

THE GROUP'S BUSINESS

INTRODUCTION

The Company was incorporated in the Cayman Islands on 20 July 2000. Following completion of the Reorganisation, the Company became the holding company of the Group and upon completion of the acquisition of the Acquisition Companies and the establishment of the New Project Companies, the Company will become the holding company of the Enlarged Group. For the details of the Reorganisation, please refer to the section headed "Corporate reorganisation" in Appendix V to this prospectus.

Following the Reorganisation and immediately after completion of the Placing, the Founders will indirectly hold 70% of the enlarged share capital of the Company before the exercise of the Over-allotment Option.

The principal business of the Group is the investment in, and the operation and management of, gas pipeline infrastructure and the sale and distribution of piped gas in the PRC. The Group's business activities also consist of the sale of gas appliances and equipment and the provision of repair, maintenance and other services in connection with gas supply.

PRINCIPAL STRENGTHS OF THE GROUP

- **The Group is one of the first non state-owned piped gas distributors in the PRC and has an experienced management and operational team.** The Company's management and operational team has extensive experience in numerous aspects of the natural gas industry such as business operations, technical know-how and sales and marketing. The management and operational team also has strong contacts with local and provincial governmental departments and authorities, which can assist in obtaining first hand information on the latest developments of the natural gas industry in the PRC. Each Project Company employs staff who have a thorough understanding of the local business environment. Such local expertise is particularly useful in the Group's business development. The local management teams of the Project Companies, under the supervision of the Group, jointly formulate business development and marketing plans suitable for the relevant Operational Locations.
- **The Group has a clear focus in the piped gas business and benefits from favourable governmental policies, in particular, those encouraging the use of natural gas and promoting environmental protection.** In view of growing environmental concerns in the PRC, the PRC Government is highly supportive of businesses which contribute to environmental protection and is keen to promote the use of natural gas as one of the most environmentally friendly and cheap fuel sources. The Group is, therefore, able to benefit from favorable governmental policies, in particular, those encouraging the use of natural gas such as requiring the installation of gas connections in new buildings and banning the use of other less environmentally friendly fuel products such as coal within a specified period of time.
- **The Group is well positioned to capture a significant share of the expanding piped gas market and to exploit anticipated demographic and economic developments in the Operational Locations.** The Group expects to experience significant growth from both growth in the existing Operational Locations and expansion into new Operational Locations and, in particular, by seeking business opportunities in locations near to its existing Operational Locations and existing and future long distance pipelines. For existing Operational Locations, growth is expected to come primarily from (i) further expansion of its gas pipeline infrastructure within its Operational Locations; (ii) future development of its Operational

THE GROUP'S BUSINESS

Locations; (iii) increase in gas consumption per capita; and (iv) increase in gas consumption by the commercial and industrial customers as a result of economic developments. The Group also expects to take advantage of (i) the natural gas industry in the PRC being in the early stages of development; (ii) the fact that natural gas is not widely available as a source of fuel in the PRC; and (iii) the planned construction of long distance pipelines by the PRC Government. Accordingly, the Directors believe that there is potential for expansion. The Group's ability to capture increased market share, along with a steady income stream from an established customer base, puts the Group in a strong position for growth in the natural gas sector.

- **The Group is able to obtain exclusive rights or rights of first refusal from local governments to supply piped gas in Operational Locations.** The Company has obtained exclusive rights to supply piped gas to all of the existing Operational Locations. In the future, the Group will participate in projects that it can obtain exclusive rights or rights of first refusal. The Group also obtains local governmental support such as tax breaks and other concessions (including exemption or reduction in payment of local governmental fees and levies) when it invests in an Operational Location.
- **The Group has a diversified portfolio of residential, commercial and industrial customers that provides the Group with several sources of revenue and reduces the risk of dependency on any one particular category of customer.** In the early years of operating a new gas project, the Group focuses on maximising connection fees through the development of its customer base, a large proportion of which come from residential users. As a gas project develops, the sources of revenue will become more diversified. Gas usage charges, particularly from commercial and industrial customers which are large consumers of gas, will represent a larger proportion of revenue. The Group is not reliant on any one particular category of customers.
- **Due to the Group's experience in, and strict enforcement of, quality and safety control procedures, the Group has a solid track record of providing safe and reliable gas supply service to its customers.** There have been no major accidents that have resulted in serious human injury or death since the Group began operations in 1993. The Group has earned an excellent reputation for delivering safe service to its customers.

HISTORY AND DEVELOPMENT

The Group was founded by Mr. Wang who has extensive experience and in-depth knowledge of the gas business in the PRC. Mr. Wang first invested in the gas business in 1985 when he began operating a LPG processing station in Bazhou, Hebei Province, the PRC.

Recognising that the use of natural gas would gradually become an important source of fuel because it is clean, inexpensive and safe when compared to other sources of fuel, the Founders formed Langfang Xinao in 1993 to invest in the construction of gas pipeline infrastructure for the sale and distribution of piped natural gas in the Langfang Economic and Technical Development Zone, the first location in the Hebei Province with piped natural gas supply. In 1994, the business of Langfang Xinao was expanded to include the supply of piped natural gas to the Langfang city centre.

THE GROUP'S BUSINESS

In 1998, the PRC Government began to actively promote the use of natural gas as an environmentally friendly, economical and efficient source of fuel and encouraging privately-owned enterprises to participate in gas projects. The Founders believed this to be an excellent opportunity to expand the business and began to actively explore and seek investment opportunities in neighboring locations. Upon completion of the acquisition of the Acquisition Companies and the establishment of the New Project Companies, the Enlarged Group will have obtained relevant approvals to operate in ten locations. As at the Latest Practicable Date, all of the four Existing Project Companies and the three Acquisition Companies were in operation. The Group is also actively exploring new business opportunities.

STATEMENT OF ACTIVE BUSINESS PURSUITS

The following table sets out the active business pursuits of the Group for the Track Record Period:

	1998	1999	2000
Existing Project Companies	Langfang Xinao	Langfang Xinao	Langfang Xinao Liaocheng Xinao Beijing Xinao Huludao Xinao
Accumulated approval(s) to operate piped gas business	1	1	6 ⁽¹⁾
Turnover (RMB'000)			
Connection fees			
Residential households	26,456	32,651	88,646
Commercial and industrial customers	5,485	5,857	12,636
	31,941	38,508	101,282
Gas usage charges ⁽²⁾			
Residential households	2,237	3,092	6,327
Commercial and industrial customers	6,808	11,250	14,190
	9,045	14,342	20,517
Sale of gas appliances	123	73	471
	41,109	52,923	122,270
Units of gas sold ('000 m³)			
Residential households	2,120	2,893	5,645
Commercial and industrial customers	5,791	8,890	11,259
	7,911	11,783	16,904

THE GROUP'S BUSINESS

	1998	As at 31 December 1999	2000
Accumulated contracted number of gas supply locations			
Residential households	22,962	32,155	78,326
Commercial and industrial sites	136	165	258
	<u>23,098</u>	<u>32,320</u>	<u>78,584</u>
Accumulated number of gas connections made			
Residential households	22,823	30,607	66,253 ⁽³⁾
Commercial and industrial sites	131	165	242 ⁽⁴⁾
	<u>22,954</u>	<u>30,772</u>	<u>66,495</u>
Accumulated gas pipeline infrastructure and ancillary facilities			
Pipelines constructed (km)			
Intermediate pipelines	55	55	61
Main pipelines	56	88	196
Processing stations			
In operation	1	2	7
Under construction	–	1	–
Storage tanks			
In use	–	1	3
Under construction	1	–	1
Designed daily gas supply capacity (m³)	50,000	100,000	561,800
Staff (headcount)			
Management	4	10	20
Gas operations (including safety)	49	138	203
Engineering	25	88	119
Sales and marketing	10	34	41
Construction design and research and development	7	25	39
Planning and finance	4	16	33
Administration	17	46	23
Procurement	3	9	12
Business development	4	8	11
	<u>123</u>	<u>374</u>	<u>501</u>

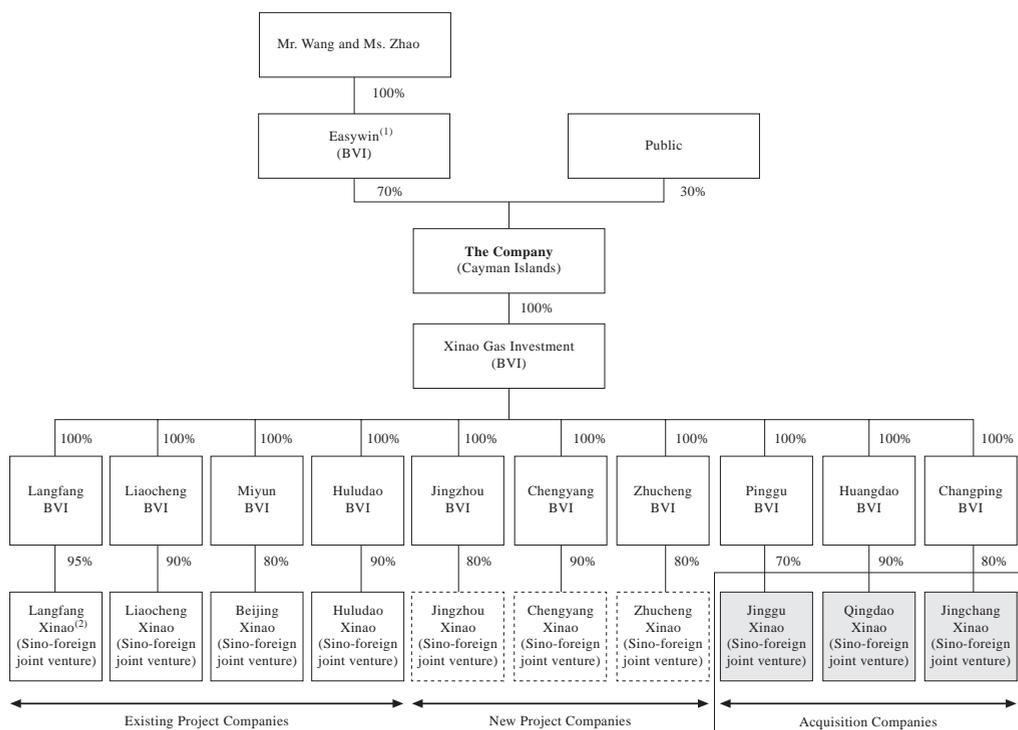
Notes:

- (1) Including exclusive rights to operate piped gas business granted in Chengyang and Zhucheng.
- (2) Net of value added tax.
- (3) Inclusive of a total of 15,802 households acquired as a result of the Reorganisation.
- (4) Inclusive of a total of seven commercial and industrial sites acquired as a result of the Reorganisation.

THE GROUP'S BUSINESS

CORPORATE STRUCTURE

The diagram below illustrates the corporate structure of the Enlarged Group and its controlling entities immediately after completion of (i) the Placing (but before any exercise of the Over-allotment Option), (ii) the acquisition of the Acquisition Companies and (iii) the establishment of the New Project Companies:



 denotes company to be established

 denotes companies to be acquired under the Acquisition Agreements

Notes:

- (1) Easywin is equally owned by Mr. Wang and Ms. Zhao.
- (2) The remaining 5% interest in Langfang Xinao is owned by Langfang City Gas which in turn is approximately 93.2% indirectly owned by Mr. Wang and approximately 6.8% by Ms. Wang Yuping, sister of Mr. Wang.

THE GAS DELIVERY PROCESS

The natural gas delivery process can be broadly categorised into three segments: production, transmission and distribution. A general description of the gas delivery process is set out below.

Production involves underground exploration, drilling, extraction and purification of natural gas. After extraction from a gas well, natural gas is transmitted to nearby refineries for removal of water content and impurities. The natural gas is then transported from the refineries via the long distance pipelines under super high pressure so that natural gas may be supplied to a large number of locations near such pipelines at high speed. The long distance pipelines are owned and operated by PRC oil and gas exploration and production companies or pipeline operators.

THE GROUP'S BUSINESS

Distribution companies (such as the Group) distribute natural gas to the end users and often own the gas pipeline infrastructure of an Operational Location (including the intermediate pipelines, the processing stations, the main pipelines and the branch pipelines). A distribution company purchases natural gas from oil and gas exploration and production companies. The distribution company determines the method of delivering natural gas to its desired destination after taking into account factors such as the distance between the collection and delivery points and the expected demand for gas from the relevant gas supply locations.

The collection of CNG involves the delivery of CNG by CNG truck to a processing station from gas wells or stations located along the relevant long distance pipeline. If an intermediate pipeline is constructed, the intermediate pipeline transports the natural gas under high pressure to a processing station. Such processing station may contain CNG pressure regulating facilities which will depressurise the CNG to natural gas under medium pressure and/or natural gas pressure regulating facilities to reduce the pressure of natural gas from high pressure to medium pressure, before transmitting the natural gas to a main pipeline.

LPG, which is sometimes used as a backup gas supply, is purchased primarily from refineries. Processing stations may also contain LPG air mixing facilities to enable air to be mixed with LPG in the required portion to produce petroleum gas with heat content equivalent to natural gas, which can then be transmitted through the main pipelines. LPG is purchased from refineries and transported to the LPG air mixing facilities located within the processing stations by LPG trucks.

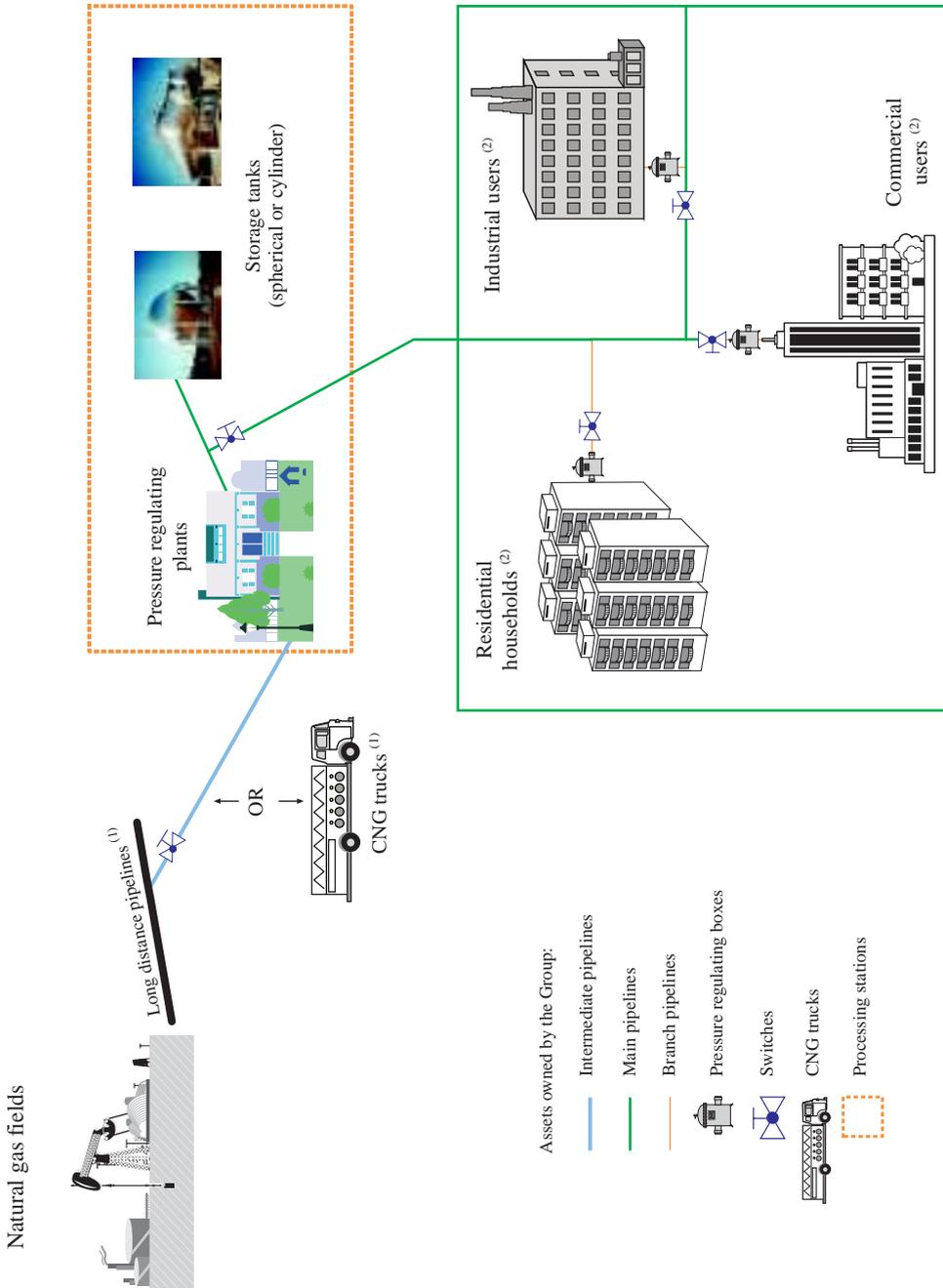
The processing station is usually located on the outskirts of an Operational Location for safety reasons and it provides certain ancillary facilities (i) to add bromine to the gas to enable the detection of leakages when the gas is transmitted through the main pipelines, and (ii) to store gas under high, medium or low pressure to be used as reserves for future unexpected demand. Gas storage tanks for storage of gas under high pressure usually have thicker walls and hence are more expensive to construct than gas storage tanks for storage of gas under medium or low pressure.

After processing, the gas is transmitted under medium pressure to the main pipelines. Main pipelines are laid within an Operational Location and represent the backbone of the gas delivery system. Different sections of the main pipelines operate at slightly different pressures, with computer controlled regulators controlling the flow of natural gas for delivery to end users via the branch pipelines and customers' pipelines.

When there is a demand for a connection of gas to a particular area within a gas supply location, the distribution company will invest in the construction of the branch pipelines to connect the main pipelines to the pressure regulating boxes located in the end-users' buildings or premises. The pressure regulating box reduces the natural gas to a lower pressure before the natural gas is transmitted to the customers' pipelines. Customers' pipelines, which constructions are supervised by the distribution company (on behalf of the customers) and located within the end-users' premises, transmit the natural gas through the pressure regulating box to the end-users. The customers' pipelines are not owned by the distribution company.

THE GROUP'S BUSINESS

The gas delivery process can be illustrated in the diagram set out below:



Notes:

(1) Gas delivery using either intermediate pipelines or CNG trucks.

(2) Customers' pipelines which are not owned by the Group are within the customers' premises and are not highlighted in this diagram.

THE GROUP'S BUSINESS

DESCRIPTION OF THE BUSINESS

The gas pipeline infrastructure owned and operated by the Group is comprised of intermediate pipelines, processing stations, main pipelines, branch pipelines and other ancillary facilities such as gas storage tanks and pressure regulating boxes. The customers' pipelines are owned by the customers. The Group's business activities, from the identification of a project to the supply of gas to end users, can be described as follows:

Identification and securing new Operational Locations

Preliminary review and feasibility studies

The Group's business development team actively explores and identifies suitable investment opportunities by conducting market research on potential locations where the demand for piped gas is apparent. Due to its experience and reputation in the industry, the Group has also received invitations from local governments to bid for new gas projects or to take over existing gas projects. The piped gas supply industry in the PRC is still in its early stages of development with many areas not yet supplied with piped gas notwithstanding their close proximity to gas sources. Due to the capital intensive nature of its projects, the Group is extremely selective in its new investments. The selection of new Operational Locations is arrived at after conducting preliminary evaluation and extensive feasibility studies on the target locations, and after assessing the project's return on investment to the Group. The Group conducted preliminary reviews on approximately 40 cities in 1999 and 2000 out of which the Group has secured exclusive rights or rights of first refusal to supply gas to six Operational Locations. The Group will identify new Operational Locations that it can strategically expand and in which there are existing or anticipated gas sources or long distance pipelines (typically within 200 km of a potential Operational Location).

In order to shortlist potential locations for further investigation, the Group conducts preliminary reviews to assess factors, which include:

- (i) size and concentration of population;
- (ii) extent and concentration of industrial and commercial activities;
- (iii) likely level of connection fees and gas usage charges;
- (iv) extent of the local government's commitment to environmental protection, environmental policies in place, and the local population's awareness of environmental issues;
- (v) whether exclusive operational rights and preferential treatment on tax and governmental fees will be obtained;
- (vi) types of gas supply (natural gas, CNG or LPG) and methods of delivery (whether by way of intermediate pipeline (if the gas source or long distance pipeline is located within 100 km) or by trucks (if the gas source or long distance pipeline is located within 200 km));
- (vii) economic statistics of the relevant locations; and

THE GROUP'S BUSINESS

- (viii) in the case of acquisition of existing gas projects, the cost of acquisition, quality of assets and/or business to be acquired, extent of liabilities of the business and whether the Group is able to resolve problems perceived or encountered in respect of the relevant existing gas projects.

Based on the findings of the feasibility studies which cover the abovementioned factors, the business development team will decide whether to make a recommendation to the board of Directors for approval to proceed with discussions and negotiations on a new project.

Securing a new Operational Location

Once the board of Directors has approved a potential project, the Group will prepare and submit a detailed gas project proposal to the local government and commence negotiations on major issues such as the granting of exclusive rights or rights of first refusal to supply gas to that location, proposed connection fees and gas usage charges and whether any tax and other concessions or favourable policies would be granted by the local government. At around the same time, the Group may also commence negotiations with a potential local joint venture partner who is familiar with the local environment. In instances where the Group takes over an existing gas project (whether acquiring assets or a business), the Group will commence negotiations with the owner(s) of the gas project.

The Group attempts to reach an agreement with the local government on the proposed connection fees and gas usage charges, but such fees and charges are subject to final approval of the local state price bureau.

The Group's marketing team plays an active role in lobbying the relevant government authorities during the negotiation stage. After the formation of a project company, the Group will begin to negotiate gas purchase agreements to purchase gas from oil and gas exploration and production companies.

Investment in the construction of the gas pipeline infrastructure

Design stage

The design of the gas pipeline infrastructure for a gas project (which includes the intermediate pipelines, the processing stations, the main pipelines and other ancillary facilities such as gas storage tanks) is carried out by a government approved design institute in accordance with the requirements of the Group and takes into account the local population size, the development of the economy, the utilisation of energy resources and environmental conditions. At present, the Group has appointed 中國市政工程華北設計研究院 (China Urban Engineering Huabei Design and Research Institute) to design the Group's gas pipeline infrastructure. The design takes into consideration the technical requirements of the Group, the needs of the local population and the environmental conditions of the area covered by the design. The master design is subject to approval by experts appointed by the local city construction department. The design stage normally takes two to three months.

THE GROUP'S BUSINESS

Construction stage

Once the master design is approved, the Group will invite independent qualified contractors to tender for the construction work. The selection criteria for the contractors include their qualifications, experience, expertise, reputation, familiarity with the local environment, prior relationship with the Group and tender price. The Group generally enters into turnkey contracts with independent contractors for construction, installation and maintenance of gas pipes. The Group generally provides a down payment with the remainder to be paid upon completion of a project. In the case of delay or failure on the part of the contractor to complete the project, the Group is entitled to damages or, in some instances, rescission of the contract. At the time of entering into turnkey contracts, the Group will commence the sourcing of raw materials such as pipes, gas regulating equipment and machinery. The Group has strict quality control procedures for the sourcing of supplies for construction purposes.

The Group's internal engineers and independent external inspectors monitor the entire construction process to ensure that each stage of construction meets the Group's quality and safety standards and the relevant legal requirements.

Although the gas pipeline infrastructure is designed to cover the entire Operational Location, the Group's construction programme generally focuses on early gas delivery to areas of concentrated customer demand within an Operational Location, so that gas supply can commence as soon as the essential gas pipeline infrastructure and facilities (such as the processing stations and the intermediate pipelines) are completed. Accordingly, although the utilisation rate of the processing stations (being the total daily gas consumption by customers as a percentage of designed daily capacity of the processing stations) is low at the early stages of development, measures are taken to provide a return on investment as soon as practicable. Construction work in an initial target area will gradually extend to cover the whole Operational Location, which typically takes two to five years.

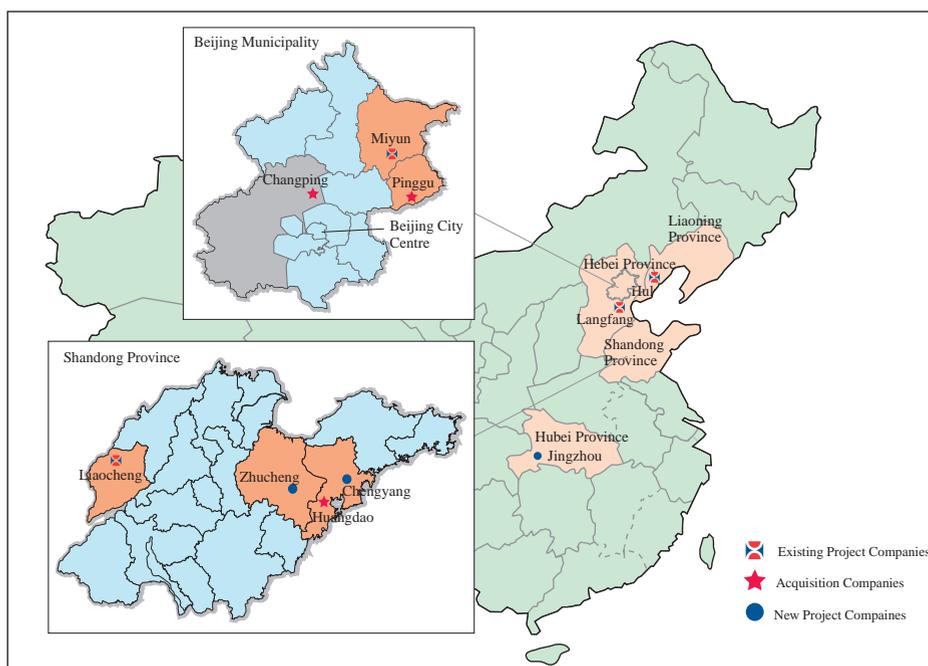
Connection to end users

Once the Group enters into a gas supply contract with a customer, the Group begins the design and construction of the branch pipelines and customers' pipelines. Unless complex designs are involved, the designs of branch pipelines and customers' pipelines are normally prepared by the Group, reviewed by a government approved design institute, and carried out by external contractors.

THE GROUP'S BUSINESS

AREAS OF OPERATIONS

The map below shows the locations in which the Enlarged Group has interests in the provision of piped gas:



As indicated above, the Enlarged Group is interested in three locations in Beijing Municipality (being Miyun, Pinggu and Changping), one location in Hebei Province (being Langfang), one location in Hubei Province (being Jingzhou), one location in Liaoning Province (being Huludao) and four locations in Shandong Province (being Liaocheng, Huangdao (Qingdao City), Chengyang (Qingdao City) and Zhucheng). The population and certain economic statistics of these locations are shown in the table below:

	Total population ⁽¹⁾		Average annual increase (%)	GDP per capita		Average annual increase (%)	Retail sales of consumer goods		Average annual increase (%)	Industrial output		Average annual increase (%)
	1995 ('000)	1999 ('000)		1995 (RMB)	1999 (RMB)		1995 (RMB million)	1999 (RMB million)		1995 (RMB million)	1999 (RMB million)	
Beijing Municipality	12,510	12,570	0.1%	13,085	19,846	12.9%	82,700	131,300	14.7%	190,862	208,100	2.3%
Miyun	423	425	0.1%	5,999	7,192	5.0%	1,158	1,560	8.7%	4,573	4,013	-3.1%
Pinggu	387	389	0.1%	7,392	7,709	1.1%	1,109	1,284	3.9%	3,976	4,460	3.0%
Changping	418	428	0.6%	7,990	11,931	12.3%	1,674	1,722	0.7%	3,403	5,216	13.3%
Hebei Province	64,370	66,140	0.7%	4,427	6,932	14.1%	85,210	145,880	17.8%	399,572	299,458	-7.5%
Langfang	3,604	3,748	1.0%	5,596	8,871	14.6%	4,251	7,622	19.8%	27,395	51,474	22.0%
Hubei Province	57,720	59,380	0.7%	4,162	6,514	14.1%	93,180	161,710	18.4%	410,258	283,435	-7.8%
Jingzhou	6,174	6,421	1.0%	2,185	4,347	24.7%	10,147	15,414	13.0%	30,048	51,070	17.5%
Liaoning	40,920	41,710	0.5%	6,880	10,086	11.6%	112,200	169,610	12.8%	497,490	732,900	11.8%
Huludao	2,611	2,662	0.5%	4,558	5,704	6.3%	4,067	5,420	8.3%	19,858	24,711	6.1%
Shandong	87,050	88,830	0.5%	5,747	8,673	12.7%	144,270	231,010	15.0%	845,632	1,119,500	8.1%
Liaocheng	5,450	5,539	0.4%	3,009	4,580	13.1%	3,197	4,633	11.2%	24,898	32,545	7.7%
Qingdao	6,846	7,030	0.7%	9,293	14,124	13.0%	17,076	27,033	14.6%	94,126	114,920	5.5%
Huangdao	137	189	9.5%	16,632	34,399	26.7%	3,501	6,223	19.4%	634	13,416	504.0%
Chengyang	413	426	0.8%	7,763	19,373	37.4%	765	1,102	11.0%	6,319 ⁽²⁾	19,823 ⁽²⁾	53.4%
Zhucheng	1,033	1,053	0.5%	6,133	7,407	5.2%	1,859	2,698	11.3%	9,277	15,757	17.5%

Source: Relevant China Statistical Yearbooks for 1995 and 1999.

Notes:

- (1) Population statistics for the Operational Locations and their forecasts for 2010 are set out in the paragraph headed "Description of the Project Companies".
- (2) Real industrial output (values exclude effect of inflation).

THE GROUP'S BUSINESS

Provinces and cities where the Project Companies are located

Beijing Municipality

The Group currently has operations in Miyun and, pursuant to the Acquisition Agreements, has contracted to acquire operations in Pinggu and Changping, which are all located in the suburban areas of Beijing Municipality (“Beijing”).

Beijing is the capital city of the PRC and is one of the most populated cities in the PRC. It is divided into 13 districts and five counties. Beijing, Chongqing, Shanghai and Tianjin are the only four municipalities under the direct central administration of the State Council. Beijing is also the political and cultural centre of the PRC, housing most of the ministries of the PRC Government and their respective departments. In addition, Beijing is an important commercial, industrial and financial centre.

Beijing residents enjoy one of the highest standards of living in the PRC with disposable income also ranking among the highest in the PRC. Since the commencement of economic reforms in the PRC more than 20 years ago, the economy of Beijing has grown significantly. The GDP of Beijing had grown from RMB139 billion in 1995 to RMB217 billion in 1999 (Source: China Statistical Year Book, 1999 and 2000), representing an average rate of increase of 14.0% per year. Due to the rapid development of Beijing in recent years, the quality of air has deteriorated significantly. The Beijing Municipality Government is committed to reduce pollution in Beijing by closely monitoring the pollution in Beijing, setting targets for the improvement of air quality on an annual basis and encouraging the movement of residents from the Beijing city centre to the suburban areas of Beijing.

Hebei Province

The Group currently has operations in Langfang, Hebei Province (“Hebei”).

Hebei is located in the northeastern part of the PRC surrounding both Beijing and Tianjin Municipalities. In terms of population, it is the sixth largest province in the PRC and is divided into 11 cities.

Hebei is the fourth largest agricultural province in the PRC with a gross output value in the farming sector of RMB880 billion in 1999. The GDP of Hebei had grown from RMB285 billion in 1995 to RMB457 billion in 1999 (Source: China Statistical Year Book, 1999 and 2000), representing an average rate of increase of 15.2% per year. Hebei is also rich in natural resources and minerals which include coal, iron and crude oil.

Hubei Province

The Group will have operations in Jingzhou, Hubei Province (“Hubei”) following the establishment of Jingzhou Xinao.

Hubei is located in the central region of the PRC, along the Yangtze River. In terms of population, Hubei is the ninth largest province in the PRC and has 10 cities.

Similar to Hebei, the agricultural industry plays an important role in the overall economy of the province with approximately 70% of the population involved in agriculture. The GDP of Hubei has grown from RMB239 billion in 1995 to RMB386 billion in 1999 (Source: China Statistical Year Book, 1999 and 2000), representing an average rate of increase of 15.4% per year.

THE GROUP'S BUSINESS

Liaoning Province

The Group currently has operations in Huludao, Liaoning Province (“Liaoning”).

Liaoning is located on the northeastern part of the PRC. In terms of population, it is the fourteenth largest province in the PRC and is divided into 14 cities.

Liaoning is the major commercial and industrial centre for the northeastern part of the PRC. It is the sixth largest industrial province and its industrial activities are concentrated in the heavy industrial sector. The GDP of Liaoning had grown from RMB279 billion in 1995 to RMB417 billion in 1999 (Source: China Statistical Year Book, 1999 and 2000), representing an average rate of increase of 12.4% per year. Liaoning is also rich in natural resources and has proven reserves for coal, crude oil and natural gas. The growth in the heavy industrial sector in recent years has caused pollution problems in Liaoning.

Shandong Province

The Group currently has operations in Liaocheng, Shandong Province (“Shandong”). The Group has also obtained approvals to operate in Chengyang (Qingdao City) and Zhucheng. In addition, pursuant to the Acquisition Agreements, the Group has contracted to acquire operations in Huangdao (Qingdao City).

Shandong is located in the northeastern area of the PRC, adjacent to Hebei. In terms of population, it is the second largest province in the PRC and is divided into two districts and 15 cities.

Shandong is rich in natural resources such as gold, crude oil, graphite and coal. The second largest oil field in the PRC, 勝利油田 (Shengli Oil Field) and one of the nation's largest coal reserves, 兗滕礦區 (Yanteng Coal Mine Area) are located in Shandong. The GDP of Shandong had grown from RMB500 billion in 1995 to RMB766 billion in 1999 (Source: China Statistical Year Book, 1999 and 2000), representing an average rate of increase of 13.3% per year. Such increase is mainly the result of strong growth in the industrial sector of Shandong. Shandong is the third largest industrial province in the PRC.

Qingdao City is located on the eastern coast of Shandong and is one of the fastest growing cities in the PRC. Qingdao City has the highest GDP within Shandong, amounting to RMB64 billion and RMB99 billion in 1995 and 1999, respectively, representing an average rate of increase of 13.7% per year. Qingdao City also has the busiest harbour in Shandong with an annual throughput of 73 million tonnes of cargo in 1999.

DESCRIPTION OF THE PROJECT COMPANIES

Upon completion of the acquisition of the Acquisition Companies and the establishment of the New Project Companies and taking into account the Existing Project Companies, the Enlarged Group will have interests in 10 gas projects in the PRC. Details regarding each of the Project Companies are set out below.

Existing Project Companies

The Existing Project Companies are Langfang Xinao, Liaocheng Xinao, Beijing Xinao and Huludao Xinao.

THE GROUP'S BUSINESS

Langfang Xinao

Information on Langfang Xinao

Langfang Xinao was established as a Sino-foreign joint venture on 28 March 1993 in anticipation of the growing trend towards the use of environmentally friendly fuel and to take advantage of the governmental policy encouraging the use of natural gas and the development of untapped natural gas resources in Langfang. The shareholders of Langfang Xinao at the time of its establishment were Langfang City Gas (approximately 67.7%) and Ms. Zhao (approximately 33.3%). In 1993, Langfang Xinao began to supply piped natural gas to Langfang Economic and Technical Development Zone (the “Langfang Development Zone”). In 1994, Langfang Xinao expanded its piped natural gas business to the Langfang city centre. In 1999, Langfang Xinao obtained the exclusive right to supply piped gas to the Langfang city centre (which includes the Langfang Development Zone).

In July 1998, Langfang City Gas (a company owned as to approximately 93.2% by Mr. Wang) transferred approximately 45.1% interest in Langfang Xinao to XGCL (another company owned as to approximately 50.7% by Mr. Wang). After a further subscription of interest in Langfang Xinao in July 1998, Langfang Xinao was beneficially owned as to 50% by XGCL, approximately 30.4% by Ms. Zhao and approximately 19.6% by Langfang City Gas.

As part of the Reorganisation, XGCL, Ms. Zhao and Langfang City Gas transferred their equity interests in Langfang Xinao as to 50%, approximately 30.4% and approximately 14.6%, respectively, to Langfang BVI on 1 August 2000, as a result of which Langfang Xinao is now owned as to 95% by Langfang BVI and 5% by Langfang City Gas. The main terms of the joint venture contract relating to Langfang Xinao are set out in the paragraph headed “Further information about the Company – Particulars of the Existing Project Companies” in Appendix V to this prospectus.

As at 28 February 2001, the piped gas development of Langfang Xinao covered the Langfang city centre (which includes the Langfang Development Zone) and was comprised of approximately 58 km of intermediate pipelines and approximately 99 km of main pipelines with pressure regulating facilities installed in three processing stations located on the northern, southern and eastern outskirts of the Langfang city centre and in one processing station located at the Langfang Development Zone with a current combined designed daily capacity to supply 409,800 m³ of natural gas. The processing station at the Langfang Development Zone is currently equipped with CNG supply facilities, which are capable of loading CNG equivalent to approximately 1,800 m³ of natural gas onto CNG trucks per hour. Currently, the CNG supply facility is primarily intended to supply CNG to Beijing Xinao, Jinggu Xinao and Jingchang Xinao, which will be delivered by way of CNG trucks with each truck capable of carrying CNG equivalent to approximately 4,500 m³ of natural gas.

The supply of natural gas for Langfang Xinao is currently obtained from 華北油田 (Huabei Oil Field), which includes 廊東氣田 (Langdong Gas Well) and 永清氣田 (Yongqing Gas Well). The two processing stations located on the northern outskirts of the Langfang city centre and the Langfang Development Zone obtain natural gas from Yongqing Gas Well by an approximately 27 km long intermediate pipeline connected to 永北長輸管道 (Yongbei long distance pipeline) at 萬庄 (Wangzhuang). The processing station located on the southern outskirts of the Langfang city centre also obtains natural gas from Yongqing Gas Well by an approximately 28 km long intermediate pipeline connected to Yongbei long distance pipeline at 永清 (Yongqing).

Pursuant to a gas purchase agreement dated 17 January 2001 entered into between Langfang Xinao and 中國石油天然氣股份有限公司華北油田分公司運銷部 (PetroChina Company Limited Huabei Oil Field Branch Company Transmission and Sales Office), 26,000,000 m³ of natural gas will be supplied to Langfang Xinao from the Yongbei long distance pipeline for 2001. The processing station located on the eastern outskirts of the Langfang city centre obtains natural gas from

THE GROUP'S BUSINESS

Langdong Gas Well by an approximately 3 km long intermediate pipeline connected directly to such gas well. Langfang Xinao is currently negotiating with PetroChina Company Limited Huabei Oil Field Branch Company Transmission and Sales Office for the purchase of natural gas from Langdong Gas Well.

The 陝甘寧長輸管道 (Shanganning long distance pipeline), which transmits natural gas from gas fields located in 陝西省 (Shanxi Province), 甘肅省 (Gansu Province) and 寧夏自治區 (Ningxia Autonomous Region) to Beijing, is connected to the Yongbei long distance pipeline at Yongqing, and can serve as an additional source of supply of natural gas for the Group via the existing intermediate pipeline, which is connected to the processing station located on the southern outskirts of the Langfang city centre.

The table below summarises the number of supply contracts Langfang Xinao has entered into since its establishment and up to 28 February 2001:

	Number of supply contracts	Contracted number of gas supply locations	Number of gas connections made	Estimated daily gas consumption ⁽³⁾ (m ³)
Residential	9,457	52,088 households ⁽¹⁾	46,074 households	18,430
Commercial and industrial	221	221 sites ⁽²⁾	215 sites	63,760
	9,678	52,088 households and 221 sites	46,074 households and 215 sites	82,190

Notes:

- (1) Contracted households represent approximately 62.0% of the current estimated residential households of approximately 84,000 in the Langfang city centre (which includes the Langfang Development Zone).
- (2) The commercial and industrial customers of Langfang Xinao include Beijing Xinao, Jinggu Xinao and Jingchang Xinao, fellow subsidiaries of Langfang Xinao. Pursuant to three CNG supply agreements all dated 10 January 2001, Langfang Xinao has agreed to supply and deliver 7,000,000 m³ of natural gas per annum (in the form of CNG) to each of Beijing Xinao, Jinggu Xinao and Jingchang Xinao for a period of three years commencing from 10 January 2001 at a price of RMB1.20 per m³ (during off-peak hours) or RMB1.60 per m³ (during peak hours).
- (3) Estimated daily gas consumption for households is calculated based on an average daily gas consumption of 0.4 m³ per household for those residential households with gas connections made. Estimated daily gas consumption for commercial and industrial customers is based on 50% of the installed designed daily capacity (as set out in the respective supply contract) of 127,519 m³ as at 28 February 2001 for those customers with gas connections made.

Information on Langfang

Langfang is a city in Hebei Province with a total area of 6,429 km² and is located between Beijing and Tianjin and is approximately 50 km to the southeast of the Beijing city centre and approximately 60 km to the northwest of Tianjin. It is well connected to other areas of the PRC by means of expressways and railways. The non-agricultural population and commercial activities of Langfang are concentrated in the Langfang city centre while the industrial activities are concentrated in the Langfang Development Zone. There are over 500 enterprises established in the Langfang Development Zone.

THE GROUP'S BUSINESS

Langfang is rich in natural gas resources with Langdong Gas Well (being part of Huabei Oil Field) located only approximately 3 km from Langfang Xiniao's processing station. In addition, the Shanganning long distance pipeline and Yongbei long distance pipeline, which transport natural gas to Beijing, run nearby Langfang providing additional and stable sources of natural gas for Langfang Xiniao.

The Group's operations in Langfang cover the Langfang city centre (which includes the Langfang Development Zone). It is estimated that the total area of the Langfang city centre will increase from the existing size of 35 km² to 50 km² by 2010, which includes an anticipated increase in the area of the Langfang Development Zone from 10 km² in 1999 to 14 km² by 2010. In 1999, the population of the Langfang city centre was approximately 252,000 (comprising a total of approximately 84,000 households on the basis of the current PRC average household size of approximately three persons per household). The Langfang City People's Government anticipates that the population of the Langfang city centre for 2010 will increase by 98% to approximately 500,000 (comprising a total of approximately 166,000 households on the basis of the aforementioned PRC average household size).

The Langfang City People's Government has demonstrated its commitment to promote a non-polluted environment in Langfang. In September 1999, the Langfang City People's Government and the Langfang Environmental Bureau required that Jinguang Road, the main street of the Langfang city centre, be coal free and that the use of crude coal along such road be replaced by other fuel for all boilers and heaters which meet the national standard in relation to the emission of smoke. In addition, no cooking appliances using coal are allowed in food stalls along Jinguang Road.

With the planned increase in the area of the Langfang city centre and the Langfang Development Zone and the development of 東方大學城 (Oriental University City), which is expected to accommodate 150,000 students, lecturers and staff, the Directors believe that the economic activities and population of Langfang will continue to grow thereby facilitating the growth in demand for connection and usage of natural gas.

Liaocheng Xiniao

Information of Liaocheng Xiniao

Liaocheng Xiniao was originally established as a PRC joint venture on 11 June 1999 and was owned as to 80% by XGCL, as to 10% by 廊坊開發區市政建設工程有限公司 (Langfang Development Zone Urban Construction Engineering Company Limited) and as to 10% by 聊城市公用事業管理局 (Liaocheng City Public Utilities Supervisory Bureau). Liaocheng City Public Utilities Supervisory Bureau is independent of the Group. Liaocheng Xiniao is principally engaged in the business of providing piped natural gas to Liaocheng. After successfully competing against a number of competitors, Liaocheng Xiniao was granted the exclusive right on 28 April 1999 to develop and operate piped natural gas supply in the Liaocheng city centre (which includes the Liaocheng Economic and Technical Development Zone (the "Liaocheng Development Zone")).

In July 2000, XGCL increased its shareholding in Liaocheng Xiniao to 90% by acquiring an additional 10% equity interest in Liaocheng Xiniao from Langfang Development Zone Urban Construction Engineering Company Limited and Liaocheng City Public Utilities Supervisory Bureau sold its 10% interest in Liaocheng Xiniao to 聊城市熱力公司 (Liaocheng City Heating Company, a state-owned enterprise engaged in electricity and gas-related business). As part of the Reorganisation, XGCL transferred its entire equity interest in Liaocheng Xiniao to Liaocheng BVI on 7 August 2000 and Liaocheng Xiniao was converted into a Sino-foreign equity joint venture with the joint venture period extended from 20 years to 30 years commencing from 8 August 2000. The main terms of the joint venture contract relating to Liaocheng Xiniao are set out in the paragraph headed "Further information about the Company – Particulars of the Existing Project Companies" in Appendix V to this prospectus.

THE GROUP'S BUSINESS

The initial phase of piped gas development of Liaocheng Xinao covers the Liaocheng city centre and involves the construction of approximately 1 km of intermediate pipeline and 50 km of main pipeline with pressure regulating facilities installed in the processing station located on the northwestern outskirts of the Liaocheng city centre. As at 28 February 2001, a total of approximately 1 km of intermediate pipeline, 40 km of main pipelines and a processing station with a current designed daily capacity to supply 50,000 m³ of natural gas had been constructed and the main pipeline already covers a substantial part of the Liaocheng city centre.

Liaocheng Xinao currently obtains its supply of natural gas from 中原油田 (Zhongyuan Oil Field) through an approximately 1 km long intermediate pipeline constructed by Liaocheng Xinao which connects 中澹長輸管道 (Zhongcang long distance pipeline) with the processing station located on the northwestern outskirts of Liaocheng city centre at which point the pressure of natural gas is reduced to the requisite level before delivery to end users via the main pipelines. Pursuant to a natural gas purchase agreement dated 11 November 2000 entered into between Liaocheng Xinao and 中原油氣高新股份有限公司天然氣產銷廠 (Natural Gas Production and Sales Factory of Zhongyuan Petroleum and Natural Gas High Technology Company Limited), 3,600,000 m³ of natural gas per annum will be supplied to Liaocheng Xinao from the Zhongcang long distance pipeline for the period from 11 November 2000 to 31 December 2001.

In order to secure further gas supply, Liaocheng Xinao also entered into an agreement with 中國石化集團管道儲運公司聊城管理處 (China Petrochemical Group Pipe Storage and Transportation Company Liaocheng Administration Office) on 20 December 2000 pursuant to which Liaocheng Xinao intends to construct a new intermediate pipeline of approximately 1 km in length connecting the 濮臨長輸管道 (Pulin long distance pipeline) with its processing station located on the northwestern outskirts of Liaocheng city centre.

Liaocheng Xinao began to sign supply contracts with its customers in September 1999 and commenced the partial supply of natural gas in December 1999. The table below summarises the number of supply contracts Liaocheng Xinao has entered into since its establishment and up to 28 February 2001:

	Number of supply contracts	Contracted number of gas supply locations	Number of gas connections made	Estimated daily gas consumption ⁽²⁾ (m ³)
Residential	182	6,865 households ⁽¹⁾	4,298 households	1,719
Commercial and industrial	16	16 sites	14 sites	3,070
	<u>198</u>	<u>6,865 households and 16 sites</u>	<u>4,298 households and 14 sites</u>	<u>4,789</u>

Notes:

- (1) Contracted households represent approximately 6.9% of the current estimated residential households of approximately 100,000 in the Liaocheng city centre (which includes the Liaocheng Development Zone).
- (2) Estimated daily gas consumption for households is calculated based on an average daily gas consumption of 0.4 m³ per household for those residential households with gas connections made. Estimated daily gas consumption for commercial and industrial customers is based on 50% of the installed designed daily capacity (as set out in the respective supply contract) of 6,140 m³ as at 28 February 2001 for those customers with gas connections made.

THE GROUP'S BUSINESS

Information on Liaocheng

Liaocheng is a city in Shandong Province with a total area of 8,590 km² and is located approximately 91 km to the west of 濟南 (Jinan). The non-agricultural population and commercial activities of Liaocheng are concentrated in the Liaocheng city centre while the industrial activities are concentrated in the Liaocheng Development Zone within the Liaocheng city centre. With its close proximity to Shanxi, Hebei and Henan Provinces, Liaocheng is a connection point and business hub for provinces in eastern China. Liaocheng is also well connected to other areas of the PRC by means of expressways and railways including 京九鐵路 (Beijing-Kowloon Railway).

The Group's operations in Liaocheng cover the Liaocheng city centre (which includes the Liaocheng Development Zone). The Liaocheng City People's Government has estimated that the total area of Liaocheng city centre will increase from the existing size of 31 km² to 57 km² by 2010. In 1999, the population of Liaocheng city centre was approximately 300,000 (comprising a total of approximately 100,000 households on the basis of the aforementioned PRC average household size). The Liaocheng City People's Government anticipates that the population of Liaocheng city centre for 2010 will increase by 60% to approximately 480,000 (comprising a total of approximately 160,000 households on the basis of the aforementioned PRC average household size).

The Liaocheng City People's Government has demonstrated its commitment to promote a non-polluted environment in Liaocheng. Since 1995, the Liaocheng City People's Government has been encouraging the establishment of low pollution industries and restricting the operations of industries with high pollution in the Liaocheng city centre. In addition, the Liaocheng City People's Government now requires that all new and existing residential developments and all industrial and commercial institutions (including hotels, restaurants, canteens and schools) use natural gas for cooking, air-conditioning, space heating and water heating and has banned the use of coal burning boilers. In addition, all new property developments must be equipped with facilities for natural gas connections before the issuance of construction and sale permits.

With the Liaocheng City People's Government targeting to connect 80% of the residents in the Liaocheng city centre to natural gas, the intended development of the Liaocheng city (which includes the construction of approximately 500,000 m² of residential premises per annum in the next three years), the planned expansion of the Liaocheng city centre and the development of Liaocheng as a tourist attraction, the Directors believe that the economic activities and population of Liaocheng will continue to grow thereby facilitating the growth in demand for connection and usage of natural gas.

Beijing Xinao

Information on Beijing Xinao

Beijing Xinao was originally established as a PRC joint venture on 10 September 1999 and was owned as to 80% by XGCL and 20% by 北京市密雲化工公司 (Beijing City Miyun Chemicals Company ("Miyun Chemicals")), a state-owned enterprise engaged in gas-related business and the sale of building materials) for the purpose of engaging in the business of providing piped gas to Miyun. Prior to the establishment of Beijing Xinao, Miyun Chemicals and its then joint venture partner (the "Original Miyun JV") supplied LPG to Miyun (the "Miyun LPG Project"). After successfully competing against a number of competitors, Beijing Xinao successfully convinced the Miyun County People's Government to replace the use of LPG with piped natural gas as the main source of fuel for Miyun and was selected to replace the Original Miyun JV. On 10 September 1999, the Miyun County People's Government granted Beijing Xinao the exclusive right to develop and operate piped gas supply for the residential districts in Miyun and has further agreed not to approve other piped gas projects in the Miyun county centre (which includes the Miyun Industrial Development Area). On 25 September 1999, Beijing Xinao formally acquired the assets of the Miyun LPG Project which included approximately 3 km of main pipelines already constructed. After acquiring such assets, Beijing Xinao was able to immediately proceed with the other necessary investment in the gas pipeline infrastructure since the relevant approvals, permits and consents had already been obtained, which provided substantial savings in time and work.

THE GROUP'S BUSINESS

As part of the Reorganisation, XGCL transferred its entire equity interest in Beijing Xinao to Miyun BVI on 30 July 2000 and Beijing Xinao was converted into a Sino-foreign equity joint venture with the joint venture period extended from 10 years to 30 years commencing from 8 August 2000. The main terms of the joint venture contract relating to Beijing Xinao are set out in the paragraph headed "Further information about the Company – Particulars of the Existing Project Companies" in Appendix V to this prospectus.

The initial phase of piped gas development of Beijing Xinao covers the Miyun county centre (which includes the Miyun Industrial Development Area). Such development involves the construction of more than 70 km of main pipelines with CNG pressure regulating facilities and the installation of additional backup LPG air mixing facilities in the processing station located on the western outskirts of Miyun county centre. As at 28 February 2001, a total of approximately 17 km of the main pipelines had been constructed.

Natural gas is currently supplied to Miyun Xinao by transporting CNG using CNG trucks to its processing station. This processing station has a current designed daily capacity to supply 72,000 m³ of natural gas. The pressure of the CNG is reduced to the requisite level at such station before delivery to end users via the main pipelines. Pursuant to a gas purchase agreement dated 10 January 2001 entered into between Beijing Xinao and Langfang Xinao, Langfang Xinao will supply and deliver 7,000,000 m³ of natural gas per annum (in the form of CNG) to Beijing Xinao for a period of three years at a price of RMB1.20 per m³ (during off-peak hours) or RMB1.60 per m³ (during peak hours). The purchase price was determined with reference to the market price and taking into account the transportation and operation costs. In the event of an adjustment to the gas purchase price payable by Langfang Xinao, Beijing Xinao and Langfang Xinao will enter into a supplemental agreement with newly agreed upon prices. In addition, Beijing Xinao has entered into a gas purchase agreement dated 16 November 2000 with 北京天然氣集輸公司北京中油匯園公司 (Beijing Natural Gas Transportation Zhongyou Huiyuan Company), a state-owned enterprise, whereby Beijing Xinao will be supplied with up to 4,500 m³ of natural gas per day during the winter and 3,000 m³ of natural gas per day during the summer for a period of one year commencing from the date of the agreement. Under such agreement, Beijing Xinao is responsible for the collection of natural gas (in the form of CNG) at 衙門口 (Yamenkou) in Beijing, which is located 120 km from the Miyun county centre.

The construction of a new long distance pipeline (being the eastern extension of the 陝甘寧長輸管道 (Shanganning long distance pipeline), is currently being planned by the Beijing Municipality Government. Such long distance pipeline is expected to pass nearby Miyun and will be available to supply natural gas to Miyun in 2006. Beijing Xinao currently intends to construct an intermediate pipeline connecting such new long distance pipeline with a new processing station to be constructed by Beijing Xinao on the outskirts of the Miyun county centre.

Beijing Xinao began to sign supply contracts with its customers in October 1999 and commenced the partial supply of natural gas in January 2000. The table below summarises the number of supply contracts Beijing Xinao has entered into since its establishment and up to 28 February 2001:

	Number of supply contracts	Contracted number of gas supply locations	Number of gas connections made	Estimated daily gas consumption ⁽²⁾ (m ³)
Residential	182	3,437 households ⁽¹⁾	2,778 households	1,111
Commercial and industrial	8	8 sites	8 sites	2,551
	<u>190</u>	<u>3,437 households and 8 sites</u>	<u>2,778 households and 8 sites</u>	<u>3,662</u>

THE GROUP'S BUSINESS

Notes:

- (1) Contracted households represent approximately 10.7% of the current estimated residential households of approximately 32,000 in the Miyun county centre (which includes the Miyun Industrial Development Area).
- (2) Estimated daily gas consumption for households is calculated based on an average daily gas consumption of 0.4 m³ per household for those residential households with gas connections made. Estimated daily gas consumption for commercial and industrial customers is based on 50% of the installed designed daily capacity (as set out in the respective supply contract) of 5,101 m³ as at 28 February 2001 for those customers with gas connections made.

Information on Miyun, Beijing Municipality

Miyun is a county in the suburban area of Beijing Municipality with a total area of 2,226 km² and is located approximately 65 km to the northeast of Beijing city centre. The non-agricultural population and commercial activities of Miyun are concentrated in the Miyun county centre while the industrial activities are concentrated in the Miyun Industrial Development Area within the Miyun county centre. In addition, over ten universities have been established in Miyun. In 1993, Miyun (together with 13 other counties within the Beijing Municipality) was approved by the State Council as a satellite city of Beijing Municipality and developmental policies have been established in order to encourage the movement of population from the Beijing city centre to Miyun.

The Group's operations in Miyun cover the Miyun county centre (which includes the Miyun Industrial Development Area). The Miyun County People's Government has estimated that the total area of Miyun county centre will increase from the existing size of 21 km² to 30 km² by 2010. In 1999, the population of Miyun county centre was approximately 97,000 (comprising a total of approximately 32,000 households on the basis of the aforementioned PRC average household size). The Miyun County People's Government anticipates that the population of Miyun county centre for 2010 will increase by 210% to approximately 300,000 (comprising a total of approximately 100,000 households on the basis of the aforementioned PRC average household size).

The Beijing Municipality Government and the Miyun County People's Government have demonstrated their commitment to promote a non-polluted environment in Miyun. A reservoir which serves as the main source of water supply for the urban area of Beijing city is located in Miyun. Hence, it is particularly important to promote a non-polluted environment in Miyun in order to preserve the quality of water for use by Beijing residents. To further demonstrate its commitment to promote a non-polluted environment in Miyun, the Miyun County People's Government has implemented numerous environmental protection policies. For example, in 1995, the local government targeted a reduction in coal consumption by 3.5% per annum within Miyun county, beginning in 1995. In 1999, the Miyun County People's Government restricted the use of environmentally unfriendly fuel in the Miyun county centre. Furthermore, the Miyun County People's Government required that coal as a source of energy be replaced by other types of cleaner fuel for all boilers located in the Miyun county centre by 2000.

With the rapid development of Beijing, the planned construction of three additional residential districts in Miyun county centre and the construction of new residential premises (with a total gross floor area of approximately 1,700,000 m²) in its existing districts to commence in 2001, along with the aforementioned planned expansion of the Miyun county centre and the commencement of the construction of an expressway from the Beijing city centre to Miyun in fall 2001, the Directors believe that the economic activities and population will continue to grow thereby facilitating the growth in demand for connection and usage of natural gas.

THE GROUP'S BUSINESS

Huludao Xinao

Information on Huludao Xinao

Huludao Xinao was originally established as a PRC joint venture on 24 December 1999 and was owned as to 90% by XGCL and as to 10% by 葫蘆島市城市建設委員會 (Huludao Construction Committee) which is a party independent of the Group. Prior to the establishment of Huludao Xinao, 葫蘆島市城市建設委員會 (Huludao City Urban Construction Commission) supplied piped natural gas to Huludao City (the “Original Huludao Project”). On 14 December 1999, the Huludao City People’s Government granted Huludao Xinao the exclusive right to supply natural gas to the Huludao city centre (which includes the Huludao Economic and Technical Development Zone (the “Huludao Development Zone”). The Huludao City People’s Government further agreed not to approve the establishment of any LPG supply station within the Operational Location of Huludao Xinao in Huludao. On 24 December 1999, Huludao Xinao formally acquired the assets and liabilities of the Original Huludao Project which included approximately 2 km of intermediate pipeline and approximately 32 km of main pipelines already constructed and covering major parts of Huludao city centre. At that time, a processing station with a designed daily capacity to supply 30,000 m³ of natural gas had already been constructed on the southern outskirts of Huludao city centre with additional LPG air mixing facilities as backup gas supply. After acquiring such assets, Huludao Xinao was able to immediately continue supplying natural gas to existing customers.

As part of the Reorganisation, XGCL transferred its entire equity interest in Huludao Xinao to Huludao BVI on 3 August 2000 and Huludao Xinao was converted into a Sino-foreign equity joint venture with the remaining 10% being owned by 葫蘆島市城市建設投資有限公司 (Huludao City Urban Construction Investment Company Limited, a state-owned enterprise engaged in the investment in, and operation of, infrastructure projects). The main terms of the joint venture contract relating to Huludao Xinao are set out in the paragraph headed “Further information about the Company – Particulars of the Existing Project Companies” in Appendix V to this prospectus.

The initial phase of piped gas development of Huludao Xinao currently in progress covers the Huludao city centre (which includes the Huludao Development Zone). The development involves the construction of more than 208 km of main pipelines. In addition to the existing processing station, a new processing station is to be constructed on the northern outskirts of the Huludao city centre, which is expected to have a designed daily capacity to supply 50,000 m³ of natural gas. Such station will also be equipped with LPG air mixing facilities as backup gas supply. As at 28 February 2001, a total of approximately 40 km of main pipelines had been constructed.

Natural gas for Huludao Xinao is currently being supplied by 渤海油田 (Bohai Gas Wells) at a connection point located to the south of the Huludao city centre. Huludao Xinao’s existing processing station is connected to such connection point by an approximately 2 km long intermediate pipeline. Pursuant to a gas supply agreement dated 31 January 2001 entered into between Huludao Xinao and 中海石油(中國)有限公司 (China National Offshore Oil (PRC) Limited), up to 30,000 m³ of natural gas from Bohai Gas Wells will be supplied per day to Huludao Xinao from 31 January 2001 through 5 November 2012.

THE GROUP'S BUSINESS

Huludao Xiniao began to sign supply contracts with its customers after the acquisition of the assets and liabilities of the Original Huludao Project on 24 December 1999. The table below summarises the number of supply contracts Huludao Xiniao has entered into since its establishment and up to 28 February 2001:

	Number of supply contracts	Contracted number of gas supply locations ⁽¹⁾	Number of gas connections made	Estimated daily gas consumption ⁽³⁾ (m ³)
Residential	10,402	17,243 households ⁽²⁾	14,547 households	5,819
Commercial and Industrial	20	20 sites	20 sites	4,627
	10,422	17,243 households and 20 sites	14,547 households and 20 sites	10,446

Notes:

- (1) Supply contracts in respect of 10,037 households and two commercial and industrial sites were entered into and gas connections were made to 8,802 households and two commercial and industrial sites when the assets and liabilities of the Original Huludao Project were taken over by Huludao Xiniao on 24 December 1999.
- (2) Contracted households represent approximately 11.3% of the current estimated residential households of approximately 152,000 in Huludao city centre (which includes the Huludao Development Zone).
- (3) Estimated daily gas consumption for households is calculated based on an average daily gas consumption of 0.4 m³ per household for those residential households with gas connections made. Estimated daily gas consumption for commercial and industrial customers is based on 50% of the installed designed daily capacity (as set out in the respective supply contract) of 9,254 m³ as at 28 February 2001 for those customers with gas connections made.

Information on Huludao

Huludao is a city located on the southwestern part of Liaoning Province with a total area of 10,415 km². It is also a seaport and one of the centres for heavy industry in the PRC which includes the petrochemical, mining and shipbuilding industries. The non-agricultural population together with both commercial and industrial activities of Huludao are concentrated in the Huludao city centre.

Huludao is rich in petroleum and gas resources with 渤海油氣田 (Bohai Oil Field) located off the coast of Huludao, which provides a stable, secure source of natural gas for the piped gas supply business of Huludao Xiniao.

The Group's operations in Huludao cover the Huludao city centre (which includes the Huludao Development Zone). The Huludao City People's Government has estimated that the total area of the Huludao city centre will increase from the existing size of 50 km² to 60 km² in 2010. In 1997, the Huludao City People's Government forecasted that the population of Huludao city centre would increase from approximately 340,000 in 1997 to approximately 400,000 in 2000 and approximately 500,000 in 2010. However, by 1999 the population of the Huludao city centre had already reached approximately 456,000 (comprising a total of approximately 152,000 households on the basis of the aforementioned PRC average household size), exceeding the forecast made by the Huludao City People's Government for 2000.

THE GROUP'S BUSINESS

The Huludao City People's Government has demonstrated its commitment to promote a non-polluted environment in Huludao and has required piped gas facilities to be included as a condition for approval of the design and construction of residential property development projects. On 21 August 2000, the Huludao City People's Government announced that effective as at 30 September 2000, all boilers in the Huludao city centre should comply with the emission requirements of the local environmental protection department.

With the planned construction of approximately 10 additional residential districts (with a total gross floor area of approximately 14,540,000 m²) in Huludao city centre during the next five years, and the aforementioned planned expansion of the Huludao city centre, the Directors believe that the economic activities and population will continue to grow thereby facilitating the growth in demand for connection and usage of natural gas.

Acquisition Companies

Pursuant to the Acquisition Agreements, the Company (through its wholly-owned subsidiaries) will acquire from XGCL its entire equity interests in each of the Acquisition Companies. XGCL is a joint stock limited company established in the PRC and is indirectly owned as to approximately 50.7% by Mr. Wang. The Acquisition Companies are **not** included in the existing structure of the Group as a result of the requirement that the Group must complete the acquisitions by means of foreign currency (which will be funded by the proceeds of the Placing) since such acquisitions, as advised by the Company's PRC legal adviser, could not be effected by way of share swaps and, therefore, must be settled in cash. Each of the Acquisition Agreements is conditional upon, inter alia, approval of the relevant local foreign trade and economic co-operation department being obtained and the satisfaction of the due diligence review on the Acquisition Companies and their assets (including property interests). The Group intends to complete the Acquisition Agreements as soon as practicable after the listing of Shares on GEM using funds raised by way of the Placing.

Jinggu Xinao

Information on Jinggu Xinao

Jinggu Xinao was established as a PRC joint venture on 11 August 2000 and is owned as to 70% by XGCL and 30% by 平谷縣液化石油氣公司 (Pinggu County LPG Company, a state-owned enterprise engaged in gas-related projects) for the purpose of providing piped gas to Pinggu. After successfully competing against a number of competitors, the Pinggu County People's Government granted Jinggu Xinao the exclusive right to develop and supply piped gas in the Pinggu county centre (which includes the 興谷開發區 (Xinggu Development Zone) and the 濱河開發區 (Binhe Development Zone)) on 18 July 2000.

As part of the Reorganisation, Pinggu BVI entered into a conditional agreement with XGCL on 31 January 2001 to acquire XGCL's entire equity interest in Jinggu Xinao for a consideration equal to the total amount invested by XGCL in Jinggu Xinao at the completion of the agreement. As at 28 February 2001, the total amount invested in Jinggu Xinao by XGCL was RMB6,930,000. Upon completion of the agreement, the legal status of Jinggu Xinao will be changed from a PRC joint venture to a Sino-foreign joint venture. The main terms of the joint venture contract relating to Jinggu Xinao are set out in the paragraph headed "Further information about the Company – Particulars of the Acquisition Companies" in Appendix V to this prospectus.

THE GROUP'S BUSINESS

The initial phase of piped gas development of Jinggu Xinao covers the Pinggu county centre (which includes the aforementioned development zones) and involves investment in the construction of more than 40 km of main pipelines with CNG pressure regulating facilities to be installed in a processing station to be located on the northern outskirts of the Pinggu county centre. As at 28 February 2001, a total of approximately 9 km of the main pipelines had been constructed.

Natural gas is currently being supplied to Jinggu Xinao by transporting CNG using CNG trucks to its processing station. This processing station has a current designed daily capacity to supply 72,000 m³ of natural gas. The pressure of the CNG is reduced to the requisite level at such station before delivery to end users via the main pipelines. Pursuant to a gas purchase agreement dated 10 January 2001 made between Jinggu Xinao and Langfang Xinao, Langfang Xinao will supply and deliver 7,000,000 m³ of natural gas per annum (in the form of CNG) to Jinggu Xinao for a period of three years at a price of RMB1.20 per m³ (during off-peak hours) or RMB1.60 per m³ (during peak hours). The purchase price was determined with reference to the market price and taking into account the transportation and operation costs. In the event of an adjustment in the gas purchase price payable by Langfang Xinao, Jinggu Xinao and Langfang Xinao will enter into a supplemental agreement with newly agreed upon prices. In addition, Jinggu Xinao entered into a gas purchase agreement dated 26 December 2000 with 北京天然氣集輸公司北京中油滙園公司 (Beijing Natural Gas Transportation Zhongyou Huiyuan Company) whereby Jinggu Xinao will be supplied with up to 2,000 m³ of natural gas per day during the winter and 1,000 m³ of natural gas per day during the summer for a period of one year commencing from the date of the agreement. Under this agreement, Jinggu Xinao is responsible for the collection of natural gas (in the form of CNG) at Yamenkou in Beijing.

Jinggu Xinao began to sign supply contracts with its customers in September 2000 and commenced the partial supply of natural gas in January 2001. The table below summarises the number of supply contracts Jinggu Xinao has entered into since its establishment and up to 28 February 2001:

	Number of supply contracts	Contracted number of gas supply locations	Number of gas connections made	Estimated daily gas consumption ⁽²⁾ (m ³)
Residential	69	1,282 households ⁽¹⁾	135 households	54
Commercial and industrial	1	1 site	1 site	200
	<u>70</u>	<u>1,282 households and 1 site</u>	<u>135 households and 1 site</u>	<u>254</u>

Notes:

- (1) Contracted households represent approximately 4.1% of the current estimated residential households of approximately 31,000 in the Pinggu county centre (which includes the Xinggu Development Zone and the Binhe Development Zone).
- (2) Estimated daily gas consumption for households is calculated based on an average daily gas consumption of 0.4 m³ per household for those residential households with gas connections made. Estimated daily gas consumption for commercial and industrial customers is based on 50% of the installed designed daily capacity (as set out in the respective supply contract) of 400 m³ as at 28 February 2001 for those customers with gas connections made.

THE GROUP'S BUSINESS

Information on Pinggu, Beijing Municipality

Pinggu is a county in the suburban area of Beijing Municipality with a total area of 1,070 km² and is located approximately 70 km to the northeast of Beijing city centre. Pinggu has numerous tourist attractions. The non-agricultural population and commercial activities of Pinggu are concentrated in the Pinggu county centre while the industrial activities are concentrated in the Xinggu Development Zone and the Binhe Development Zone, which are located within the northern and southern parts of the Pinggu county centre, respectively. In 1993, Pinggu (together with 13 counties within the Beijing Municipality) was approved by the State Council as a satellite city of Beijing Municipality and developmental policies have been established in order to encourage the movement of population from Beijing city centre to Pinggu.

The initial operations of Jinggu Xinao in Pinggu will cover the Pinggu county centre (which includes the aforementioned development zones). The Pinggu County People's Government has estimated that the total area of the Pinggu county centre will increase from the existing size of 19 km² to 24 km² by 2010. In 1999, the population of Pinggu county centre was approximately 93,000 (comprising a total of approximately 31,000 households on the basis of the aforementioned PRC average household size). The Pinggu County People's Government anticipates that the population of the Pinggu county centre for 2010 will increase by 104% to approximately 190,000 (comprising a total of approximately 63,000 households on the basis of the aforementioned PRC average household size).

The Beijing Municipality Government and Pinggu County People's Government have demonstrated their commitment to promote a non-polluted environment in Pinggu by closely monitoring the pollution in Beijing and setting targets for the improvement of air quality on an annual basis. It has also required all satellite cities in Beijing to ban the use of coal burning boilers. In 2000, the Pinggu County People's Government required piped gas facilities to be included in all new property development projects before the design and construction of such property development projects would be approved.

For the purpose of facilitating transportation between Beijing city centre and Pinggu and in order to encourage the migration of residents from the urban area of Beijing Municipality to its suburban area, the Beijing Municipality Government has built a highway, which was completed in 1999, connecting the Beijing city centre with the Pinggu county centre.

With the rapid development of Beijing, the aforementioned planned expansion of the county centre and the completion of the highway from Beijing city centre to Pinggu, the Directors believe that the economic activities and population will continue to grow thereby facilitating the growth in demand for connection and usage of natural gas.

Qingdao Xinao

Information on Qingdao Xinao

Qingdao Xinao was established as a PRC joint venture on 30 October 2000 and is owned as to 90% by XGCL and 10% by 青島經濟技術開發區熱電燃氣總公司 (Qingdao Economic and Technical Development Zone Heating, Electricity and Gas Corporation, a state-owned enterprise engaged principally in the supply of hot water and steam, the production and supply of electricity with steam and residual heat, the installation and maintenance of heating ducts, electrical engineering and urban construction) for the purpose of providing piped gas to Huangdao. On 30 September 2000, Qingdao Xinao was granted a right of first refusal to develop piped gas supply in Huangdao by the Huangdao District People's Government.

THE GROUP'S BUSINESS

As part of the Reorganisation, Huangdao BVI entered into a conditional agreement with XGCL on 31 January 2001 to acquire XGCL's entire equity interest in Qingdao Xinao for a consideration equal to the total amount invested by XGCL in Qingdao Xinao at the completion of the agreement. As at 28 February 2001, the total amount invested in Qingdao Xinao by XGCL was RMB18,000,000. Upon completion of the agreement, the legal status of Qingdao Xinao will be changed from a PRC joint venture to a Sino-foreign joint venture. The main terms of the joint venture contract relating to Qingdao Xinao are set out in the paragraph headed "Further information about the Company – Particulars of the Acquisition Companies" in Appendix V to this prospectus.

The initial phase of the piped gas development of Qingdao Xinao covers four sub-districts of Huangdao and involves investment in the construction of more than 50 km of main pipelines with CNG pressure regulating facilities to be installed at two processing stations, one of which has been constructed on the eastern outskirts (the "Huangdao East Station") and the other to be constructed in the central part of Huangdao district centre (the "Huangdao Central Station"). Additional backup LPG air mixing facilities will also be installed in the Huangdao Central Station. The CNG pressure regulating facilities have the ability to unload approximately 4,500 m³ of natural gas per hour from CNG trucks. As at 28 February 2001, a total of approximately 3 km of the main pipelines were constructed and CNG pressure regulating facilities with a designed daily capacity to supply approximately 12,000 m³ were installed at the Huangdao East Station.

Natural gas is currently being supplied to Qingdao Xinao by transporting CNG using CNG trucks to the Huangdao East Station. The pressure of the CNG is then reduced to the requisite level at such station before delivery to end users via the main pipelines.

The nearest sources of natural gas in Qingdao are the gas wells located in 昌邑 (Changyi), approximately 184 km to the north of Huangdao. Pursuant to a gas purchase agreement dated 4 November 2000 entered into between Qingdao Xinao and 勝利油田勝大集團油氣總公司 (Shengli Oil Field Shengda Group Oil and Gas Corporation), natural gas (in the form of CNG) will be supplied to Qingdao Xinao for a term of 15 years. From 4 November 2000 until the end of 2001, Qingdao Xinao will be supplied with up to 30,000 m³ of natural gas per day. Thereafter, the amount of gas to be supplied will be agreed upon annually. Qingdao Xinao will collect the CNG from Shengli Oil Field's gas station at Changyi.

Qingdao Xinao began to sign supply contracts with its customers in November 2000 and commenced the partial supply of natural gas in December 2000. The table below summarises the number of supply contracts Qingdao Xinao has entered into since its establishment and up to 28 February 2001:

	Number of supply contracts	Contracted number of gas supply locations	Number of gas connections made	Estimated daily gas consumption ⁽²⁾ (m ³)
Residential	13	1,184 households ⁽¹⁾	44 households	18
Commercial and industrial	–	–	–	–
	<u>13</u>	<u>1,184 households</u>	<u>44 households</u>	<u>18</u>

Notes:

- (1) Contracted households represent approximately 1.9% of the current estimated residential households of approximately 63,000 in Huangdao district centre.
- (2) Estimated daily gas consumption for households is calculated based on an average daily gas consumption of 0.4 m³ per household for those residential households with gas connections made.

THE GROUP'S BUSINESS

Information on Huangdao District, Qingdao City

Huangdao is a district of Qingdao City, Shandong Province. It has a total area of 214 km² and is also known as the Qingdao Economic and Technical Development Zone. Huangdao is separated from other districts of Qingdao City by 膠洲灣 (Jiaozhou Bay) and are approximately 5 km apart. Currently, transportation between Huangdao and Qingdao city centre is by ferry or via the 膠洲灣高速公路 (Jiaozhou Bay Expressway). There are five sub-districts in Huangdao with the non-agricultural population and commercial and industrial activities concentrated in four sub-districts around Jiaozhou Bay.

Huangdao, being the Economic and Technical Development Zone for Qingdao, is a centre for high technology industries in Qingdao. In addition, Huangdao is a popular tourist location with numerous attractions. To further develop Huangdao, a cross harbour bridge connecting Huangdao and the Qingdao city centre will commence construction in mid-2001. Upon completion of the bridge, the travelling time between Huangdao and the Qingdao city centre will be substantially reduced from the current time of approximately one hour to approximately five minutes.

The initial operations of Qingdao Xinao in Huangdao will cover four out of five sub-districts around Jiaozhou Bay. The Huangdao District People's Government has estimated that the total area of the Huangdao district centre will increase from the existing size of 27 km² to 54 km² by 2010. In 1999, the population of Huangdao was approximately 189,000 (comprising a total of approximately 63,000 households on the basis of the aforementioned PRC average household size). The Huangdao District People's Government anticipates that the population of Huangdao for 2010 will increase by 217% to approximately 600,000 (comprising a total of approximately 200,000 households on the basis of the aforementioned PRC average household size).

The Qingdao City People's Government and the Huangdao District People's Government have demonstrated their commitment to promote a non-polluted environment in Huangdao. In 1996, the Huangdao District People's Government limited the use of coal in manufacturing and in the production of electricity, and has required gas fuel to replace coal by 2010. In May 2000, the Qingdao City People's Government set a target to connect 90% of the households in Qingdao City with piped gas fuel by 2005.

With the construction of the cross harbour bridge between the Qingdao city centre and Huangdao, the promotion of the use of gas fuel by the government and the further development of Huangdao, the Directors believe that the economic activities and population will continue to grow thereby facilitating the growth in demand for connection and usage of natural gas.

Jingchang Xinao

Information on Jingchang Xinao

Jingchang Xinao was established as a PRC joint venture on 16 November 2000 and is owned as to 80% by XGCL and 20% by 北京市昌平市政經濟發展總公司 (Beijing City Changping Urban Economic Development Corporation ("Changping Corp"), a state-owned enterprise engaged in civil engineering, tourism and sale of building materials) for the purpose of providing piped gas to Changping. Prior to the establishment of Jingchang Xinao, Changping Corp and its then joint venture partner (the "Original Changping JV") supplied LPG to Changping (the "Changping LPG Project"). After successfully competing against a number of competitors, Jingchang Xinao was selected to replace the Original Changping JV and on 2 November 2000, was granted the exclusive

THE GROUP'S BUSINESS

right to develop and supply piped gas to satellite cities in Changping (which include the Changping district centre). In addition, during 2000, the Changping District People's Government declared that no small size LPG supply station could be built in the Changping district centre and Jingchang Xinao convinced the Changping District People's Government to replace the use of LPG with natural gas as the main source of piped fuel for Changping. The joint venture partner of Jingchang Xinao has contributed assets (including assets of the Changping LPG Project) of value equivalent to RMB1.98 million for its 20% interest in Jingchang Xinao and XGCL has contributed cash of RMB7.92 million for its 80% interest in Jingchang Xinao. On 27 November 2000, Jingchang Xinao formally took over the assets of the Changping LPG Project which includes 16 km main pipeline already constructed. After taking over such assets, Jingchang Xinao was able to immediately proceed with the necessary construction since the relevant approvals, permits and consents had already been obtained, which provided substantial savings of time and work.

As part of the Reorganisation, Changping BVI entered into a conditional agreement with XGCL on 31 January 2001 to acquire XGCL's entire equity interest in Jingchang Xinao for a consideration equal to the total amount invested by XGCL in Jingchang Xinao at the completion of the agreement. As at 28 February 2001, the total amount invested in Jingchang Xinao by XGCL was RMB7,920,000. Upon completion of the agreement, the legal status of Jingchang Xinao will be changed from a PRC joint venture to a Sino-foreign joint venture. The main terms of the joint venture contract relating to Jingchang Xinao are set out in the paragraph headed "Further information about the Company – Particulars of the Acquisition Companies" in Appendix V to this prospectus.

The initial phase of piped gas development of Jingchang Xinao covers the Changping district centre (which includes 中關村科技園區昌平園 (Changping sector of Zhongguangcun Science Park), a branch of Zhongguangcun Science Park, which is a famous district for high technology companies located in the urban area of Beijing, and involves the investment in the construction of more than 40 km of main pipelines with CNG pressure regulating facilities to be installed in the processing station and LPG air mixing facilities previously installed in respect of the Changping LPG Project as backup facilities. Such processing station is to be located on the northern outskirts of the Changping district centre (the "Changping North Station"). As at 28 February 2001, a total of approximately 16 km of the main pipelines had been constructed.

The Directors currently anticipate that the second phase of piped gas development for Jingchang Xinao will cover two satellite cities located within Changping, namely 小湯山鎮 (Xiaotangshan Town) located on the southeastern part of Changping and 沙河鎮 (Shahe Town) located to the south of the Changping district centre.

Natural gas is currently being supplied to Jingchang Xinao by transporting CNG using CNG trucks to the Changping North Station. This station has a current designed daily capacity to supply 72,000 m³ of natural gas. The pressure of the CNG is reduced to the requisite level at such station before delivery to end users via the main pipelines. Pursuant to a gas purchase agreement dated 10 January 2001 entered into between Jingchang Xinao and Langfang Xinao, Langfang Xinao will supply and deliver 7,000,000 m³ of natural gas per annum (in the form of CNG) to Jingchang Xinao for a period of three years at a price of RMB1.20 per m³ (during off-peak hours) or RMB1.60 per m³ (during peak hours). The purchase price was determined with reference to the market price and taking into account the transportation and operation costs. In the event of an adjustment to the gas purchase price payable by Langfang Xinao, Jingchang Xinao and Langfang Xinao will enter into a supplemental agreement with newly agreed upon prices. In addition, Jingchang Xinao entered into a gas purchase agreement dated 26 December 2000 with 北京天然氣集輸公司北京中油滙園公司 (Beijing Natural Gas Transportation Zhongyou Huiyuan Company)

THE GROUP'S BUSINESS

whereby Jingchang Xinao will be supplied with up to 4,500 m³ of natural gas per day during the winter and 2,000 m³ of natural gas per day during the summer for a period of one year commencing from the date of the agreement. Under this agreement, Jingchang Xinao is responsible for the collection of natural gas (in the form of CNG) at 衙門口 (Yamenkou) in Beijing.

The construction of two new long distance pipelines (both being the western extensions of the 陝甘寧長輸管道 (Shanganning long distance pipeline)) is currently being planned by the Beijing Municipality Government. The pipelines, being the 北湯綫 (the "Beitang Extension"), which connects the Shanganning long distance pipeline at 北苑 (Beiyuan) with Xiaotangshan Town, and the 回南綫 (the "Huinan Extension"), which connects the Shanganning long distance pipeline at 回龍觀 (Huilongguan) with 南口鎮 (Nankou Town) in Changping, pass nearby the Changping district centre and Shahe Town. It is currently expected that the Huinan Extension will be able to supply natural gas to Shahe Town by the end of 2001. Jingchang Xinao currently intends to construct an intermediate pipeline connecting the Huinan Extension with a new processing station to be located on the southern outskirts of the Changping district centre.

Jingchang Xinao began to sign supply contracts with its customers in November 2000 and commenced the partial supply of natural gas in December 2000. The table below summarises the number of supply contracts Jingchang Xinao has entered into since its establishment and up to 28 February 2001:

	Number of supply contracts	Contracted number of gas supply locations	Number of gas connections made	Estimated daily gas consumption ⁽²⁾ (m ³)
Residential	10	1,248 households ⁽¹⁾	284 households	114
Commercial and industrial	1	1 site	1 site	250
	<u>11</u>	<u>1,248 households and 1 site</u>	<u>284 households and 1 site</u>	<u>364</u>

Notes:

- (1) Contracted households represent approximately 4.0% of the current estimated residential households of 31,000 in Changping.
- (2) Estimated daily gas consumption for households is calculated based on an average daily gas consumption of 0.4 m³ per household for those residential households with gas connections made. Estimated daily gas consumption for commercial and industrial customers is based on 50% of the installed designed daily capacity (as set out in the respective supply contract) of 500 m³ as at 28 February 2001 for those customers with gas connections made.

Information on Changping, Beijing Municipality

Changping, being known as one of the back gardens of Beijing Municipality, is a district in the suburban area of Beijing Municipality with a total area of 1,352 km² and is located approximately 30 km to the northwest of Beijing city centre. The non-agricultural population and commercial activities of Changping are both concentrated in the Changping district centre with industrial activities concentrated in the Changping Science Park. In 1993, Changping (together with 13 counties within Beijing Municipality) was approved by the State Council as a satellite city of Beijing Municipality and developmental policies have been established in order to encourage movement of the population from Beijing city centre to Changping.

THE GROUP'S BUSINESS

The initial operations of Jingchang Xinao in Changping will cover the Changping district centre. The Beijing Municipality Government has estimated that the total area of the Changping district centre will increase from the existing size of 10 km² to 19 km² in 2010. In 1999, the population of Changping district centre was approximately 94,000 (comprising a total of approximately 31,000 households on the basis of the aforementioned PRC average household size). The Changping District People's Government anticipates that the population of Changping district centre for 2010 will increase by 76% to approximately 165,000 (comprising a total of approximately 55,000 households on the basis of the aforementioned PRC average household size).

The Beijing Municipality Government and the Changping District People's Government have demonstrated their commitment to promote a non-polluted environment in Changping due to Changping's close proximity to the urban area of Beijing and its status as a tourist attraction in Beijing. The Changping District People's Government has restricted the use of environmentally unfriendly fuel in its district centre since 2000 and has required piped gas facilities to be included as a condition for approval of the design and construction of property development projects.

In order to facilitate access between Changping and Beijing city centre and to promote migration of the population from the urban area of Beijing Municipality to its suburban area, the 八達嶺高速公路 (Badaling Expressway) was completed in 1998 connecting Beijing city centre with Changping district centre.

With the rapid development of Beijing and the aforementioned planned expansion of Changping district centre, the Directors believe that the economic activities and population will continue to grow thereby facilitating the growth in demand for connection and usage of natural gas.

New Projects

The New Projects are Project Jingzhou, Project Chengyang and Project Zhucheng which envisage the establishment of Jingzhou Xinao, Chengyang Xinao and Zhucheng Xinao. **As at the Latest Practicable Date, the New Project Companies have not been established.**

Project Jingzhou

Information on Jingzhou Xinao

Jingzhou BVI entered into a Sino-foreign joint venture contract with 荊州市城市建設投資開發公司 (Jingzhou City Urban Construction Investment Development Company ("Jingzhou Investment"), a state-owned enterprise engaged in city construction investment) on 23 March 2001 relating to the establishment of Jingzhou Xinao. Jingzhou Xinao will be owned as to 80% by Jingzhou BVI and 20% by Jingzhou Investment for the purpose of providing piped gas to Jingzhou, which was previously undertaken by 荊州市燃氣總公司 (Jingzhou City Gas Corporation) in connection with the supply of coal gas to Jingzhou (the "Jingzhou Coal Gas Project").

The establishment of Jingzhou Xinao is subject only to approval of the relevant foreign trade and economic co-operation department in Jingzhou. Jingzhou BVI is in the course of applying, for the granting of the exclusive right to operate piped gas in Jingzhou district centre (which includes the Jingzhou Economic and Technical Development Zone (the "Jingzhou Development Zone")) to be issued in the name of Jingzhou Xinao. The main terms of the Sino-foreign joint venture contract are set out in the paragraph headed "Further information about the Company – Particulars of the New Project Companies" in Appendix V to this prospectus.

THE GROUP'S BUSINESS

Pursuant to the Sino-foreign joint venture contract, Jingzhou Investment has agreed to inject assets of a value equivalent to RMB12 million (including assets of the Jingzhou Coal Gas Project such as approximately 30 km of main pipelines and a processing station located on the eastern outskirts of the Jingzhou city centre with a designed daily capacity to supply 700,000 m³ of coal gas into Jingzhou Xinao) as a capital contribution for its 20% interest in Jingzhou Xinao. The approximately 23,000 existing residential customers of the Jingzhou Coal Gas Project will also be transferred to Jingzhou Xinao and it is expected that Jingzhou Xinao will continue to supply piped coal gas to these customers after the transfer. The supply of coal gas will be replaced by the supply of natural gas at a later date as described below.

The initial phase of piped gas development of Jingzhou Xinao covers the Jingzhou district centre and involves the investment in the construction of more than 2 km of intermediate pipeline and 110 km of main pipelines with pressure regulating facilities to be installed in a new processing station to be located on the northern outskirts of the Jingzhou city centre. The new processing station has a designed daily capacity to supply 300,000 m³ of natural gas and is expected to be supported by LPG air mixing facilities as backup gas supply and will replace the coal gas facilities located in the existing processing station.

As mentioned in the PRC's tenth five-year plan for the period 2001 to 2005, one of the PRC Government's pillar projects is to construct various long distance pipelines connecting the natural gas rich western provinces to the more affluent eastern provinces. One of these pipelines will connect the gas fields in 四川 (Sichuan) to 武漢 (Wuhan) which passes nearby Jingzhou. Construction of this long distance pipeline began in mid-2000 and is expected to be completed in 2002. Jingzhou will be one of the first cities to be supplied with natural gas by this long distance pipeline. It is currently intended that Jingzhou Xinao will construct an intermediate pipeline connecting the new long distance pipeline with the aforementioned new processing station.

Prior to the completion of the new processing station and the availability of natural gas supply via the long distance pipeline to Jingzhou, it is expected that Jingzhou Xinao will continue to supply coal gas utilising the existing pipeline and coal gas facilities located in the existing processing station. Coal gas will be purchased under an agreement entered into by the existing operator. Thereafter, the supply of piped coal gas in Jingzhou will be replaced by natural gas. The natural gas will be supplied through the intermediate pipeline to the new processing station at which point the pressure of the natural gas will be reduced to the requisite level before delivery to end users via the main pipelines. A gas purchase agreement will be entered into after Jingzhou Xinao is established to take over the operations.

Information on Jingzhou

Jingzhou is the second largest city in Hubei Province (based on population) with a total area of 12,000 km² and is located approximately 220 km west of Wuhan. The non-agricultural population together with both commercial and industrial activities of Jingzhou are concentrated in the Jingzhou city centre. Jingzhou is well connected to other parts of the PRC by means of roads, railways, waterways and air transportation. Jingzhou is also a popular historical city with numerous tourist attractions.

The initial operations of Jingzhou Xinao will cover the Jingzhou district centre (including the Jingzhou Development Zone). It is currently envisaged that the total area of the Jingzhou city centre will increase from the existing size of 54 km² to 75 km² by 2010. In 1999, the population of Jingzhou city centre was approximately 602,000 (comprising a total of approximately 201,000 households on the basis of the aforementioned PRC average household size). The Jingzhou City

THE GROUP'S BUSINESS

People's Government anticipates that the population of the Jingzhou city centre for 2010 will increase by 33% to approximately 800,000 (comprising a total of approximately 267,000 households on the basis of the aforementioned PRC average household size). In addition, the Jingzhou City People's Government forecasted that the natural gas usage for Jingzhou will increase to approximately 85 million cubic metres per annum in 2005 and 191 million cubic metres per annum in 2010.

The Jingzhou City People's Government has demonstrated its commitment to promote a non-polluted environment in Jingzhou. In order to reduce air pollution in the Jingzhou city centre, the Jingzhou People's Government plans to encourage the use of dual-fuel vehicles. The Jingzhou City People's Government also plans to require manufacturers with high energy consumption such as fertiliser manufacturers and neon light producers to use natural gas as fuel in their production process. In addition, the Jingzhou City People's Government has required piped gas facilities to be included as a condition for approval of the design and construction of property development projects.

With the development and planned expansion of the Jingzhou city centre, which includes the Jingzhou Development Zone, the Directors believe that economic activities and population will continue to grow thereby facilitating the growth in demand for connection and usage of natural gas.

Project Chengyang

Information in Chengyang Xinao

Chengyang BVI entered into a Sino-foreign joint venture contract with 青島市城陽區建設工程監理處 (Qingdao City Chengyang District Construction Engineering Supervisory Office ("Chengyang Construction"), a state-owned enterprise engaged in the supervision of utility projects) on 31 January 2001 relating to the establishment of Chengyang Xinao. Chengyang Xinao will be owned as to 90% by Chengyang BVI (a wholly-owned subsidiary of Xinao Gas Investment) and 10% by Chengyang Construction for the purpose of providing piped gas to Chengyang.

The Chengyang District People's Government has approved the operation of piped gas in Chengyang district centre (which includes the Qingdao Round Sea Economical and Technical Development Zone (the "Chengyang Development Zone")) by Xinao Gas Investment or its subsidiary and has granted it the exclusive right to develop and supply piped gas to the Chengyang district centre for a period of 30 years. The establishment of Chengyang Xinao is subject only to the approval of the relevant foreign trade and economic co-operation department in Qingdao City. The main terms of the Sino-foreign joint venture contract are set out in the paragraph headed "Further information about the Company – Particulars of the New Project Companies" in Appendix V to this prospectus.

The initial phase of piped gas development of Chengyang Xinao is currently intended to cover the Chengyang district centre which will involve the construction of more than 30 km of main pipelines with pressure regulating facilities to be installed in the processing station located on the northwestern outskirts of the Chengyang district centre. Such station has a designed daily capacity to supply 30,000 m³ of natural gas and is supported by LPG air mixing facilities as backup gas supply.

Natural gas will be supplied to Chengyang by transporting CNG via CNG trucks to the processing station. The pressure of the CNG will be reduced to the requisite level at such station before delivery to end users via the main pipelines.

THE GROUP'S BUSINESS

The nearest source of natural gas in Qingdao are the gas wells located in 昌邑 (Changyi), approximately 100 km northwest of Chengyang. The Group is currently negotiating a gas purchase agreement with 勝利油田勝大集團油氣總公司 (Shengli Oil Field Shengda Group Oil Corporation) on terms similar to the gas purchase agreement already entered into by XGCL in respect of Qingdao Xinao with such corporation. It is expected that a gas purchase agreement will be signed after Chengyang Xinao is established.

Information on Chengyang District, Qingdao City

Chengyang is a district within Qingdao City with a total area of 553 km² and is located approximately 35 km to the north of the Qingdao city centre. The non-agricultural population together with both commercial and industrial activities of Chengyang are concentrated in the Chengyang district centre. Chengyang is well connected to other parts of the PRC by air, sea and road transportation. The Qingdao International Airport, Qingdao Harbour, railway and numerous expressways support the district.

Furthermore, the Qingdao City People's Government is currently constructing an underground railway connecting Qingdao city centre and Chengyang district centre for the purpose of facilitating access to the city centre of Qingdao and promoting migration of the population from the city centre of Qingdao to Chengyang. Upon completion, the travelling time between the Chengyang district centre and the Qingdao city centre will be reduced from 50 minutes to 20 minutes.

The initial operations of Chengyang Xinao in Chengyang are currently intended to cover the Chengyang district centre (which includes the Chengyang Development Zone). The Chengyang District People's Government has estimated that the total area of Chengyang district centre will increase from the existing size of 7 km² to 22 km² by 2010. In 1999, the population of Chengyang district centre was approximately 50,000 (comprising a total of approximately 17,000 households on the basis of the aforementioned PRC average household size). The Chengyang District People's Government anticipates that the population of Chengyang district centre for 2010 will increase by 220% to approximately 160,000 (comprising a total of approximately 53,000 households on the basis of the aforementioned PRC average household size).

The Qingdao City People's Government and the Chengyang District People's Government have demonstrated their commitment to promote a non-polluted environment for Chengyang. The Chengyang District People's Government has required piped gas facilities to be included as a condition for approval of the design and construction of property development projects. In May 2000, the Qingdao City People's Government set a target to connect 90% of the households in Qingdao City with piped gas fuel by 2005.

With the planned construction of the underground railway and the aforementioned planned expansion of the Chengyang district centre, the Directors believe that the economic activities and population will continue to grow thereby facilitating the growth in demand for connection and usage of natural gas.

THE GROUP'S BUSINESS

Project Zhucheng

Information on Zhucheng Xinao

Zhucheng BVI entered into a Sino-foreign joint venture contract with 諸城市燃氣熱力總公司 (Zhucheng City Gas and Heating Corporation (“Zhucheng Gas”), a state-owned enterprise engaged in the sale of LPG and gas-related business) on 31 January 2001, relating to the establishment of Zhucheng Xinao. Zhucheng Xinao will be owned as to 80% by Zhucheng BVI and 20% by Zhucheng Gas for the purpose of providing piped gas to Zhucheng. Prior to the establishment of Zhucheng Xinao, Zhucheng Gas supplied LPG to Zhucheng (the “Zhucheng LPG Project”).

The Zhucheng City People's Government has approved in-principle the operation of piped gas in the Zhucheng district centre (which includes the Zhucheng Eastern Economic and Technical Development Zone (the “Zhucheng Development Zone”)) by Zhucheng Xinao and has granted Zhucheng Xinao the exclusive right to develop and operate piped gas supply for the Zhucheng city centre (including Zhucheng Development Zone) for a period of 30 years. The establishment of Zhucheng Xinao is subject only to the approval of the relevant foreign trade and economic co-operation department in Zhucheng City. The main terms of the Sino-foreign joint venture contract are set out in the paragraph headed “Further information about the Company – Particulars of the New Project Companies” in Appendix V to this prospectus.

Pursuant to the Sino-foreign joint venture contract, Zhucheng Gas has agreed to inject assets of a value equivalent to US\$600,000 (including assets of the Zhucheng LPG Project) into Zhucheng Xinao as capital contribution for its 20% interest in Zhucheng Xinao. The assets consist mainly of LPG installed storage facilities and customers' pipelines constructed separately at each of the existing residential LPG supply locations in the Zhucheng city centre.

The initial phase of piped gas development of Zhucheng Xinao is currently intended to cover the Zhucheng city centre (including the Zhucheng Development Zone) and will involve investment in the construction of more than 60 km of main pipelines with pressure regulating facilities to be installed in the processing station located on the northern outskirts of the Zhucheng city centre. Such station will have a planned daily capacity to supply 40,000 m³ of natural gas to its Operational Location and will be supported by LPG air mixing facilities as backup gas supply. Regarding the existing customers of the Zhucheng LPG Project, it is expected that Zhucheng Xinao will continue to supply LPG to such customers to be replaced with natural gas by connecting main pipelines to the relevant customers' pipelines. The LPG storage tanks currently located at such existing supply locations will be relocated to the aforementioned processing station.

Natural gas will be supplied to Zhucheng by transporting CNG via CNG trucks to the processing station where the pressure of the CNG will be reduced to the requisite level at such station before delivery to end users via main pipelines.

The nearest source of natural gas from Zhucheng is the gas wells located in 昌邑 (Changyi), approximately 100 km northwest of the Zhucheng city centre. The Group is currently negotiating a gas purchase agreement with 勝利油田勝大集團油氣總公司 (Shengli Oil Field Shengda Group Oil Corporation) on terms similar to the gas purchase agreement already entered into by Qingdao Xinao with such corporation. It is expected that a gas purchase agreement will be signed after Zhucheng Xinao is established.

THE GROUP'S BUSINESS

The PRC Government is currently considering the feasibility of constructing a long distance pipeline for obtaining natural gas from the Russian Federation to日照 (Rizhao) (located approximately 50 km from Zhucheng), which will pass nearby Zhucheng. Such long distance pipeline could provide additional natural gas supply to Zhucheng Xinao if the PRC Government decides to proceed with such construction.

Information on Zhucheng

Zhucheng is a city situated at the southeastern part of Shandong Province with a total area of 2,183 km². The non-agricultural population together with both industrial and commercial activities of Zhucheng are concentrated in the Zhucheng city centre. Zhucheng is also an important transportation interchange for the coastal and inland area for Shandong.

The initial operations in Zhucheng are currently intended to cover the Zhucheng city centre (which includes the Zhucheng Development Zone). The Zhucheng City People's Government has estimated that the total area of Zhucheng city centre will increase from the existing size of 16 km² to 34 km² by 2010. In 1999, the population of Zhucheng city centre was approximately 110,000 (comprising a total of approximately 37,000 households on the basis of the aforementioned PRC average household size). The Zhucheng City People's Government anticipates that the population of Zhucheng city centre for 2010 will increase by 173% to approximately 300,000 (comprising a total of approximately 100,000 households on the basis of the aforementioned PRC average household size).

The Zhucheng City People's Government has demonstrated its commitment to promote a non-polluted environment for Zhucheng and has implemented restrictions on emissions for the Zhucheng city centre. In addition, approval is required from the environmental protection department for any extension or construction of any coal burning boilers in the Zhucheng city centre.

With the planned construction of new residential premises in Zhucheng city centre (having a total gross floor area of approximately 2,700,000 m²) in the next five years and the planned expansion of the Zhucheng city centre, the Directors believe that the economic activities and population will continue to grow thereby facilitating the growth in demand for connection and usage of natural gas.

SALES AND MARKETING

The Group's head office will be responsible for structuring the Group's overall sales and marketing strategies. The individual sales and marketing team of each Project Company will work together with the head office team to structure an appropriate plan with reference to a specific Operational Location's situation and needs. The sales and marketing team is responsible for company imaging and brand building as well as promoting the advantages and concept of using natural gas as a necessary part of modern day life. Shortly after a Project Company is established, the Group will implement a series of promotional campaigns (which may include joint promotional campaigns with the local government) to increase public awareness of piped gas in an Operational Location. At around the same period, the Group will also commence active marketing negotiations on the terms of supply contracts with target customers with the aim of entering into supply contracts with potential customers as soon as possible. The Group's customers can be classified into two broad categories, namely (i) residential customers and (ii) commercial and industrial customers. Different marketing strategies are adopted for different customer groups.

THE GROUP'S BUSINESS

As at 28 February 2001, the Group has made gas connections to a total of 67,697 households and 257 commercial and industrial sites (connected to gas appliance facilities with a total installed designed daily capacity of approximately 148,014 m³). For each of the three financial years ended 31 December 2000, the Group's largest customer accounted for approximately 5.7%, 7.6% and 11.0% of the Group's total turnover, respectively. For the same period, the Group's five largest customers accounted in aggregate for approximately 20.3%, 22.3% and 30.3% of the Group's total turnover, respectively.

For the purpose of the GEM Listing Rules, save for Langfang Xincheng Property Development Company Limited, none of these five largest customers are associated with any of the Directors, chief executives, management Shareholders or substantial Shareholders or any of their respective associates.

Residential customers

Gas is primarily used by residential owners for cooking and water and space heating. The Group focuses on marketing to property developers, government departments and organisations and state-owned enterprises as these entities enter into master supply contracts with the Group for the connection of gas to all the units within a residential development (new or existing, owned by such entities or their respective employees). These entities are responsible for, or coordinate, the advance payment of connection fees to the Group, while gas usage charges are paid by the individual households.

In respect of new residential developments, connection fees are collected in advance by installment based on the percentage-of-completion of the pipeline construction work. The Group receives full payment of connection fees once construction is completed irrespective of whether the units are sold or occupied. The actual supply of gas will, however, only commence after the unit is occupied.

The Group also markets to owners' committees of existing buildings without piped gas supply. Representatives of the owners' committees will consult individual households as to whether they wish to have piped gas supply and coordinate the collection of connection fees from the households on the Group's behalf. Both connection fees and gas usage charges are payable in advance by the individual households.

Commercial and industrial customers

Commercial customers use natural gas primarily for heating, air conditioning, water heating and cooking purposes. These customers include owners of hotels, restaurants, office buildings, shopping centres, hospitals, educational establishments, sports and leisure facilities and exhibition halls. Natural gas has a wide variety of applications for industrial customers such as fueling industrial boilers, furnaces, ovens, incinerators, foundries and steamers as well as water and space heating in staff canteens and dormitories within the industrial customers' premises. The Group enters into supply contracts with these customers for the connection of gas to their premises, and both connection fees (payable in advance) and gas usage charges (payable monthly in arrears) are borne by such customers.

Although the existing number of commercial and industrial customers are less than the number of residential customers, these customers are equally important to the Group as they are high volume gas users. The Directors are confident that with adequate sales and marketing efforts, the number of commercial and industrial customers will gradually increase in the future.

THE GROUP'S BUSINESS

PRICING

Connection fees are determined after a detailed analysis of factors such as estimated capital expenditure, number of users, growth in penetration rates, income levels and affordability of local residents. The Group arrives at the gas usage charges after taking into consideration the wholesale price of gas, operating costs, the price of substitute products and the purchasing power of local residents. As mentioned in the sub-paragraph headed "Securing a new Operational Location" above, connection fees and gas usage fees are subject to the approval of the local state price bureau. Future price increases are also subject to the same approval process. In considering applications for an increase in gas usage charges, the local state price bureau may consider factors such as increases in the wholesale price of gas or operating expenses, inflation, additional capital expenditure, and whether the profit margin remains fair and reasonable.

For each of the three financial years ended 31 December 2000, connection fees accounted for approximately 77.7%, 72.8% and 82.8% of the Group's total turnover, respectively. Gas usage charges accounted for approximately 22.0%, 27.1% and 16.8% of the Group's total turnover for each of the three years ended 31 December 2000, respectively. Connection fees and gas usage charges are usually settled by bank drafts denominated in Renminbi. During the Track Record Period, the Group recorded an insignificant amount of bad debts.

Connection fees

The Group charges residential customers a flat connection fee for connections made in respect of each type of gas appliance, namely cooking stoves, water heaters and boilers, the latter of which provides both space and water heating. The level of connection fees and whether such fees are inclusive of a particular gas appliance varies among Operational Locations and are approved by the relevant local state price bureau. In the event supply contracts are entered into for the connection of gas to a large number of households within a residential development, discounts of up to 10% of the approved fee payable may be offered, the extent of which will be subject to negotiation and agreement between the contract parties.

For commercial and industrial customers, the connection fee is determined based on the designed capacity of the gas appliance facilities (on a per cubic metre per day basis) installed at the customers' premises. Should additional appliances be installed subsequently, these customers are required to pay additional connection fees to reflect the additional capacity installed. Generally, if gas usage volume is expected to be large, discounts of 5% to 25% of the approved fee payable may be offered, the extent of which will be subject to negotiation and agreement between the contract parties.

The table below sets out the approved connection fees for each Existing Project Company as at 28 February 2001:

Name of Existing Project Companies	Residential users			Commercial & industrial users (RMB/day/m ³)
	Cooking stove (RMB/household)	Water heater (RMB/household)	Boiler (RMB/household)	
Langfang Xinao	3,200 <i>(Note)</i>	2,200	2,500	1,200
Liaocheng Xinao	2,400	740	n.a.	680
Beijing Xinao	3,300 <i>(Note)</i>	1,800	2,500	600
Huludao Xinao	2,350	n.a.	4,000	900

Note: Inclusive of relevant gas appliance.

THE GROUP'S BUSINESS

Gas usage charges

Gas usage charges are based on actual usage on a per cubic metre basis. The gas usage charges per cubic metre vary between Operational Locations, and the payment mechanism between different categories of customers is different.

Since September 1996, residential customers of Langfang Xinao have purchased gas units in cash at the Group's sales outlet with details of the prepaid gas units stored electronically in a stored value card. The stored value card is inserted into a stored value card gas metre installed at the user's premises to activate the gas supply. Units of gas used are deducted from the stored value card. When the level of prepaid gas units drops to a certain level (currently pre-set at 3 m³), the gas metre will produce a sound signal to remind the customer to replenish the value stored in the stored value card. Since the Group will not be able to raise the gas usage charges for the gas units sold, the Group has imposed a limit on the maximum amount of gas units that can be stored in the stored value cards to prevent excess prepayment by residential customers in anticipation of future price increases. The Group has set the maximum stored value at 100 m³, and for households with boilers, a maximum stored value of 500 m³. The same payment mechanism is used by the other Existing Project Companies and will be used by the Acquisition Companies and the New Project Companies.

For those residential customers without a stored valued card gas metre installed (amounting to 17,424 households) and for commercial and industrial customers, payment for gas usage charges are made in arrears. Gas metres that record actual gas consumption are installed at the users' premises and metre readings are taken physically by the Group every month. Monthly bills based on the prior month's actual usage are then sent to customers and are immediately payable. In general, settlements are received by the Group about one week from the date of billing. In respect of commercial users with large gas usage volume, the Group may offer discounts of 14% to 30% of the approved charges, the extent of which will be subject to negotiation and agreement between the parties.

The table below sets out the approved gas usage charges (inclusive of value added tax of 13%) for each Existing Project Company as at 28 February 2001:

Name of Existing Project Companies	Residential users (RMB per m ³)	Commercial & industrial users (RMB per m ³)
Langfang Xinao	1.2	1.4 ^(Note)
Liaocheng Xinao	1.8	2.0
Beijing Xinao	2.5	2.9
Huludao Xinao	2.1	3.0

Note: Pursuant to the approval granted, the approved gas usage charges for schools, old aged homes and hospitals is RMB1.2 per m³.

PURCHASES

The main categories of purchases made by the Group are gas, pipes, machinery, equipment and gas appliances. Save for the purchase of CNG by Beijing Xinao from Langfang Xinao, all of the materials purchased by the Group were acquired from independent third parties during the Track Record Period.

THE GROUP'S BUSINESS

For each of the three financial years ended 31 December 2000, the Group's largest supplier accounted for approximately 34.4%, 35.5% and 23.1% of the Group's total purchases, respectively, and the Group's five largest suppliers accounted for approximately 79.2%, 75.9% and 59.8% of the Group's total purchases, respectively. For the purpose of the GEM Listing Rules, none of these five largest suppliers are connected with any of the Directors, chief executives, management Shareholders or substantial Shareholders or any of their respective associates.

The Group has established firm business relationships with its major suppliers for long periods (ranging from two to eight years). The Directors believe that the Group has good relationships with its suppliers and the Group has not experienced any difficulty in the sourcing of natural gas or other major supplies.

Gas

The Group has entered into gas purchase agreements to purchase natural gas (the terms of which range from one to 15 years). The wholesale price of natural gas is agreed between the suppliers and the Group with reference to the wellhead price, distance of transportation of gas, purification fees and the supplier's operating costs. The wellhead price of natural gas, which is determined by the State Development and Planning Commission with approval from the State Council, is currently set at RMB0.90 per m³ with a 10% allowance for upward or downward adjustments as a result of negotiations between suppliers and distribution companies. Since 1993, the wellhead price has increased only twice, but such increase was absorbed by Langfang Xinao and was not passed on to its customers in order to develop the market. LPG (currently used as a backup gas source) is purchased when appropriate at the prevailing market price.

The quantity of natural gas to be supplied to the Group by its suppliers is usually stated in the gas purchase agreements. The Group is only required to pay the actual quantity purchased and there is no penalty to the Group should the Group purchase less than the stated amount. The Directors are satisfied that the stated quantities of natural gas as set out in the relevant existing gas purchase agreements are sufficient for the potential demand of gas by the respective Project Companies.

Payment for natural gas by the Group to its suppliers is made monthly in advance and is based on the estimated purchase submitted quarterly by the Group. Any surplus will be carried forward as part of the pre-payment for the next calendar month and is recorded by a metre installed at the point where the Group's intermediate pipelines connect with the suppliers' long distance pipelines. Payment for gas purchased is made by the Group by bank drafts denominated in Renminbi in accordance with the gas supply agreements.

Pipes, machinery and equipment

The Group purchases pipes of various diametres and thicknesses for installation in different segments of the gas pipeline infrastructure (the specifications of which must comply with PRC standards and regulations). The Group also purchases machinery and equipment, both domestically and abroad.

Pipes are purchased domestically and payments are settled in Renminbi with credit terms ranging from 30 to 90 days. Machinery and equipment are sourced domestically and externally from the United States and Italy. Payments for equipment and machinery purchased are primarily settled in Renminbi (in the case of domestic purchases) and US dollars (in the case of overseas

THE GROUP'S BUSINESS

purchases) by letters of credit or telegraphic transfer with credit terms ranging from 30 to 90 days. Payments settled in Renminbi represented approximately 100%, 81.8% and 100% of the total pipes, machinery and equipment purchases for each of the three financial years ended 31 December 2000.

Gas appliances

As residential customers often require the Group to provide gas appliances, the Group purchases gas appliances in bulk directly from manufacturers in the PRC and holds a limited amount of stock. The Group will provide customers repair and maintenance services to the gas appliance facilities it has supplied. Payments are usually settled by bank drafts denominated in Renminbi one month after receipt of goods. The Directors believe that the Group has good relationships with its suppliers.

SAFETY AND QUALITY CONTROL

Safety

The Group places great emphasis on safety control and has, accordingly, adopted a safety administrative system and set up a safety department to oversee safety issues for the Project Companies. The Group carries out, through the Project Companies, routine inspection of the branch pipelines, customers' pipelines, gas metres and gas appliances at the customers' premises twice a year. These semi-annual inspections are free unless major repairs are required in which case the Group charges the customers for labour, replacement parts and other materials used for the repairs.

The Group believes in educating users about safety procedures. Accordingly, before gas is actually supplied, the Group will give a thorough explanation of safety procedures to users, and will arrange regular seminars or distribute brochures and booklets on safety for end users. A 24-hour hotline for enquiries and emergency repairs is also in operation at each Operational Location.

In order for the Group to monitor the operations of the pipelines, in particular, gas usage, gas leakages, or any other irregularities, the Group collects information about the temperature, pressure and volume of gas from key points along the main pipelines. The information is collated in the control centre located in the head office of each Operational Location for analysis. In Langfang, a computerised system known as Supervisory Control and Data Acquisition system ("SCADA") is used whereby a number of small detectors are installed along the main pipelines to collect such information and send it back to the control centre electronically. In other locations, the information collection is currently carried out manually by the Operational Location's own personnel. The Group plans to install the SCADA system in other Operational Locations when the customer base reaches a sizeable level. Each Project Company conducts a major inspection of its pipelines, processing station and other equipment at least once a year. Should gas leakages or any other irregularities be detected, the Group will take remedial action immediately.

Due to the Group's strict implementation of safety control procedures, there have been no major accidents which have resulted in serious injury or death since the Group began operations in 1993.

THE GROUP'S BUSINESS

Quality control

Quality control begins in the design and construction phase of the gas supply infrastructure. The quality control team is comprised of a team of five engineers who regularly make inspection visits and conduct tests to ensure that construction work meets the Group's required standards.

The Group also has strict quality control procedures for the sourcing of raw materials. As such, the Group only purchases from its approved list of qualified suppliers.

In order to monitor the quality of gas purchased by the Group, the Group obtains gas composition reports regularly from its gas suppliers with details on the heat content and composition of impurities. The Group also conducts tests on the gas purchased in order to verify the quality.

RESEARCH AND DEVELOPMENT

As at 28 February 2001, the Group had an in-house research and development team of approximately 40 employees, a majority of whom specialise in the fields of energy, mechanical and electronic engineering. Areas under research and development include:

- methods to increase operating efficiency and safety standards;
- expansion of the applications of natural gas, such as gas fuelled air conditioners, washing machines and dryers, and use of CNG in motor vehicles; and
- improvement of gas storage and transportation methods.

Furthermore, to closely track gas-related developments overseas, representatives from the research and development department regularly attend international gas conferences and have exchange programmes with overseas gas companies.

There were no research and development expenses for the two financial years ended 31 December 1999. Research and development expenses for the financial year ended 31 December 2000 amounted to approximately RMB762,000.

COMPETITION

Due to the nature of the piped gas supply business, where substantial capital investment and extensive physical installation of gas pipeline infrastructure are required, it is not economically or practically feasible for more than one distribution company to operate in one location. Therefore, the local government will normally grant exclusive rights or rights of first refusal to a selected distributor to operate in a location. Once the Group has identified a potential Operational Location, it will negotiate with the local government to obtain an exclusive right or right of first refusal to supply gas to that Operational Location, which might cover the whole or the most densely populated areas of such Operational Location. In the process of securing such exclusive rights or rights of first refusal, the Group may face competition from other distribution companies which include stated-owned companies and non state-owned enterprises. Once the Group has successfully obtained an exclusive right or right of first refusal, that Operational Location is considered to be secure and the Group will not face competition from another piped gas distribution company. Due to the Group's extensive experience and sound track record of safe and reliable piped gas supply to end-users, the Directors believe that the Group will be able to successfully obtain exclusive rights or

THE GROUP'S BUSINESS

rights of first refusal to supply gas to new Operational Locations notwithstanding inevitable strong competition from other companies. As at the Latest Practicable Date, the Existing Project Companies have obtained exclusive rights to supply gas to their respective Operational Locations and the Acquisition Companies have obtained exclusive rights or rights of first refusal to supply gas to their respective Operational Locations.

After the Group secures an Operational Location, the Group faces competition from existing providers of other fuel substitutes such as bottled LPG, coal and to a lesser extent electricity, as electricity for heating purposes is more expensive than gas and less popular for cooking purposes. The Directors believe that with the PRC Government's planned phasing out of the use of coal as a result of its environmental policies, and the comparative advantages of natural gas over coal and LPG as a safer, cleaner and more convenient form of fuel, competition from other fuel substitutes does not represent a serious threat to the Group's business. From a cost perspective and on an energy adjusted per unit basis, natural gas is more economical than bottled LPG and electricity.

Each of the Initial Management Shareholders and XGCL has entered into a non-competition deed (conditional upon the listing of, and commencement of dealing in, the Shares on GEM) on 28 March 2001. Under the non-competition deeds, the Initial Management Shareholders and XGCL have irrevocably undertaken and covenanted with the Company that they will not and will procure that their respective associates shall not, directly or indirectly, during the period from the date on which the non-competition deed shall take effect and until the date on which the non-competition deed is terminated in accordance with the terms therein, carry on for their own accounts or for any other persons, firm or organisation any business which is or may be in competition with (i) the business currently carried on by the Group; or (ii) the business relating to gas supply (including but not limited to investment in, and the operation and management of gas pipeline infrastructure and the sale and distribution of piped gas) in the PRC (the "Restricted Business").

The non-competition deed given by each of the Initial Management Shareholders and XGCL does not apply to the following:

- (i) the holding of shares or other securities by each of the Initial Management Shareholders and XGCL and their associates issued by the Company or any of its subsidiaries;
- (ii) the holding of shares or other securities by each of the Initial Management Shareholders and XGCL and their associates in any company whose securities are listed on a stock exchange and the total securities beneficially held by each of the Initial Management Shareholders and XGCL and (as the case may be) their associates (other than members of the Group) whether taken together as a whole or singly do not amount to more than 5% of the issued shares or other securities of the company in question; and
- (iii) the holding of equity interest or other securities by each of the Initial Management Shareholders and XGCL and their associates in any of the Acquisition Companies prior to completion of the respective Acquisition Agreements.

The non-competition deed given by each of the Initial Management Shareholders and XGCL will remain effective until (i) the Initial Management Shareholders and XGCL and their associates (individually or taken as a whole) cease to be a controlling shareholder and the single largest shareholder of the Company; or (ii) the securities of the Company cease to be listed on GEM, whichever occurs earlier.

THE GROUP'S BUSINESS

TRANSACTIONS WITH CONNECTED PERSONS

Completed connected transactions

The Group entered into the following significant arrangements with certain associates of Mr. Wang during the Track Record Period, which would constitute connected transactions under the GEM Listing Rules should the Shares be listed on GEM:

- (i) the provision of gas connection service to 廊坊新城房地產開發有限公司 (Langfang Xincheng Property Development Company Limited (“Langfang Xincheng”)), 廊坊新奧酒店管理有限公司 (Langfang Xinao Hotel Management Company Limited (“Langfang Xinao Hotel Management”)) and 廊坊新奧物業管理有限公司 (Langfang Xinao Property Management Company Limited (“Langfang Xinao Property Management”)), all being associates of Mr. Wang, for aggregate connection fees of approximately RMB16,838,000, RMB453,000 and RMB82,000, respectively, during the Track Record Period, in accordance with rates agreed to by reference to the Group's similar transactions with independent third parties;
- (ii) the supply of piped gas to Langfang Xinao Property Management, XGCL, 新奧集團太陽能有限公司 (Xinao Group Solar Energy Company Limited (“Xinao Solar Energy”)) and Langfang Xinao Hotel Management Company for aggregate gas usage charges of approximately RMB11,056,000, RMB1,271,000, RMB158,000 and RMB125,000, respectively, during the Track Record Period, in accordance with rates agreed to between the Group and the related parties by reference to the Group's similar transactions with independent third parties;
- (iii) acquisition of land and buildings from Langfang City Gas, XGCL and Langfang Xinao Property Management, at considerations determined based on negotiations or by reference to the then market value of the land and buildings:
 - (a) the acquisition by Langfang Xinao from Langfang City Gas of the gas processing station buildings (with a total area of 658.16 m²) on the northern outskirts of Langfang City, Hebei Province, the PRC at a cash consideration of RMB1,000,000 pursuant to an agreement dated 3 July 1999;
 - (b) the acquisition by Langfang Xinao from Langfang City Gas of a parcel of land (with a total site area of 20,000 m²) at Heping Road, Langfang City, Hebei Province, the PRC at a cash consideration of RMB4,251,600 pursuant to an agreement dated 12 July 1999;
 - (c) the acquisition by Langfang Xinao from Langfang City Gas of a parcel of land (with a total site area of 19,999.91 m²) at Yaohua Road, Langfang Economic and Technical Development Zone, Langfang City, Hebei Province, the PRC at a cash consideration of RMB3,600,000 pursuant to an agreement dated 10 July 1999;
 - (d) the acquisition by Langfang Xinao from Langfang City Gas of a parcel of land (with a total site area of 13,067.40 m²) at Langzhuo Road, Langfang City, Hebei Province, the PRC at a cash consideration of RMB2,300,000 pursuant to an agreement dated 20 July 1999;

THE GROUP'S BUSINESS

- (e) the acquisition by Langfang Xinao from Langfang City Gas of the gas processing station buildings (with a total area of 323.10 m²) on the southern outskirts of Langfang City, Hebei Province, the PRC at a cash consideration of RMB540,000 pursuant to an agreement dated 3 July 2000;
 - (f) the acquisition by Langfang Xinao from XGCL of the office building (with a total gross floor area of 10,605.17 m²) erected at the site situated at the junction of Huaxiang Road and Hongrun Road, Langfang Economic & Technical Development Zone, Langfang City, Hebei Province, the PRC at a cash consideration of RMB47,900,000 (which was arrived at by reference to valuation made by an independent valuer) pursuant to an agreement dated 30 September 2000; and
 - (g) the acquisition by Langfang Xinao from Langfang Xincheng, a subsidiary of XGCL, of the office building (with a total gross floor area of 4,368.63 m²) erected at the site situated at Jinguang Road, Langfang City, Hebei Province, the PRC, at a cash consideration of RMB7,600,000 (which was arrived at by reference to valuation made by an independent valuer) pursuant to an agreement dated 30 September 2000; and
- (iv) acquisition of pipelines and related facilities by Langfang Xinao from Langfang City Gas during the financial year ended 31 December 2000 at an aggregate cash consideration of RMB27,431,000, which was determined by reference to valuations made by an independent valuer.

Connected transactions to be completed

For the purpose of the listing of Shares on GEM, the Group has entered into Acquisition Agreements (referred to as material contracts numbered (19) to (21) in the paragraph headed "Further information about the business – Summary of material contracts" in Appendix V to this prospectus) with XGCL in relation to the acquisition of XGCL's entire interests in the registered capital of Jinggu Xinao, Qingdao Xinao and Jingchang Xinao, at a consideration equal to the investment by XGCL in these Acquisition Companies at the date of completion. As at 28 February 2001, the aggregate amount of investment made by XGCL in the Acquisition Companies was RMB32,850,000. XGCL has given a written undertaking to the Group that it will not increase or vary the registered capital of the Acquisition Companies and that its nominated directors on the respective boards of directors of these companies will not permit any increase or variation of registered capital of these companies until the completion of the Acquisition Agreements.

Each of the Acquisition Agreements is conditional on all necessary approvals being obtained in relation to the transfer of the relevant equity interest and the conversion of the relevant Acquisition Companies into Sino-foreign equity joint ventures (including the approval from the relevant local foreign trade and economic co-operation departments). Following the completion of the Acquisition Agreements, an announcement in accordance with Rule 20.35 of the GEM Listing Rules will be made by the Company describing the final terms of the transactions.

A portion of the proceeds raised through the Placing will be applied to the acquisition of the Acquisition Companies. It is expected that the acquisitions will be completed shortly after the listing of Shares on GEM.

THE GROUP'S BUSINESS

Exempt continuing connected transactions

The following transaction will continue after the listing of Shares on GEM and will constitute exempt continuing connected transaction under Rule 20.25(1) of the GEM Listing Rules:

- (i) the supply of piped gas to connected persons of the Company (including certain Directors), XGCL, Langfang Xinao Property Management, Langfang Xinao Hotel Management and Xinao Solar Energy for their own consumption with gas usage charges which will not be more favourable than those charged by Langfang Xinao to independent third parties.

The following transactions will continue after the listing of Shares on GEM and will constitute exempt continuing connected transactions under Rule 20.25(3) of the GEM Listing Rules:

- (i) the leasing by Langfang Xinao to Langfang Xinao Property Management of certain staff quarters at Yinhe Main Street, Langfang Economic and Technical Development Zone, Langfang City, Hebei Province, the PRC (with a total gross floor area of 1,373.38 m²) at an annual rental of RMB329,611 for a term of three years commencing from 1 January 2001;
- (ii) the leasing by XGCL to Langfang Xinao of warehousing units at Changfu Road, Anzi District, Langfang City, Hebei Province, the PRC (in respect of a site with a total gross floor area of 7,907 m² and a covered warehousing space with a gross floor area of 343 m²) for an aggregate annual rental of RMB136,044 for a term of three years commencing from 1 January 2001;
- (iii) the granting by XGCL to Xinao Gas Investment (for itself, the Company and its subsidiaries) of (a) a licence to the exclusive use of registered "XINAO" trademarks and logos in relation to gas related businesses, and (b) pre-emptive rights for a licence to the exclusive use of any "XINAO" trademarks registered in the future in relation to the business of the Group with nil consideration; and an undertaking by XGCL to the Company that it will arrange for registration of such class of the "XINAO" trademarks in the PRC as may be required for the registered use by the Company and its subsidiaries of the "XINAO" trademarks and logos for a period of 10 years from 1 January 2001 pursuant to an agreement dated 1 January 2001; and
- (iv) the leasing by Langfang Xinao to XGCL of certain staff quarters at Yingchun Road, Langfang City, Hebei Province, the PRC (with a total gross floor area of 2,017.70 m²) for an annual rental of RMB435,823 for a term of three years commencing from 1 January 2001.

The following transactions will constitute connected transactions exempted from shareholders' approval requirements under Rule 20.24 of the GEM Listing Rules but are subject to reporting and announcement requirements:

- (i) the provision of property management services by Langfang Xinao Property Management, to Langfang Xinao in relation to the management of (a) the premises of the office building erected at the site situated at the junction of Huaxiang Road East and Hongrun Road North, Langfang Economic and Technical Development Zone, Langfang City, Hebei Province, the PRC, and (b) the office building erected at the site situated at Jinguang Road, Langfang City, Hebei Province, the PRC for an aggregate annual management fee of RMB1,056,146 for a term of three years commencing from 1 January 2001; and

THE GROUP'S BUSINESS

- (ii) the leasing by Langfang Xinao to XGCL of the ground floor of the office building erected at the site situated at the junction of Huaxiang Road East and Hongyun Road North, Langfang Economic and Technical Development Zone, Langfang City, Hebei Province, the PRC (with a total gross floor area of 3,299 m²) for an annual rental of RMB1,039,185 plus a reimbursement of management fee on the basis of RMB80 per m² per annum (the aggregate amount being RMB1,303,105 per annum) for a term of three years commencing from 1 January 2001.

The following transaction will constitute a connected transaction and will be subject to the reporting and announcement requirements under Rule 20.53(b)(i) of the GEM Listing Rules:

- (i) the guarantee provided on a several basis (not on a joint and several basis) by Langfang BVI and Langfang City Gas to a bank in proportion to their respective equity interests in Langfang Xinao, being 95% and 5%, respectively, for loans in the aggregate amount of approximately RMB32,000,000 granted by the bank to Langfang Xinao.

Non-exempt continuing connected transactions

The following transactions will constitute non-exempt continuing connected transactions of the Group:

- (i) the provision and delivery of natural gas (in the form of CNG) by Langfang Xinao to each of Beijing Xinao, Jinggu Xinao and Jingchang Xinao for a period of three years commencing 10 January 2001 at a price of RMB1.20 per m³ (during off-peak hours at between 20:00 and 08:00) or RMB1.60 per m³ (during peak hours at between 08:00 and 20:00) of natural gas with an annual contracted supply of 7,000,000 m³. The purchase price was determined with reference to the market price and taking into account the transportation and operation costs. In the event of an adjustment to the gas purchase price payable by Langfang Xinao, the parties will enter into supplemental agreements with newly agreed upon prices. Pursuant to the gas purchase agreements (the form of which is standard for all customers of Langfang Xinao), each of Beijing Xinao, Jinggu Xinao and Jingchang Xinao are required to provide estimated gas requirements in respect of the coming year to Langfang Xinao in September of each year. In the event more CNG is required by any of Beijing Xinao, Jinggu Xinao and Jingchang Xinao, a new contract will be entered into by the relevant parties and the relevant requirements under the GEM Listing Rules will be complied with. The Directors, based on their experience with Langfang Xinao and economic statistics of these locations, estimate that the annual cap for the purchase of CNG from Langfang Xinao by each of Beijing Xinao, Jinggu Xinao and Jingchang Xinao will not exceed RMB6.5 million, RMB4.5 million and RMB14.0 million, respectively, for each of the three financial years ending 31 December 2003; and
- (ii) the provision of gas connection services for certain property developments to Langfang Xincheng by Langfang Xinao for a period of three years commencing 1 January 2001 at connection fees which will not be more favourable than those charged by Langfang Xinao to other independent third parties. The terms of the master supply contract are substantially the same as those master supply contracts entered into with independent third parties and have been arrived at after arm's length negotiations. For the three financial years ended 31 December 2000, the turnover derived by the Group from Langfang Xincheng for the provision of gas connection services was approximately

THE GROUP'S BUSINESS

RMB2.0 million, RMB3.4 million and RMB11.4 million, respectively. The Directors estimate that the annual maximum turnover derived from Langfang Xincheng will not exceed RMB12.0 million for the three financial years ending 31 December 2003 based on the expected increase in property development activities in Langfang City, Heibei Province, the PRC.

As these transactions will be conducted on a regular basis and the property development cycle in the PRC is relatively short, the Directors believe that it would not be practicable to make disclosure or, if necessary, obtain Shareholders' approval on each occasion when every such transaction arises. Accordingly, an application has been made to the Stock Exchange to grant a waiver from strict compliance with the maximum aggregate annual requirement under Rule 20.26(2) of the GEM Listing Rules and the corresponding announcement and shareholders' approval requirements under Rules 20.35 and 20.36 of the GEM Listing Rules. The Stock Exchange has granted a waiver on the conditions as set out in the paragraph headed "Waiver from compliance with the GEM Listing Rules – Connected transactions" in this prospectus.

Sponsor's opinion

Having reviewed the information and documents in respect of all the transactions described in the sub-paragraph headed "Non-exempt continuing connected transactions" above provided by the Company and in reliance upon representations from the Directors, Rothschild is of the view that the transactions described above, which are subsisting and are of a commercial nature, have been entered into in the ordinary course of business of the Group on normal commercial terms and are fair and reasonable as far as the Shareholders taken as whole are concerned. In reaching its views with respect to the connected transactions described above, Rothschild has placed significant reliance upon the information, documents and representations provided by the Company and the Directors.