3,927
新奧集團太陽能有限公司 ("Xinao Group Solar Energy Company Limited")	Sales of piped natural gas by the Group (Notes ii and iv)	25	52	81
Langfang City Natural Gas Company Limited	Acquisition of land and buildings by the Group (Note iii)	–	11,152	540
	Acquisition of pipelines and related facilities by the Group (Note iii)	–	–	27,431

APPENDIX I**ACCOUNTANTS' REPORT FOR THE COMPANY**

Name of related party	Nature of transaction	1998	1999	2000
		RMB'000	RMB'000	RMB'000
Xinao Group Company Limited	Sales of piped natural gas by the Group (<i>Notes ii and iv</i>)	271	475	525
	Acquisition of land and buildings by the Group (<i>Note iii</i>)	<u>–</u>	<u>–</u>	<u>47,900</u>

Notes:

- (i) The provision of gas connection services was charged in accordance with rates agreed between the Group and the related parties by reference to the Group's similar transactions with outside customers.
- (ii) The sales of piped natural gas were charged in accordance with rates agreed between the Group and the related parties by reference to the Group's similar transactions with outside customers.
- (iii) The consideration for the acquisition of property, plant and equipment from the related parties during the year ended 31 December 2000 was determined by reference to valuations made by independent valuers and during the year ended 31 December 1999 was determined at amounts mutually agreed by parties involved.
- (iv) These transactions will continue after the listing of the Company's shares on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited ("GEM").

Certain of the Group's bank loans were guaranteed by certain related companies controlled by Mr. Wang. The Group has been in the process of negotiation with its bankers to release these guarantees following the listing of the Company's shares on GEM.

In the opinion of the directors of the Company, all of the above-mentioned transactions were entered into in the ordinary course of business of the Group.

APPENDIX I	ACCOUNTANTS' REPORT FOR THE COMPANY
-------------------	--

4. NET TANGIBLE ASSETS

The following is a summary of the combined net tangible assets of the Group as at 31 December 2000 prepared on the basis set out in section 1 above:

	<i>Notes</i>	<i>RMB'000</i>	<i>RMB'000</i>
Non-current assets			
Property, plant and equipment	<i>(a)</i>		260,999
Current assets			
Inventories	<i>(b)</i>	12,903	
Trade and other receivables		21,589	
Amounts due from customers for contract work	<i>(c)</i>	22,134	
Amounts due from related companies	<i>(d)</i>	74,548	
Amount due from ultimate holding company	<i>(e)</i>	3,492	
Bank balances and cash		39,366	
		174,032	
Current liabilities			
Trade and other payables		61,472	
Amounts due to customers for contract work	<i>(c)</i>	5,505	
Amount due to ultimate holding company	<i>(e)</i>	81,374	
Amounts due to related companies	<i>(f)</i>	90,482	
Dividend payable to minority shareholder of a subsidiary		1,625	
Taxation payable		6,657	
Bank loans – due within one year	<i>(g)</i>	87,392	
		334,507	
Net current liabilities			(160,475)
Total assets less current liabilities			100,524
Non-current liabilities			
Bank loans – due after one year	<i>(g)</i>		20,915
Minority interests			9,779
Net tangible assets			69,830

APPENDIX I	ACCOUNTANTS' REPORT FOR THE COMPANY
-------------------	--

Notes:

(a) Property, plant and equipment

	Cost <i>RMB'000</i>	Accumulated depreciation and amortisation <i>RMB'000</i>	Net book value <i>RMB'000</i>
Land and buildings	85,986	4,010	81,976
Pipelines	153,545	13,353	140,192
Machinery and equipment	15,902	501	15,401
Motor vehicles	10,272	2,281	7,991
Office equipment	2,243	478	1,765
Construction in progress	13,674	–	13,674
	<u>281,622</u>	<u>20,623</u>	<u>260,999</u>

The land and buildings were situated in the PRC with medium term land use rights.

At 31 December 2000, construction in progress included interest capitalised of RMB274,000.

(b) Inventories

	<i>RMB'000</i>
Construction materials	10,988
Gas appliances for sales	1,534
Piped natural gas	169
Spare parts and consumables	212
	<u>12,903</u>

At 31 December 2000, all inventories of the Group were stated at cost.

(c) Amounts due from (to) customers for contract work

	<i>RMB'000</i>
Contract costs incurred plus recognised profits less recognised losses	109,010
Less: Progress billings	(92,381)
	<u>16,629</u>
Analysed for reporting purposes as:	
Amounts due from customers for contract work	22,134
Amounts due to customers for contract work	(5,505)
	<u>16,629</u>

At 31 December 2000, advances received from customers for contract work amounted to RMB4,682,000.

(d) Amounts due from related companies

Particulars of the amounts due from related companies are as follows:

Name of company	At 31 December 2000 RMB'000	At 1 January 2000 RMB'000	Maximum amount outstanding during the year RMB'000
Langfang City Natural Gas Company Limited 廊坊開發區市政建設工程有限公司 ("Langfang Development Zone Urban Construction Engineering Company Limited")	29,876	1,487	29,876
Newstar Australia Pty. Ltd.	20,400	–	20,400
Langfang Xinao Property Management Company Limited 廊坊新奧建築安裝工程有限公司 ("Langfang Xinao Construction and Decoration Engineering Company Limited")	17,253	–	17,253
北京市密雲化工公司 ("Beijing City Miyun Chemicals Company")	2,745	9,743	9,743
新奧集團石家莊化工機械股份有限公司 ("Xinao Group Shijiazong Chemical and Machinery Company Limited")	2,000	–	2,000
北京新奧京昌燃氣有限公司 ("Beijing Xinao Jingchang Gas Company Limited")	1,445	–	1,445
Langfang Xinao Hotel Management Company Limited	322	–	322
Xinao Group Solar Energy Company Limited 北京新奧京谷燃氣有限公司 ("Beijing Xinao Jinggu Gas Company Limited")	202	–	202
青島新奧燃氣有限公司 ("Qingdao Xinao Gas Company Limited")	136	–	136
Xinao Group Company Limited 廊坊新奧化工有限公司 ("Langfang Xinao Chemicals Company Limited")	100	2,180	3,009
Beijing Xinao Gas Company Limited	58	–	95
Huludao Xinao Gas Company Limited 廊坊開發區新奧洗衣有限責任公司 ("Langfang Development Zone Xinao Laundry Limited Liability Company")	10	–	10
	1	134,278	134,278
	–	3,299	6,686
	–	2,848	2,848
	–	1,820	2,005
	–	266	266
	<u>74,548</u>	<u>155,921</u>	

All the above related companies are controlled by Mr. Wang except for Beijing City Miyun Chemicals Company, which is the minority shareholder of Beijing Xinao Gas Company Limited, and Newstar Australia Pty. Ltd. which is controlled by Ms. Zhao.

The amounts arose from trading transactions and advances by the Group to these related companies.

The amounts were unsecured and interest free. Other than the amounts due from Beijing City Miyun Chemicals Company, Beijing Xinao Jingchang Gas Company Limited, Beijing Xinao Jinggu Gas Company Limited and Qingdao Xinao Gas Company Limited, the remaining balances were fully settled subsequent to 31 December 2000.

(e) Amounts due from/to ultimate holding company

The amounts were unsecured and interest free. The amount due from ultimate holding company was fully settled subsequent to 31 December 2000. The amount due to the ultimate holding company was fully capitalised subsequent to 31 December 2000. Details of the capitalisation are set out in section 9 below.

(f) Amounts due to related companies

Particulars of the amounts due to related companies are as follows:

Name of company	<i>RMB'000</i>
Xinao Group Company Limited	73,176
Langfang Xincheng Property Development Company Limited	10,346
Langfang Development Zone Urban Construction Engineering Company Limited	4,000
Beijing Xinao Jinggu Gas Company Limited	1,312
Langfang City Natural Gas Company Limited	1,023
Xinao Group Solar Energy Company Limited	503
Langfang Xinao Construction and Decoration Engineering Company Limited	122
	<u>90,482</u>

All the above related companies are controlled by Mr. Wang. The amounts due to related companies arose from acquisition of certain property, plant and equipment, dividend payable and advances to the Group. The amounts were unsecured and interest free. Other than the amount due to Beijing Xinao Jinggu Gas Company Limited, the remaining balances were fully settled subsequent to 31 December 2000.

(g) Bank loans

	<i>RMB'000</i>
Secured bank loans	51,507
Unsecured bank loans	56,800
	<u>108,307</u>

The bank loans are repayable:

Within one year	87,392
In one to two years	20,210
In two to five years	705
	<u>108,307</u>
<i>Less: Amount due within one year shown under current liabilities</i>	<u>(87,392)</u>
Amount due after one year	<u>20,915</u>

(h) Operating lease commitments

At 31 December 2000, the Group had outstanding annual commitments payable in the following year under non-cancellable operating leases in respect of land and buildings as follows:

	<i>RMB'000</i>
Operating leases which expire:	
Within one year	34
In the second to fifth year inclusive	515
	<u>549</u>

(i) Capital commitments

At 31 December 2000, the Group had commitments of approximately RMB3,311,000 relating to the acquisition of property, plant and equipment which was contracted for but not provided in the Summaries.

(j) Pledge of assets

At 31 December 2000, certain of the Group's property, plant and equipment with an aggregate net book value of approximately RMB130,235,000 were pledged to banks for the bank loans granted to the Group.

5. DISTRIBUTABLE RESERVES

At 31 December 2000, the Company had no reserve available for distribution to its shareholders at that date.

6. NET TANGIBLE ASSETS OF THE COMPANY

The Company was incorporated on 20 July 2000. At 31 December 2000, the Company did not have significant net tangible assets.

On the basis set out in section 1 above, the net tangible assets of the Company as at 31 December 2000 were approximately RMB69,830,000.

7. DIRECTORS' REMUNERATION

Save as disclosed herein, no remuneration has been paid or is payable by the Company or any of its subsidiaries to the directors in respect of the Relevant Periods.

Under the arrangement currently in force, the aggregate remuneration of the directors of the Company for the year ending 31 December 2001 is expected to be approximately HK\$3.3 million (excluding any management bonus which may be paid).

8. ULTIMATE HOLDING COMPANY

The directors of the Company consider Easywin Enterprises Limited, a company which is incorporated in the British Virgin Islands, to be the ultimate holding company of the Company.

9. SUBSEQUENT EVENTS

The following transactions took place subsequent to 31 December 2000:

- (a) On 31 January 2001, certain subsidiaries of the Company entered into conditional acquisition agreements with Xinao Group Company Limited to acquire an 80 per cent. interest in 北京新奧京昌燃氣有限公司 ("Beijing Xinao Jingchang Gas Company Limited"), a 70 per cent. interest in 北京新奧京谷燃氣有限公司 ("Beijing Xinao Jinggu Gas Company Limited") and a 90 per cent. interest in 青島新奧燃氣有限公司 ("Qingdao Xinao Gas Company Limited") (the "Acquisition Companies") at an aggregate consideration of RMB32,850,000, which represents the capital contribution made by Xinao Group Company Limited in these Acquisition Companies. The completion of each acquisition agreement is conditional on all necessary approvals being obtained in relation to the transfer of interest and the conversion of the relevant Acquisition Company into a Sino-foreign equity joint venture.

All of them are engaged in the sales of piped natural gas, gas pipeline investment and provision of connection services.

Beijing Xinao Jingchang Gas Company Limited was established as a PRC joint venture and commenced business on 16 November 2000. As at 31 January 2001, the registered capital of Beijing Xinao Jingchang Gas Company Limited was RMB9,900,000, of which RMB7,920,000 was contributed by Xinao Group Company Limited.

Beijing Xinao Jinggu Gas Company Limited was established as a PRC joint venture and commenced business on 11 August 2000. As at 31 January 2001, the registered capital of Beijing Xinao Jinggu Gas Company Limited was RMB9,900,000, of which RMB6,930,000 was contributed by Xinao Group Company Limited.

Qingdao Xinao Gas Company Limited was established as a PRC joint venture and commenced business on 30 October 2000. At 31 January 2001, the registered capital of Qingdao Xinao Gas Company Limited was RMB20,000,000, of which RMB18,000,000 was contributed by Xinao Group Company Limited.

- (b) Certain subsidiaries of the Company entered into agreements for the establishment of three Sino-foreign equity joint ventures, i.e., 荊州新奧燃氣有限公司 (“Jingzhou Xinao Gas Company Limited”), 城陽新奧燃氣有限公司 (“Chengyang Xinao Gas Company Limited”) and 諸城新奧燃氣有限公司 (“Zhucheng Xinao Gas Company Limited”). Details of these companies are set out in the paragraph headed “Particulars of the New Project Companies” in Appendix V to the prospectus.
- (c) In preparation of the listing of the Company’s shares on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited, the companies comprising the Group underwent a reorganisation to rationalise the group structure. As a result of the reorganisation, the Company became the holding company of the Group on 28 March 2001. The details of this reorganisation and other changes, including the capitalisation of an amount of RMB81,374,000 due to Easywin Enterprises Limited, are set out in the paragraph headed “Corporate reorganisation” in Appendix V to the prospectus.

10. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements of the Group, the Company or any of its subsidiaries have been prepared in respect of any period subsequent to 31 December 2000.

11. OTHER SUPPLEMENTARY INFORMATION

During the Relevant Periods, there were certain costs, details of which are set out in notes (i) and (ii) below, which were attributable to the activities of the Group but were not reflected in the Group's combined results set out in section 3 above. Had these costs been incurred by the Group during the Relevant Periods, the combined results would have been adjusted as follows:

	1998 RMB'000	1999 RMB'000	2000 RMB'000
Profit for the year	9,332	15,083	37,376
Notional adjustments:			
Staff costs attributable to the activities of the Group incurred by Xinao Group Company Limited (<i>Note i</i>)	(282)	(417)	(818)
Rental and building management expenses for certain premises (<i>Note ii</i>)	–	(738)	(836)
Rental income for certain staff quarters and office premises (<i>Note iii</i>)	–	221	912
Tax effect on the above notional adjustments	42	140	111
Profit for the year after notional adjustments	<u>9,092</u>	<u>14,289</u>	<u>36,745</u>

Notes:

- (i) Xinao Group Company Limited is a private limited company established in the PRC. It is controlled by Mr. Wang and was previously a shareholder of Langfang Xinao Gas Company Limited. During the Relevant Periods, certain employees of the Group were employed under Xinao Group Company Limited. These employees were engaged in the activities of the Group and were transferred to the Group on 1 January 2001.
- (ii) During the Relevant Periods, Langfang Xincheng Property Development Limited and Langfang Xinao Property Management Company Limited provided certain premises to the Group for its use free of charge. A notional amount of rental charge and building management fee was calculated with reference to the actual facilities utilised by the Group and included in the above to reflect the results of the Group on a comparable basis.
- (iii) During the Relevant Periods, the Group provided certain of the staff quarters and office premises free of charge to Xinao Group Company Limited and Langfang Xinao Property Management Company Limited. A notional amount of rental income was calculated with reference to the actual facilities utilised and included in the above to reflect the results of the Group on a comparable basis.

Yours faithfully,
Deloitte Touche Tohmatsu
Certified Public Accountants
 Hong Kong