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If you have sold or transferred all your shares in China Ground Source Energy Limited, you should at once hand this circular and accompanying form of proxy to the purchaser or the transferee or to the bank, stockbroker or other agent through whom the sale or the transfer was effected for transmission to the purchaser or the transferee.

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CGS

CHINA GROUND SOURCE ENERGY LIMITED

中國地能有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 8128)

**SUBSCRIPTION OF NEW SHARES UNDER SPECIFIC MANDATE
RE-ELECTION OF DIRECTOR**

AND

NOTICE OF EXTRAORDINARY GENERAL MEETING

Financial adviser to the Company

VEDA | CAPITAL
智略資本

A notice convening the extraordinary general meeting of the Company (“EGM”) to be held at Room 1301 York House, The Landmark, 15 Queen’s Road Central, Central, Hong Kong on Friday, 22 June 2012 at 11:00 a.m. is set out on pages 18 to 20 of this circular.

A form of proxy for use at the EGM is enclosed with this circular. Whether or not you are able to attend the meeting, you are requested to complete and return the accompanying form of proxy in accordance with the instructions printed thereon and deposit the same as soon as possible and in any event not later than 48 hours before the time of the meeting or any adjournment thereof to the Company’s share registrar, Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17/F, Hopewell Centre, 183 Queen’s Road East, Wan Chai, Hong Kong. Completion and return of the form of proxy will not preclude you from attending and voting at the meeting or any adjournment thereof should you so wish.

This circular will remain on the page of “Latest Company Announcements” on the GEM website for at least 7 days from the date of its posting and the website of the Company at www.cgsenergy.com.hk.

5 June 2012

CONTENTS

	<i>Pages</i>
Characteristics of GEM	ii
Definitions	1
Letter from the Board	4
Notice of EGM	18

CHARACTERISTICS OF GEM

GEM has been positioned as a market designed to accommodate companies to which a higher investment risk may be attached than other companies listed on the Stock Exchange. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the Main Board of the Stock Exchange and no assurance is given that there will be a liquid market in the securities traded on GEM.

DEFINITIONS

In this circular, unless the context otherwise requires, the following expressions shall have the following meanings:

“associate(s)”	has the meanings ascribed to it under the GEM Listing Rules
“Board”	the board of Directors
“Business Day”	means a day on which banks are generally open for business in Hong Kong (excluding Saturdays, Sundays and public holidays)
“CECEP”	China Energy Conservation and Environmental Protection Group* (中國節能環保集團公司), a state-owned enterprise under the supervision of State-owned Assets Supervision and Administration Commission of the State Council of the PRC
“Company”	China Ground Source Energy Limited, a company incorporated in the Cayman Islands with limited liability and the Shares of which are listed on GEM
“Director(s)”	director(s) of the Company
“EGM”	the extraordinary general meeting to be convened by the Company to consider and approve, the Specific Mandate and any transactions contemplated thereunder and the re-election of Director
“GEM”	the Growth Enterprise Market of the Stock Exchange
“GEM Listing Rules”	the Rules Governing the Listing of Securities on GEM
“General Mandate”	the general mandate granted to the Directors at the annual general meeting of the Company held on 10 August 2011 to allot or otherwise deal with the unissued Shares
“Group”	the Company and its subsidiaries
“Hong Kong”	Hong Kong Special Administrative Region of the PRC
“Independent Third Party(ies)”	third party(ies) independent of the Group and connected persons of the Group
“Last Trading Day”	11 April 2012, being the last trading day prior to the signing of the Letter of Intent

DEFINITIONS

“Latest Practicable Date”	1 June 2012, being the latest practicable date prior to the printing of this circular for ascertaining certain information for inclusion in this circular
“Letter of Intent”	the letter of intent dated 11 April 2012 entered into between the Company and the Subscriber in relation to the allotment and issue of the Subscription Shares, which is legally binding in nature
“PRC”	The People Republic of China, excluding Hong Kong, the Macau Special Administrative Region of the PRC and Taiwan
“SFC”	Securities and Futures Commission of Hong Kong
“Share(s)”	ordinary shares of US\$0.01 each in the share capital of the Company
“Shareholder(s)”	holder(s) of the Share(s)
“Specific Mandate”	a specific mandate to be sought from the Shareholders at the EGM to allot and issue the Tranche B Subscription Shares pursuant to the Letter of Intent
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Subscriber”	China Energy Conservation and Environmental Protection (Hong Kong) Investment Company Limited* (中國節能環保(香港)投資有限公司), a company incorporated in Hong Kong with limited liability and wholly owned by CECEP
“Subscription”	the subscription of the Subscription Shares in the amount of HK\$348.5 million by the Subscriber
“Subscription Price”	the subscription price of HK\$0.41 per Subscription Share
“Subscription Shares”	850,000,000 Shares to be issued by the Company and to be subscribed by the Subscriber
“Takeovers Code”	the Code on Takeovers and Mergers issued by the SFC
“Tranche A Subscription Shares”	413,061,423 Subscription Shares to be issued and allotted under the General Mandate
“Tranche B Subscription Shares”	436,938,577 Subscription Shares to be issued and allotted under the Specific Mandate

DEFINITIONS

“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong
“kW”	Kilowatt
“US\$”	the United States of America dollars, the lawful currency of the United States of America
“%”	per cent.

* *for identification purposes only*

LETTER FROM THE BOARD

CGS

CHINA GROUND SOURCE ENERGY LIMITED

中國地能有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 8128)

Executive Directors:

Ms. Chan Wai Kay, Katherine (*Chairman*)

Mr. Xu Shengheng

Non-executive Directors:

Ms. Luk Hoi Man

Independent non-executive Directors:

Mr. Jia Wenzeng

Mr. Paul Chow Wan Hoi

Mr. Wu De Sheng

Registered office:

Scotia Centre, 4th Floor

P.O. Box 2804

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Cayman Islands

*Head office and principal place
of business in Hong Kong:*

Room 1301, York House

The Landmark

15 Queen's Road Central

Central, Hong Kong

5 June 2012

To the Shareholders

Dear Sir or Madam,

**SUBSCRIPTION OF NEW SHARES UNDER SPECIFIC MANDATE
AND RE-ELECTION OF DIRECTOR**

INTRODUCTION

The purpose of this circular is to provide you with, among other things, further information of the Subscription, the re-election of Director and the notice convening the EGM.

On 11 April 2012 (after trading hours), the Company entered into the Letter of Intent with the Subscriber in relation to the allotment and issue of 850,000,000 Subscription Shares at a price of HK\$0.41 per Subscription Share.

Of the 850,000,000 Subscription Shares, the Tranche A Subscription Shares (representing 413,061,423 Subscription Shares), shall be issued and allotted under the General Mandate and the Tranche B Subscription Shares (representing the remaining 436,938,577 Subscription Shares) shall be issued and allotted under the Specific Mandate. The Board shall seek the grant of a Specific Mandate from the Shareholders to allot and issue the Tranche B Subscription Shares at the EGM.

LETTER FROM THE BOARD

THE SUBSCRIPTION

On 11 April 2012 (after trading hours), the Company entered into the Letter of Intent with the Subscriber in relation to the allotment and issue of 850,000,000 Subscription Shares at a price of HK\$0.41 per Subscription Share.

Date: 11 April 2012 (after trading hours)

Parties: Issuer: the Company

Subscriber: China Energy Conservation and Environmental Protection (Hong Kong) Investment Company Limited* (中國節能環保(香港)投資有限公司), a company incorporated in Hong Kong with limited liability.

To the best of the Directors' knowledge, information and belief, and having made all reasonable enquiries, the Subscriber and its ultimate beneficial owners are Independent Third Parties and do not have prior business or other relationship with the Company and its connected persons.

Subscription Shares

The 850,000,000 Subscription Shares represent approximately 41.16% of the total issued share capital of the Company as at the date of the Letter of Intent and approximately 29.16% of the total issued share capital of the Company as enlarged by the issuance of the Subscription Shares upon Completion. Upon Completion, the Subscriber will become a substantial Shareholder (as defined under the GEM Listing Rules). As at the Latest Practicable Date, the Subscriber does not hold any Share.

Subscription Price

The Subscription Price of HK\$0.41 per Subscription Share was arrived at after arm's length negotiation between the Company and the Subscriber with reference to the prevailing market price of the Shares. The Directors consider the Subscription Price and the terms and conditions of the Letter of Intent are fair and reasonable and in the interests of the Company and Shareholders as a whole.

The Subscription Price represents:

- (i) a discount of approximately 9.89% to the closing price of HK\$0.455 per Share as quoted on the Stock Exchange on the Last Trading Day;
- (ii) a discount of approximately 6.82% to the average closing price of approximately HK\$0.44 per Share as quoted on the Stock Exchange for the last five consecutive trading days up to and including the Last Trading Day; and
- (iii) a discount of approximately 6.82% to the closing price of HK\$0.44 per Share as quoted on the Stock Exchange on the Latest Practicable Date.

LETTER FROM THE BOARD

The net proceeds from the Subscription, after deducting all the relevant costs and expenses in connection with the Subscription, is estimated to be approximately HK\$347.5 million. Accordingly, the net price per Subscription Share will be approximately HK\$0.409.

Conditions precedent

Pursuant to the Letter of Intent, (i) completion of the subscription of Tranche A Subscription Shares shall be conditional upon fulfilment of conditions (a) to (i); and (ii) completion of the subscription of Tranche B Subscription Shares shall be conditional upon fulfilment of conditions (a) to (k) of the following respectively:

- (a) the Listing Committee of the Stock Exchange granting, or having agreed to grant, the listing of, and permission to deal in, all the Subscription Shares;
- (b) the Subscriber will not be required to make a general offer pursuant to Rule 26.1 of the Takeovers Code as a result of the Subscription;
- (c) the Subscriber having obtained all consents from its holding company(ies), owners, the PRC governmental authorities or other parties which are required or appropriate for the Subscription;
- (d) the Subscriber having issued an written confirmation that it is satisfied with the due diligence performed on the Company in the aspects of financial, tax, legal, operation, capital, trading or others;
- (e) the independent auditor of the Company having confirmed no qualified opinion in the audited annual results of the Company for the year ended 31 March 2012;
- (f) no indication being received from the Stock Exchange and/or the SFC that the listing of the Shares on GEM will or may be withdrawn or objected to in connection with the Subscription;
- (g) the Company having obtained clearance from the Stock Exchange and/or the SFC on the announcement and this circular (where required);
- (h) there is no governmental departments or authorities or courts issuing any order, judgement, claims and instruction so that any transactions contemplated under the Letter of Intent become illegal or the Company is unable to allot and issue the Subscription Shares or the Subscriber is unable to subscribe the Subscription Shares;
- (i) the statements, warranties and undertakings contained in the Letter of Intent are true and accurate on the date of the Letter of Intent and remains true and accurate on the date(s) of completion in all material aspects;

LETTER FROM THE BOARD

- (j) completion of the subscription of Tranche A Subscription Shares by the Subscriber; and
- (k) the Shareholders having approved at the EGM the Specific Mandate.

Without limitation to the above conditions (a) to (k), the Subscriber and the Company confirmed and agreed that the above conditions (a) to (k) should be treated as not being fulfilled if the following situations happen:

- (I) for condition (b) above, if the SFC considers that the obligation of the Subscriber and parties acting in concert with it in making a general offer pursuant to Rule 26.1 of the Takeovers Code as a result of the Subscription has occurred or will occur; or
- (II) for condition (d) above, if the Subscriber informs the Company in writing during any time between the date of the Letter of Intent and up to the long stop date of the Letter of Intent stated therein, i.e. 31 August 2012 that it is not satisfied with the results of the due diligence on the Company.

As at the Latest Practicable Date, condition (g) has been fulfilled.

The Subscriber may at any time waive in writing any of the conditions (b) to (i) above and none of the conditions precedent is waivable by the Company. If any of the above conditions are not fulfilled (or waived, where applicable) on or before 31 August 2012 or such later date as the Company and the Subscriber may agree, the Letter of Intent shall terminate and the parties thereto shall be released and discharged from all obligations save for liabilities in respect of any antecedent breaches thereof.

Completion of the subscription of Tranche A Subscription Shares is expected to take place within three Business Days after all the relevant conditions precedent of the Letter of Intent having been fulfilled (or such other date as the parties to the Letter of Intent may agree).

Completion of the subscription of Tranche B Subscription Shares is expected to take place within three Business Days after all the conditions precedent of the Letter of Intent having been fulfilled (or such other date as the parties to the Letter of Intent may agree).

Undertakings

Upon completion of the Subscription, the Subscriber would become the single largest substantial Shareholder. Pursuant to the Letter of Intent, the Subscriber has warranted that the Nominees would propose at the Board meetings and support the distribution of dividends of not less than 15% of the net profit after tax of the Company to the Shareholders per annum. The Subscriber acknowledges that the Group will focus on research and promotion of using ground source energy as alternative energy for heating/cooling, as well as commercial models of the promotion and management team for relevant operations. The Subscriber and the Company shall jointly seek for new investment opportunities for energy conservation and environmental protection to maximize profits and value for the Shareholders.

LETTER FROM THE BOARD

Pursuant to the Letter of Intent, the Subscriber is restricted for the disposal of any of the Subscription Shares within 18 months upon completion of the subscriptions of the Tranche A Subscription Shares and Tranche B Subscription Shares respectively.

Nomination of Directors

Pursuant to the Letter of Intent, upon completion of the subscription of Tranche A Subscription Shares, the Subscriber has the rights to nominate two executive Directors, two non-executive Directors and one independent non-executive Director (the “**Nominees**”), and the Company shall accordingly appoint the Nominees who are qualified pursuant to the laws in Hong Kong and GEM Listing Rules.

As stipulated in the Article 86(3) of the Company’s Articles of Association (the “**Articles**”),

“the Directors shall have the power from time to time and at any time to appoint any person as a Director either to fill a casual vacancy on the Board or, as an addition to the existing Board. Any Director so appointed by the Board shall hold office only until the next following general meeting of the Company (in the case of filling a casual vacancy) or until the next following annual general meeting of the Company (in the case of an addition to the Board) and shall then be eligible for re-election at that meeting.”

As stipulated in the Article 88 of the Articles,

“No person other than a Director retiring at the meeting shall, unless recommended by the Directors for election, be eligible for election as a Director at any general meeting unless a Notice signed by a Member (other than the person to be proposed) duly qualified to attend and vote at the meeting for which such notice is given of his intention to propose such person for election and also a Notice signed by the person to be proposed of his willingness to be elected shall have been lodged at the head office or at the Registration Office provided that the minimum length of the period, during which Notice(s) are given, shall be at least seven (7) days and that (if the Notices are submitted after the dispatch of the notice of the general meeting appointed for such election) the period for lodgment of such Notice(s) shall commence on the day after the dispatch of the notice of the general meeting appointed for such election and end no later than seven (7) days prior to the date of such general meeting.”

According to the Articles, it provides the Shareholders who is/are qualified to exercise the Shareholders’ right for making nomination of a person for election as a director in general meeting.

The Company confirmed that it has no intention to change the board composition at present.

LETTER FROM THE BOARD

Mandate to issue the Subscription Shares

Tranche A Subscription Shares

Of the 850,000,000 Subscription Shares, the Tranche A Subscription Shares (representing 413,061,423 Subscription Shares), shall be issued and allotted under the General Mandate granted to the Directors at the annual general meeting of the Company held on 10 August 2011. The Directors were authorized to allot and issue up to 413,061,423 Shares pursuant to the General Mandate. Up to the date of the Letter of Intent, the General Mandate has not been utilized. The issue of the Tranche A Subscription Shares is not subject to any approval by the Shareholders.

Tranche B Subscription Shares

Of the 850,000,000 Subscription Shares, the Tranche B Subscription Shares (representing the remaining of 436,938,577 Subscription Shares after deducting the Tranche A Subscription Shares) shall be issued and allotted under the Specific Mandate. The Board shall seek the grant of a Specific Mandate from the Shareholders to allot and issue the Tranche B Subscription Shares at the EGM.

USE OF PROCEEDS

The aggregate gross proceeds from the Subscription will be approximately HK\$348.5 million and the net proceeds (after deducting all the relevant costs and expenses in connection with the Subscription) will be approximately HK\$347.5 million. Approximately HK\$200 million will be used for initial capital injection into Heng Run Feng Infrastructure Construction (Dalian) Co., Ltd. (恒潤豐城市基礎設施建設(大連)有限公司) (“**Heng Run Feng**”), a subsidiary of the Company, formed for the construction of the multi-source energy station. The remaining HK\$147.5 million will be mainly applied to the Company’s business development of its self-built demonstration projects in Beijing and Dalian for promotion of the application of ground source energy as alternative energy for heating/cooling supply, the general working capital of the Company and/or for future investment opportunities in the area of energy conservation and environmental protection.

REASONS FOR AND BENEFITS OF THE SUBSCRIPTION

The Company is principally engaged in environmental protection and new energy business with marketing modality of pursuing integrated services including investment, system installation and operation in promoting the ground source energy as alternative energy for heating/cooling.

The Subscriber is a wholly-owned subsidiary of CECEP which principally engaged in energy conservation and environmental protection projects and its investments. CECEP, a large-scale state-owned enterprise, is principally engaged in research and development of energy conservation, environmental protection and new energy technology, investments in projects and construction operation.

LETTER FROM THE BOARD

The similarity of the business of the Subscriber and the Group will be the energy-saving building/construction with respective expertise within this field. The difference is that the Group is principally engaged in the business of research and development and promotion of using ground source energy as alternative energy for heating/cooling whereas the Subscriber carries businesses of energy conservation and environmental protection including but not limited to solar energy, wind energy, energy-saving building materials except the ground source energy.

Business development of the Group

The Group is currently in development of self-built demonstration projects with application of ground source energy as alternative energy for heating/cooling in Beijing and Dalian, where heating supply is required in these regions under the PRC law. At present, relevant approvals has been obtained for the construction of 240,000 square meters within these projects. Within these 240,000 square meters, approximately HK\$250 million would be required for construction of 50,000 square meters, which has been commenced and expected to be completed by around the end of 2013. As such, despite the Group has cash balance of HK\$83 million as at 30 September 2011, further funding is expected to be required for investment in these projects.

The Group has signed a cooperation agreement with the government of Wafangdian City for construction and development of a multi-source energy station, an urban infrastructure with application of ground source energy as alternative energy for heating/cooling. The Company confirmed that Heng Run Feng will mainly implement the cooperation agreement with the government of Wafangdian City. Initially, the 1st phase of development will cover an area of 1.23 square kilometers of the total 4.12 square kilometers of the plot A land. Except for the multi-source energy station which will be invested and operated by the Group, the development and construction of this piece of land will be contracted by other professional firms. The capacity of the 1st phrase of the multi-source energy station for heating/cooling supply within plot A land will be 200,000kW which could guarantee for heating/cooling supply to buildings with a total area of 300,000 square meters. 1st phase multi-source energy station will require an investment of approximately HK\$400 million. Approximately HK\$200 million of the net proceeds from the Subscription will be used for initial capital injection into this infrastructure construction project and will mainly applied for the construction of the first multi-source energy station with heat generating capacity of 100,000kW. The Company will consider for arranging loans for the remaining HK\$200 million during the construction period. Given the involvement of the Subscriber being a large scale state-owned enterprise, the Company expects that it will be beneficial for the Company to procure loans on more competitive terms. It is expected that the construction period will take 300 days from obtaining the governmental approval on the overall design. The Company is now in the process of preparing the design proposal for submission to the government. After completion of the construction of the multi-source energy station, the government will acquire this facility and grant the operation right to the Company. The Company shall obtain revenue in terms of management fee via the operation right. It is expected that the multi-source energy station will commence operation by around mid 2014.

The remaining proceeds of approximately HK\$147.5 million will be utilized in the Beijing and Dalian self-built demonstration projects and applied for the general working capital such as business investment for funding and supporting on the development of the self-built demonstration projects and future investment opportunities in the area of energy conservation and environmental protection.

LETTER FROM THE BOARD

Ground source energy as alternative energy for heating/cooling supply to building is closely linked with the real estate industry. Due to the funding constraints in the PRC for the property development sector, the recovery of receivables of the Group's ongoing projects has been slowed down. As such, the Directors are of the view that the Subscription is necessary for the Company's existing business development and its ongoing working capital needs.

The Directors are of the view that ground source energy as alternative energy for heating/cooling is an emerging, sustainable and growing industry. With assurance of the working capital, the Group's principal business development can be accelerated. It is considered that the proceeds generated from the Subscription will provide sufficient fund for the development of the projects in Beijing and Dalian and cater for the funding requirement for general working capital and any business investments needs when opportunities arise.

Save for the above-mentioned significant projects, the Company confirmed that as at the Latest Practicable Date, there's no other intended acquisition under negotiation and no specific investment projects.

Proposed business cooperation with the Subscriber

Background of the Subscriber

The Subscriber came to knowledge of and is interested in the Group's international patent technology "Single-well Circulation Heat Exchange" through the purchaser (the "**Investor**") of a deemed disposal of a subsidiary of the Group in year 2009 (as referred to the announcement of the Company dated 27 October 2009). The Investor introduced the Subscriber to the Company and the Subscriber suggested for possible cooperation in early 2012.

The Subscriber is a large-scale state-owned enterprise and was established by the PRC government in 2010 with core businesses in energy conservation, environmental protection and new energy. The capital injection and energy conservation demonstration zone of the Subscriber has great importance to the increase of market share of the Group's principal business in the field of promotion of ground source energy as alternative energy for heating/cooling.

The business cooperation

The Company and the Subscriber intend to jointly develop in the energy conservation and environmental protection fields. The Company will focus on their own business models of promotion of ground source energy as alternative energy for heating/cooling to improve its revenue and market share through participation in the projects of energy conservation demonstration zone of the Subscriber. Basically, the Company, as the supplier and operator, will provide the Group's subsidiary Ever Source Science and Technology Development Company Limited ("**HYY**") ground source energy heat pump environmental system and multi-source energy stations for installation in the projects of energy conservation demonstration zone of the Subscriber and will provide maintenance service. As at the Latest Practicable Date, although the format and terms of the cooperation are yet to be determined

LETTER FROM THE BOARD

and there is no specific project that was planned or has been agreed for the Group's participation, the Subscriber has committed that, under the same terms and conditions, the HYY ground source energy heat pump environmental system and multi-source energy stations will be firstly taken and used in the Subscriber's projects. As at the Latest Practicable Date, initial discussions and site visits have been taken place to the energy conservation demonstration zone in Shanghai (上海國際節能環保園) but no concrete plan has been laid down.

The Subscriber has several hundred thousands of square meters of energy-saving building demonstration projects each year which provides the Group with opportunities to increase its revenue and market share in the promotion of ground source energy field. The application of ground source energy as alternative heating energy technologies of the Group will also be beneficial for the Subscriber to enhance and broaden their influence in the market of energy-saving building/construction. Furthermore, it will provide a strong support to the government in terms of the theory and practice for formulation of policy in development of the ground source energy as alternative energy for heating/cooling.

Upon the energy conservation demonstration zone owned by the Subscriber are widely built across the country using the Group's HYY ground source energy heat pump environmental system and multi-source energy stations in the construction of building and infrastructure, the adoption of the Group's technologies will increase the Group's revenue while the Group's involvements in the Subscriber's demonstration projects shall increase the Group's exposure to different regions of the PRC, which are expected to be beneficial to the further business development of the Group. Meanwhile, the energy conservation demonstration zone of the Subscriber uses the Group's unique alternative energy technologies and results in more than 60% of the total energy consumption for heating supply for building is renewable energy which makes the energy-saving effect to be significant and the technology practicability to be stronger and more outstanding.

The "Twelve-Fifth Plan" proposed by the PRC government clearly states that it will implement 350 million square meters construction area for using ground source heat pump for heating by 2015. According to a publication "Geothermal Energy Utilization" made by the Ministry of Science and Technology of the PRC, it is predicted that the total market of geothermal energy development and utilization will be at least RMB70 billion and that the PRC is with a great potential and a bright future for ground source energy utilization.

The Group's single-well heat exchange ground source energy collection technology can assure sustainable exploration and pollution-free for using ground source energy as alternative energy for heating/cooling. If the co-operation between the Subscriber and the Company is materialised, the Directors believe that the Company, with the investment of the Subscriber, will become the only Hong Kong listed professional company in this huge market backed by a large scale state-owned enterprise. Compounded with the enhancement of the credibility, abundant funding, unique technology as well as stringent management, the Directors are confident that the Company will rapidly become a leading enterprise within this industry in the PRC. All in all, the Group and the Subscriber have a common objective to maximize the value of the Company for the interests of the Shareholders as a whole.

LETTER FROM THE BOARD

The Directors are of the view that the scope and direction of business development in the field of energy conservation and environmental protection, particularly the energy-saving building/construction, are in line with the Group's future strategic development and the co-operation between the Company and the Subscriber will create synergies to the Group's business operations and development.

When decisions have to be made on whether new investment opportunities should be taken, the management of the Company would take into account the profitability and relevancy of the potential projects to the development of the Company's core business. Since the Group would focus on the promotion of ground source energy technologies while the Subscriber is engaged in the investment of a complete environmental protection project which includes other new energies e.g. solar energy and wind energy, the Directors are of the view that little potential conflicts of interest will be involved. The selection criteria of potential projects include, but not limited to, whether the projects could enhance the promotion of the Group's ground source energy as alternative energy in buildings and its related research and development.

The Company will continue to operate with its existing management team on a day-to-day basis. The Subscriber, through its participation in the Board will provide assistance and introduce the Group to new business opportunities. The Group is independent of the Subscriber in management and the Directors owe fiduciary duties and obligations to the Company and its Shareholders when exercising their powers in deciding on new investment opportunities. Therefore, the Directors will base on their own expertise, knowledge and assessment and will act for the best interests of the Company and the Shareholders when considering and handling of any potential investment of the Company. Any decision-making will be made in accordance with the relevant regulations and rules that governed a listed company and its memorandum and articles of association with the principle of maximizing shareholders' value. Shareholders' approval, if required, is the highest authority for exercising the decision-making rights of the Company.

The Directors confirm that the Board does not have the intention and the Company has not entered into any agreements, understanding or arrangement to dispose or discontinue its existing business.

Fund raising alternative

The Company has explored other fund raising methods such as bank loans, convertible notes and rights issue. The Directors considered that bank loans and debt financing (i.e. convertible notes) will incur heavy finance costs to the Group. The Company has also approached potential underwriters for potential rights issue and tried its best endeavor to procure an underwriter but failed. None of these fund raising methods can finally be materialized. The Directors are of the view that equity fund-raising involves lower cost, lower risk and is a reasonable means to ensure replenishment of general working capital.

Having taken into account of the background of the Subscriber and synergies to be brought by the cooperation and the financing cost burden for debt financing method, the Directors are of the view that the Subscription is in the interests of the Company and Shareholders as a whole.

LETTER FROM THE BOARD

EFFECT ON SHAREHOLDING STRUCTURE OF THE COMPANY

The table below sets out the shareholding structures of the Company (i) as at the Latest Practicable Date; (ii) immediately upon the completion of the subscription of the Tranche A Subscription Shares; and (iii) immediately upon the completion of the Subscription (assuming no Shares are issued or repurchased during the such period of time):

	As at the Latest Practicable Date		Completion of subscription of Tranche A Subscription Shares		Completion of subscription of Tranche A Subscription Shares and Tranche B Subscription Shares	
	Shares	%	Shares	%	Shares	%
Mr. Xu Shengheng (<i>Note 1</i>) and his associates	609,021,000	29.49	609,021,000	24.57	609,021,000	20.89
Ms. Chan Wai Kay Katherine (<i>Note 1</i>) and her associates	44,074,000	2.13	44,074,000	1.78	44,074,000	1.51
Subscriber (<i>Note 2</i>)	–	–	413,061,423	16.67	850,000,000	29.16
Public Shareholders	<u>1,412,212,117</u>	<u>68.38</u>	<u>1,412,212,117</u>	<u>56.98</u>	<u>1,412,212,117</u>	<u>48.44</u>
Total	<u>2,065,307,117</u>	<u>100.00</u>	<u>2,478,368,540</u>	<u>100.00</u>	<u>2,915,307,117</u>	<u>100.00</u>

Notes:

1. Being an executive Director
2. Upon the completion of the subscription of Tranche A Subscription Shares and Tranche B Subscription Shares (assuming no Shares are issued or repurchased during the such period of time), Mr. Xu Shengheng and his associates shall be regarded as parties presumed to be acting in concert with the Subscriber under the Takeovers Code since both parties are expected to hold more than 20% of the voting rights of the Company. The Subscriber will comply with the Takeovers Code and make an application to the SFC to rebut the presumption under the Takeovers Code that the Subscriber is a party acting in concert with Mr. Xu Shengheng within the meaning of the Takeovers Code when and where appropriate.

FUND RAISING ACTIVITIES DURING THE PAST TWELVE MONTHS

The Company does not have any fund raising activities during the 12-month period prior to the Latest Practicable Date.

LISTING APPLICATION AND RANKING OF SUBSCRIPTION SHARES

The Subscription Shares, when issued and fully paid, will rank pari passu among themselves and with the Shares then in issue at the time of allotment and issue of the Subscription Shares.

LETTER FROM THE BOARD

The Company will apply to the Listing Committee of the Stock Exchange for the listing of, and permission to deal in, the Subscription Shares.

GENERAL

The Tranche B Subscription Shares shall be issued and allotted under the Specific Mandate, which is subject to approval of the Shareholders by way of poll at the EGM.

To the best information, knowledge and belief of the Directors having made all reasonable enquiries, as at the Latest Practicable Date, no Shareholder has an interest in the Specific Mandate and any transactions contemplated thereunder. Accordingly, no Shareholder is required to abstain from voting on the resolution to be proposed at the EGM to approve the Specific Mandate and any transactions contemplated thereunder. As at the Latest Practicable Date, the subscription of Tranche A Subscription Shares is yet to be completed. Should the Tranche A Subscription Shares be issued and allotted to the Subscriber on or before the date of the EGM, the Subscriber will be required to abstain from voting on the resolution to be proposed at the EGM to approve the Specific Mandate and any transactions contemplated thereunder.

No Shareholder is required to abstain from voting on the resolution to be proposed at the EGM to approve the re-election of Mr. Wu De Sheng as an independent non-executive Director. Details of the re-election have been set out below.

RE-ELECTION OF DIRECTOR

In accordance with Article 86(3) of the Articles, Mr. Wu De Sheng (“**Mr. Wu**”) shall retire by rotation at the EGM, but being eligible, offer himself for re-election. Details of Mr. Wu are set out as follows:

Mr. Wu, aged 72, is an independent non-executive Director. Mr. Wu is the Vice President of the China Committee of Heating, Ventilation and Air-Conditioning of Architectural Society of China, executive director of China Association of Refrigeration, President of the Civil Engineering & Architectural Society of Beijing, Director of the Committee of Professional Education Assessment of Building Environment and Equipment under the Ministry of Housing and Urban-Rural Development, the Education Supervisor and Adjunct Professor of Tsinghua University, Beijing University of Civil Engineering and Architecture and Xi'an Jiaotong University. Mr. Wu graduated with a Bachelor's degree from the Department of Civil Engineering of Tsinghua University in 1963. He worked as a technician at the Design Institute for Glass Industry of the Ministry of Construction between 1963 and 1971. Since 1971, he has been serving in various key positions at the Beijing Institute of Architectural Design, such as the Institute Head and Chief Engineer, and currently he is the Chief Consulting Engineer of the institute. Mr. Wu has obtained a number of awards, including the silver medal of the National Design Award and the National Labour Medal.

Mr. Wu has entered into an appointment letter in respect of his appointment as an independent non-executive Director with the Company for a term of two years commencing from 21 March 2012 which can be terminated by either party by giving not less than three month's written notice to the other.

LETTER FROM THE BOARD

Pursuant to the Articles, Mr. Wu is subject to retirement by rotation and re-election at general meetings of the Company. Mr. Wu will receive an annual director's fee of HK\$120,000, which is fixed with reference to the market conditions and his duties and responsibilities as well as the director's fee payable to the existing independent non-executive Director. Mr. Wu's appointment will be automatically renewed for another term of two-years upon expiration of the 1st two-year period.

Save as disclosed above, Mr. Wu has not previously held any positions with the Company or its subsidiaries and does not have any relationship with any director, senior management or substantial or controlling shareholders of the Company. Mr. Wu has no interests in the Shares within the meaning of Part XV of the SFO. Mr. Wu did not hold any directorships in any listed companies in the past three years.

Save as disclosed above, there are no other information in relation to the appointment of Mr. Wu which are required to be disclosed pursuant to Rule 17.50(2)(h) to (v) of the GEM Listing Rules and no other matters that need to be brought to the attention of the Shareholders.

The Company has received from Mr. Wu a confirmation of independence pursuant to Rule 5.09 of the GEM Listing Rules. In consideration of Mr. Wu has not engaged in any executive management and/or in any businesses of the Group and he did not hold any Shares, the Directors (including the members of nomination committee of the Company) are of the view that Mr. Wu possessed of the independence and he is suitable to act as an independent non-executive Director of the Company.

EGM

The EGM will be held at Room 1301 York House, The Landmark, 15 Queen's Road Central, Central, Hong Kong on Friday, 22 June 2012 at 11:00 a.m., the notice of which is set out on pages 18 to 20 of this circular, to consider and, if thought fit, approve the ordinary resolutions to approve (i) the Specific Mandate and any transactions contemplated thereunder; and (ii) the re-election of Mr. Wu as an independent non-executive Director of the Company.

A form of proxy for use at the EGM is enclosed with this circular. Whether or not you are able to attend the meeting, you are requested to complete and return the accompanying form of proxy in accordance with the instructions printed thereon and deposit the same as soon as possible and in any event not later than 48 hours before the time of the meeting or any adjournment thereof to the Company's share registrar, Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong. Completion and return of the form of proxy will not preclude you from attending and voting at the meeting or any adjournment thereof should you so wish.

RESPONSIBILITY STATEMENT

This circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the GEM Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in this circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement herein or this circular misleading.

LETTER FROM THE BOARD

RECOMMENDATION

The Directors (including the independent non-executive Directors) considered that the Specific Mandate and any transactions contemplated thereunder are fair and reasonable and the approval on the Specific Mandate and any transactions contemplated thereunder as well as the re-election of Director are in the interests of the Company and the Shareholders as a whole. Accordingly, the Board recommends the Shareholders to vote in favour of the relevant resolutions at the EGM.

By order of the board of
China Ground Source Energy Limited
Chan Wai Kay, Katherine
Chairman

NOTICE OF EGM

CGS

CHINA GROUND SOURCE ENERGY LIMITED

中國地能有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 8128)

NOTICE OF EXTRAORDINARY GENERAL MEETING

NOTICE IS HEREBY GIVEN that an extraordinary general meeting (the “**EGM**”) of the shareholders of China Ground Source Energy Limited (the “**Company**”) will be held at Room 1301 York House, The Landmark, 15 Queen’s Road Central, Central, Hong Kong on Friday, 22 June 2012 at 11:00 a.m. for the purpose of considering and, if thought fit, passing with or without amendments, the following resolution as ordinary resolutions of the Company:

ORDINARY RESOLUTION

“**THAT**

- (i) the execution of the letter of intent dated 11 April 2012 (the “**Letter of Intent**”) between the Company and China Energy Conservation and Environmental Protection (Hong Kong) Investment Company Limited (中國節能環保(香港)投資有限公司) (the “**Subscriber**”) in respect of the subscription of 436,938,577 shares (the “**Tranche B Subscription Shares**”) of US\$0.01 each in the share capital of the Company be and is hereby confirmed, approved and ratified; and
- (ii) the directors of the Company be and are hereby authorized to exercise all the powers of the Company and take all steps as might in their opinion be desirable or necessary in connection with the Letter of Intent including without limitation:
 - (a) the allotment and issue of the Tranche B Subscription Shares pursuant to the Letter of Intent;
 - (b) the execution, amendment, supplement, delivery, submission and implementation of any further documents or agreements in relation to the allotment and issue of the Tranche B Subscription Shares pursuant to the Letter of Intent; and
 - (c) the taking of actions to implement the transactions contemplated under the Letter of Intent.

NOTICE OF EGM

- (iii) the re-election of Mr. Wu Desheng as an independent non-executive director of the Company.”

By order of the board of
China Ground Source Energy Limited
Chan Wai Kay, Katherine
Chairman

Hong Kong, 5 June 2012

Registered office:

Scotia Centre, 4th Floor
P.O. Box 2804
George Town
Grand Cayman
Cayman Islands

*Head office and principal place
of business in Hong Kong:*
Room 1301, York House
The Landmark
15 Queen's Road Central
Central, Hong Kong

Notes:

1. A member of the Company entitled to attend and vote at the EGM is entitled to appoint one or more proxies to attend and vote instead of him. A proxy need not be a member of the Company.
2. In compliance with Rule 17.47(4) of the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited, voting on the resolution in respect of the above matters set out in this notice will be decided by way of a poll.
3. To be valid, a form of proxy, together with the power of attorney or other authority (if any) under which it is signed (or a notarially certified copy thereof) must be deposited at the Company's branch share registrar in Hong Kong, Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong not less than 48 hours before the time fixed for the holding of the EGM or any adjournment thereof.
4. Completion and return of the form of proxy will not preclude a member from attending and voting in person at the EGM and in such event, the form of proxy shall be deemed to be revoked.
5. Members are recommended to read this circular of the Company containing information concerning the resolutions proposed in this notice.
6. If a tropical cyclone warning signal No. 8 or above is expected to be hoisted or a black rainstorm warning signal is expected to be in force at any time between 9:00 a.m. and 5:00 p.m. on the date of the EGM, then the EGM will be postponed and the Members will be informed of the date, time and venue of the postponed EGM by a supplementary notice, posted on the respective websites of the Company and Hong Kong Exchanges and Clearing Limited.

If a tropical cyclone warning signal No. 8 or above or a black rainstorm warning signal is cancelled at or before 9:00 a.m. on the date of the EGM, and where conditions permit, the EGM will be held as scheduled.

The EGM will be held as scheduled when an amber or red rainstorm warning signal is in force.

Members should decide on their own whether they would attend the EGM under a bad weather condition bearing in mind their own situations and if they do so, they are advised to exercise care and caution.

NOTICE OF EGM

As at the date of this notice, the board of directors of the Company comprises:

Executive Directors:

Ms. Chan Wai Kay, Katherine (*Chairman*)

Mr. Xu Shengheng

Non-executive Director:

Ms. Luk Hoi Man

Independent non-executive Directors:

Mr. Jia Wenzeng

Mr. Paul Chow Wan Hoi

Mr. Wu De Sheng