

Report of the Directors

The Directors have pleasure in presenting their report together with the audited financial statements of the Company and of the Group for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. The principal activities of its subsidiaries are brand development, design, manufacturing, sale and distribution of sports-related footwear, apparel and accessories sold mainly in the PRC under the Group's own LI-NING brand.

Particulars of the Company's subsidiaries and its interest in a jointly controlled entity as at 31 December 2005 are set out in notes 17 and 18, respectively, to the accounts.

RESULTS AND DIVIDENDS

The results of the Group for the year ended 31 December 2005 and the state of the Company's and the Group's affairs as at that date are set out in the financial statements on pages 74 to 121 of this annual report.

An interim dividend of RMB2.30 cents (equivalent to HK2.21 cents) per ordinary share, totalling RMB22,649,000 was paid on 30 September 2005. The Directors recommend the payment of a final dividend of RMB5.00 cents (equivalent to HK4.81 cents) (2004: RMB4.57 cents, equivalent to HK4.30 cents) per ordinary share in respect of the year ended 31 December 2005. The translation of RMB into Hong Kong dollars is made at the exchange rate of HK\$1.00=RMB1.0403 as at 31 December 2005 for illustration purpose only. The actual translation rate for the purpose of dividend payment in Hong Kong dollars will be based on the official exchange rate of RMB against Hong Kong dollars as quoted by the People's Bank of China on 12 May 2006, being the date of the annual general meeting on which the final dividend is proposed to the Shareholders for approval.

Subject to the approval of the Directors' recommendation by the Shareholders at the annual general meeting to be held on 12 May 2006, the final dividend will be paid on or about 22 May 2006 to the Shareholders whose names appear on the registers of members of the Company on 12 May 2006. The registers of members of the Company will be closed from Tuesday, 9 May 2006 to Friday, 12 May 2006 (both days inclusive). In order to qualify for the above mentioned proposed final dividend, all transfers accompanied by the relevant share certificates must be lodged with the Company's Hong Kong branch share registrar and transfer office, Computershare Hong Kong Investor Services Limited at Shops 1712 – 1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:00 p.m. on Monday, 8 May 2006.

RESERVES

As at 31 December 2005, distributable reserves of the Company amounted to RMB480,137,000 (2004: RMB555,780,000). Movements in the reserves of the Group during the year are set out in note 26 to the accounts.

Report of the Directors

MAJOR CUSTOMERS AND SUPPLIERS

Sales and purchases of the Group attributable to its major customers and suppliers respectively in the financial year were as follows:

	Year ended 31 December	
	2005	2004
	% of total turnover	% of total turnover
Five largest customers	16.6	13.1
The largest customer	5.6	3.9
	<hr/>	
	% of total purchases	% of total purchases
Five largest suppliers	40.8	30.2
The largest supplier	14.2	9.1

All of the above five largest customers and suppliers of the Group are independent third parties. To the best knowledge and belief of the Directors, none of the Directors, their associates or any Shareholder owning more than 5% of the issued share capital of the Company, has any interest in any of the Group's five largest customers or suppliers as disclosed above.

BANK LOANS AND OTHER BORROWINGS

Particulars of bank loans and other borrowings of the Company and the Group as at 31 December 2005 are set out in note 24 to the accounts.

DONATIONS

Charitable and other donations made by the Group during the year amounted to RMB13,535,000 (2004: RMB75,000).

PROPERTY, PLANT AND EQUIPMENT

Movements in the Group's property, plant and equipment during the year are set out in note 12 to the accounts.

SHARE CAPITAL

Movements in the share capital of the Company during the year are set out in note 25 to the accounts.

FIVE-YEAR FINANCIAL HIGHLIGHTS

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on pages 6 and 7 of this annual report.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's articles of association or the laws of Cayman Islands where the Company is incorporated.

DIRECTORS

The Directors of the Company during the year and up to the date of this report are as follows:

Executive Directors

Mr. Li Ning

Mr. Zhang Zhi Yong

Mr. Tan Wee Seng

Mr. Chen Yi Hong (re-elected on 12 May 2005 and resigned on 1 September 2005)

Non-Executive Directors

Mr. Lim Meng Ann

Mr. Stuart Schonberger (re-elected on 12 May 2005)

Mr. Fong Ching, Eddy

Independent Non-Executive Directors

Mr. Koo Fook Sun, Louis

Ms. Wang Ya Fei, Jane

Mr. Chan Chung Bun, Bunny (re-elected on 12 May 2005)

In accordance with article 87 of the Company's articles of association, Mr. Tan Wee Seng, Mr. Fong Ching, Eddy and Ms. Wang Ya Fei, Jane shall retire from the office and, being eligible, offer themselves for re-election as Directors at the forthcoming annual general meeting.

DIRECTORS' SERVICE CONTRACTS

Each of the Non-Executive and Independent Non-Executive Directors has entered into a service contract with the Company for a term of three years commencing on 28 June 2004 and shall continue thereafter from year to year until terminated by either party giving one month's notice in writing to the other party.

None of the Directors proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not determinable by the Company or its subsidiaries within one year without payment of compensation (other than statutory compensation).

Report of the Directors

DIRECTORS' INTEREST IN CONTRACTS

Save as disclosed in this report, no contracts of significance in relation to the Company's business to which the Company or its subsidiaries was a party and in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or any time during the year.

BIOGRAPHIES OF DIRECTORS AND SENIOR MANAGEMENT

Biographies of Directors and senior management are set out on pages 48 to 53 of this annual report.

PENSION SCHEMES

In the PRC, the Group contributes on a monthly basis to various defined contribution retirement benefit plans established and operated by relevant Chinese municipal and provincial governments (the "Pension Schemes"). The municipal and provincial governments have undertaken to assume the obligations to pay all the retirement benefits accrued to employees under these Pension Schemes upon their retirement. The Group has no further obligation for payment of post-retirement benefits to employees beyond the contributions made by the Group to these Pension Schemes.

The Group also participates in the provident fund plans mandated by the Hong Kong Government (the "MPF Schemes") which is a defined contribution retirement benefit plan. Contributions to these plans are expensed as incurred.

None of the Pension Schemes or the MPF Schemes has provision for the forfeiture of contributions made to the provident fund.

The Group's contributions to retirement benefit schemes charged to the consolidated income statement for the year ended 31 December 2005 were RMB14,011,000 .

MANAGEMENT CONTRACTS

No contract concerning the management and administration of the whole or any substantial part of the business of the Company was entered into or existed during the year.

SHARE OPTION SCHEMES

Share Purchase Scheme

As part of the reorganization of the Group prior to the listing of the Company's shares on the Hong Kong Stock Exchange in June 2004, Mr. Li Ning, a substantial shareholder and Chairman of the Company has, through Alpha Talent, established the Share Purchase Scheme. Under the Share Purchase Scheme, Mr. Li transferred 35,250,000 of the Company's shares beneficially owned by him to Alpha Talent. The objective of the Share Purchase Scheme is to provide for the grant of rights to purchase the Company's shares beneficially owned by Mr. Li Ning through Alpha Talent to key individuals who have contributed to the economic achievement of the Group.

The Share Purchase Scheme was adopted by Alpha Talent on 5 June 2004 and shall be valid and effective for a period of 10 years from that date. A committee established by the board of directors of Alpha Talent shall determine, among other things, the Directors and employees of the Group who shall be selected to receive options, the exercise price, the terms and conditions of the options.

Options to purchase for 25,230,000 Shares and 4,602,500 Shares held by Alpha Talent were granted to certain Directors and key employees under the Share Purchase Scheme on 8 June 2004 and 11 November 2005, respectively. Details of the movements of the share options granted under the Share Purchase Scheme for the year ended 31 December 2005 are set out in note 27 to the accounts.

Pre-IPO Share Option Scheme

The Company has adopted the Pre-IPO Share Option Scheme for the purposes of giving the participants an opportunity to have a personal stake in the Company and recognizing the contribution of, and providing an incentive to Directors and eligible employees of the Group who, in the sole discretion of the Board of Directors, have contributed or will contribute to the success of the Company. The Pre-IPO Share Option Scheme was adopted on 5 June 2004. Options to subscribe for 16,219,000 Shares were granted to certain Directors and eligible employees on 5 June 2004 and the exercise price per Share is HK\$1.8275, being 15% discount to the price for each Share upon the initial public offering of the Company's shares on the Hong Kong Stock Exchange in June 2004. HK\$1 was payable by the grantee who accepted the grant of an option. The option period of all options granted does not exceed 10 years. No further options will be offered or granted pursuant to the Pre-IPO Share Option Scheme

Report of the Directors

upon the listing of the shares of the Company on the Hong Kong Stock Exchange on 28 June 2004. Details of the movements of the share options under the Pre-IPO Share Option Scheme for the year ended 31 December 2005 were as follows:

	as at 01/01/2005	Number of share options exercised during the year	lapsed during the year	as at 31/12/2005	Exercise price HK\$
Executive Directors					
Zhang Zhi Yong	1,597,000	–	–	1,597,000	1.8275
Tan Wee Seng	1,287,000	(75,000)*	–	1,212,000	1.8275
Employees of the Group					
In aggregate	12,757,000	(3,053,667)#	(1,000,333)	8,703,000	1.8275
	<u>15,641,000</u>	<u>(3,128,667)</u>	<u>(1,000,333)</u>	<u>11,512,000</u>	

* Closing price per Share immediately before the date of exercise of the options is HK\$5.60.

Weighted average closing price per Share immediately before the dates of exercise of the options is HK\$4.38.

All options referred to above are subject to vesting schedules and exercise periods as follows:

% of the options granted	Vesting date	Exercise period
33.3	28/06/2005	28/06/2005 – 05/06/2010
33.3	28/06/2006	28/06/2006 – 05/06/2010
33.4	28/06/2007	28/06/2007 – 05/06/2010

Post-IPO Share Option Scheme

The Company adopted the Post-IPO Share Option Scheme on 5 June 2004. The Post-IPO Share Option Scheme will remain in force for a period of 10 years from 5 June 2004.

The purpose of the Post-IPO Share Option Scheme is to provide the Group with a means of retaining, incentivising, rewarding, remunerating, compensating high-calibre individuals who have demonstrated high level of performance, loyalty and dedication and have made valuable contribution towards the success of the Group. Eligible participants are Directors, employees, officers, agents, consultants or representatives of any member of the Group who, as the Board of Directors may determine in its absolute discretion, have made valuable contribution to the business of the Group based on their performance and/or years of service, or are regarded as valuable human resources of the Group based on their work experience, knowledge in the industry and other relevant factors.

Eligible participants of the Post-IPO Share Option Scheme are required to pay HK\$1 for each option granted upon acceptance of the grant. The exercise price of the option is determined by the Directors and being not less than the highest of: (a) the closing price of the shares of the Company as stated in the Hong Kong Stock Exchange's daily quotations sheets on the date of the grant of the option; (b) the average closing price of the shares of the Company as stated in the Hong Kong Stock Exchange's daily quotation sheets for the five business days immediately preceding the date of the grant of the option; and (c) the nominal value of the shares of the Company.

The maximum number of shares of the Company available for issue upon exercise of all options granted and yet to be exercised under the Post-IPO Share Option Scheme and other share option schemes in aggregate shall not exceed 30% of the number of issued shares of the Company from time to time. In addition, subject as provided under the Listing Rules, the total number of shares of the Company which may be available for issue upon exercise of all options to be granted under the Post-IPO Share Option Scheme, together with all options to be granted under any other share option schemes of any member of the Group, must not represent more than 10% of the nominal amount of all the issued shares of the Company as at 28 June 2004, being the date of the listing of the shares of the Company on the Hong Kong Stock Exchange. Therefore, as at the date of this report, the Company may grant options in respect of up to 98,606,200 shares of the Company (or such numbers of shares as shall result from a sub-division or a consolidation of such 98,606,200 Shares from time to time) to participants under the Post-IPO Share Option Scheme. The total number of shares of the Company issued and which may be issued upon exercise of all options (whether exercised, cancelled or outstanding) granted in any 12-month period to each participant must not exceed 1% of the number of shares of the Company in issue.

An option may be exercised in accordance with the terms of the Post-IPO Share Option Scheme at any time during a period to be notified by the Board of Directors, which must not be more than 10 years from the date of grant.

Any shares of the Company allotted and issued on the exercise of options will rank *pari passu* with other shares of the Company in issue on the date of allotment.

Report of the Directors

On 4 July 2005, options to subscribe for 15,921,000 Shares have been granted to Directors and eligible employees under the Post-IPO Share Option Scheme. Details of the movements of the share options under the Post-IPO Share Option Scheme for the year ended 31 December 2005 were as follows:

	Number of share options			Exercise price HK\$
	granted on 04/07/2005	lapsed during the year	as at 31/12/2005	
Executive Directors				
Zhang Zhi Yong	832,000	–	832,000	3.685
Tan Wee Seng	728,000	–	728,000	3.685
Non-Executive Directors				
Lim Meng Ann	246,000	–	246,000	3.685
Stuart Schonberger	246,000	–	246,000	3.685
Fong Ching, Eddy	246,000	–	246,000	3.685
Independent Non-Executive Directors				
Koo Fook Sun, Louis	246,000	–	246,000	3.685
Wang Ya Fei, Jane	246,000	–	246,000	3.685
Employees of the Group				
In aggregate	13,131,000	(416,000)	12,715,000	3.685
	<u>15,921,000*</u>	<u>(416,000)</u>	<u>15,505,000</u>	

* The closing market price per Share immediately before the date on which the options were granted as quoted in the Hong Kong Stock Exchange's daily quotation sheets was HK\$3.70.

All options referred to above are subject to vesting schedules and exercise periods as follows:

% of the options granted	Vesting date	Exercise period
33.3	04/07/2006	04/07/2006 – 04/07/2011
33.3	04/07/2007	04/07/2007 – 04/07/2011
33.4	04/07/2008	04/07/2008 – 04/07/2011

Valuations of the options granted under the Share Purchase Scheme, the Pre-IPO Share Option Scheme and the Post-IPO Share Option Scheme are set out in note 27 to the accounts.

Save as disclosed above, at no time during the year was the Company or its subsidiaries a party to any arrangement to enable the Directors or any of their spouses or children under 18 years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2005, the interests and short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")), as recorded in the register required to be kept under Section 352 of the SFO or as notified to the Company and the Hong Kong Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") contained in the Listing Rules of the Hong Kong Stock Exchange, were as follows:

Name of Director	Number of Shares/ underlying shares held	Capacity	% of issued share capital*
Li Ning	379,761,000 (note 1) (long position)	Interests of controlled corporations	37.01
	20,369,500 (note 1(c)) (short position)	Interests of controlled corporation	1.99
Zhang Zhi Yong	14,879,000 (note 2) (long position)	Personal	1.45
Tan Wee Seng	4,715,000 (note 3) (long position)	Personal	0.46
Lim Meng Ann	246,000 (note 4) (long position)	Personal	0.02
Stuart Schonberger	246,000 (note 4) (long position)	Personal	0.02
Fong Ching, Eddy	246,000 (note 4) (long position)	Personal	0.02
Koo Fook Sun, Louis	246,000 (note 4) (long position)	Personal	0.02
Wang Ya Fei, Jane	246,000 (note 4) (long position)	Personal	0.02

* The percentages have been calculated based on 1,026,166,667 shares of the Company in issue as at 31 December 2005.

Report of the Directors

Notes:

1. Mr. Li Ning is taken to be interested in an aggregate of 379,761,000 Shares held by Victory Mind Assets Limited, Champion Link Capital Limited and Alpha Talent, respectively, as follows:
 - (a) 203,374,000 Shares are held by Victory Mind Assets Limited which is owned as to 62.106% by Mr. Li Ning and 37.894% by Mr. Li Chun, the brother of Mr. Li Ning. Mr. Li Ning is taken to be interested in 203,374,000 Shares that Victory Mind Assets Limited is interested. Mr. Li Ning is a director of Victory Mind Assets Limited.
 - (b) 150,000,000 Shares are held by Champion Link Capital Limited. The entire interest in Champion Link Capital Limited is held by Dragon City Management Limited in its capacity as trustee of the Three-River Unit Trust, which is a unit trust, the units of which are owned as to 60% by Cititrust (Cayman) Limited as trustee of the Palm Trust and as to 40% by Cititrust (Cayman) Limited as trustee of the Gingko Trust. Both of the Palm Trust and the Gingko Trust are irrevocable discretionary trusts, the objects of which include the respective family members of Mr. Li Ning and his brother, Mr. Li Chun. Mr. Li Ning is the settlor of the Palm Trust and is taken to be interested in 150,000,000 Shares that Champion Link Capital Limited is interested. Mr. Li Ning is a director of Champion Link Capital Limited and Dragon City Management Limited.
 - (c) 26,387,000 Shares are held by Alpha Talent, which is established and solely owned by Mr. Li Ning for the purpose of holding the relevant Shares under the Share Purchase Scheme. Mr. Li Ning is taken to be interested in 26,387,000 Shares that Alpha Talent is interested. Mr. Li Ning is a director of Alpha Talent.

Mr. Li Ning is taken to have a short position in 20,369,500 Shares, among the total of 26,387,000 Shares, held by Alpha Talent in the Company. When the Share Purchase Scheme was first set up in June 2004, 35,250,000 Shares were held by Alpha Talent. As at 31 December 2005, Alpha Talent had granted options to purchase 29,832,500 Shares pursuant to the Share Purchase Scheme, among which options to purchase for 600,000 Shares have been lapsed due to resignation of an employee and options to purchase 8,863,000 Shares have been exercised. The total number of outstanding options as at 31 December 2005 is 20,369,500 Shares. Mr. Li Ning is the sole shareholder of Alpha Talent, a controlled corporation of Mr. Li Ning, he is thus taken to have a short position in the 20,369,500 Shares.
2. Mr. Zhang Zhi Yong is interested in 2,700,000 Shares held and is also taken to be interested as a grantee of options to purchase 9,750,000 Shares under the Share Purchase Scheme, options to subscribe for 1,597,000 Shares under the Pre-IPO Share Option Scheme and options to subscribe for 832,000 Shares under the Post-IPO Share Option Scheme.
3. Mr. Tan Wee Seng is interested in 75,000 Shares held and is also taken to be interested as a grantee of options to purchase 2,700,000 Shares under the Share Purchase Scheme, options to subscribe for 1,212,000 Shares under the Pre-IPO Share Option Scheme and options to subscribe for 728,000 Shares under the Post-IPO Share Option Scheme.
4. The respective Director is taken to be interested as a grantee of options to subscribe for 246,000 Shares each under the Post-IPO Share Option Scheme.

Save as disclosed above, so far as was known to any Director, as at 31 December 2005, none of the Directors or chief executive of the Company had, pursuant to Divisions 7 and 8 of Part XV of the SFO, nor were they taken to or deemed to have under such provisions of the SFO, any interests or short positions in any shares or underlying shares or interests in debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Hong Kong Stock Exchange, or any interests which were required, pursuant to Section 352 of the SFO, to be entered into the register referred to therein, or any interests which were required, pursuant to the Model Code, to be notified to the Company and the Hong Kong Stock Exchange.

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31 December 2005, the register of substantial shareholders maintained under section 336 of the SFO shows that the Company had been notified of the following substantial shareholders' interests and short positions, representing 5% or more of the Company's issued share capital:

Name of shareholder	Number of Shares held	Capacity	% of issued share capital*
Li Ning (Note 1)	379,761,000 (Long position)	Interest of controlled corporations	37.01
	20,369,500 (Short position)	Interest of controlled corporations	1.99
Li Chun (Note 2)	353,374,000 (Long position)	Interest of controlled corporations	34.44
Victory Mind Assets Limited (Note 2(a))	203,374,000 (Long position)	Beneficial owner	19.82
Champion Link Capital Limited (Note 2(b))	150,000,000 (Long position)	Beneficial owner	14.62
Dragon City Management Limited (Note 2(b))	150,000,000 (Long position)	Trustee	14.62
Cititrust (Cayman) Limited (Note 2(b))	150,000,000 (Long position)	Trustee	14.62
Tetrad Ventures Pte. Ltd. (Note 3)	113,055,500 (Long position)	Beneficial owner	11.02
Government of Singapore Investment Corporation (Ventures) Pte. Ltd. (Note 3)	113,055,500 (Long position)	Interest of controlled corporation	11.02
GIC Special Investments Pte. Ltd. (Note 3)	113,055,500 (Long position)	Interest of controlled corporation	11.02

Report of the Directors

Name of shareholder	Number of Shares held	Capacity	% of issued share capital*
Government of Singapore Investment Corporation Pte. Ltd. (Note 3)	113,055,500 (Long position)	Interest of controlled corporations	11.02
Minister of Finance (Incorporated) (Note 3)	113,055,500 (Long position)	Interest of controlled corporations	11.02
Fidelity International Limited	61,518,000 (Long position)	Investment manager	5.99
Matthews International Capital Management, LLC	51,317,000 (Long position)	Investment manager	5.00

* The percentages have been calculated based on 1,026,166,667 shares of the Company in issue as at 31 December 2005.

Notes:

- See note 1 under "Directors' and Chief Executive's Interests and Short Positions in Shares, Underlying Shares and Debentures".
- Mr. Li Chun is taken to be interested in an aggregate of 353,374,000 Shares held by Victory Mind Assets Limited and Champion Link Capital Limited, respectively, as follows:
 - 203,374,000 Shares are held by Victory Mind Assets Limited which is owned as to 37.894% by Mr. Li Chun, and 62.106% by Mr. Li Ning, the brother of Mr. Li Chun. Mr. Li Chun is taken to be interested in the 203,374,000 Shares that Victory Mind Assets Limited is interested; and
 - 150,000,000 Shares are held by Champion Link Capital Limited. The entire interest in Champion Link Capital Limited is held by Dragon City Management Limited in its capacity as trustee of the Three-River Unit Trust, which is a unit trust, the units of which are owned as to 60% by Cititrust (Cayman) Limited as trustee of the Palm Trust and as to 40% by Cititrust (Cayman) Limited as trustee of the Gingko Trust. Both of the Palm Trust and the Gingko Trust are irrevocable discretionary trusts, the objects of which include the respective family members of Mr. Li Chun and his brother, Mr. Li Ning. Mr. Li Chun is the settler of the Gingko Trust and is taken to be interested in the 150,000,000 Shares that Champion Link Capital Limited is interested.
- 113,055,500 Shares are held by Tetrad Ventures Pte. Ltd., a wholly-owned subsidiary of Government of Singapore Investment Corporation (Ventures) Pte. Ltd., which in turn is a wholly-owned subsidiary of Minister of Finance (Incorporated). Tetrad Ventures Pte. Ltd. is also an investment vehicle managed by GIC Special Investments Pte. Ltd., the private equity investment arm of Government of Singapore Investment Corporation Pte. Ltd., which in turn is a wholly-owned subsidiary of Minister of Finance (Incorporated).

Save as disclosed above, as at 31 December 2005, the Company had not been notified by any person (other than a Director or chief executive of the Company or their respective associate(s)) of any interests and short positions in the shares and underlying shares of the Company which were required to be recorded in the register kept under Section 336 of the SFO.

CONNECTED TRANSACTION

On 30 June 2005, Shanghai Yue Ao, a subsidiary of the Company, agreed to transfer its entire 80% equity interest in Beijing Dong Xiang to Shanghai Tai Tan for a consideration of RMB8,614,000 (the "Disposal"). Shanghai Tai Tan is a company owned as to 93% by Mr. Chen Yi Hong (an Executive Director of the Company before his resignation on 1 September 2005) and his spouse and is therefore a connected person of the Company under the Listing Rules. Concurrent with the Disposal, Shanghai Li Ning, a subsidiary of the Company, agreed to assign all its rights in the outstanding debts in the sum of RMB36,200,000 owed to it by Beijing Dong Xiang to Shanghai Tai Tan for a consideration of RMB36,200,000 (the "Assignment"). The Disposal and the Assignment constituted connected and discloseable transaction of the Company under the Listing Rules.

The transaction was approved by independent shareholders of the Company at the extraordinary general meeting held on 11 August 2005 and has been completed. Since the completion of the Disposal and the Assignment, Beijing Dong Xiang has ceased to be a subsidiary of the Company. More information of the Disposal is set out on pages 31 and 32 of this annual report under the section headed "Disposal of interests in KAPPA brand business".

CONTINUING CONNECTED TRANSACTIONS

During the year under review, the Group had the following transactions which constituted continuing connected transactions under the Listing Rules:

1. *Sports organizing and promotion framework agreement ("Sports Organizing Agreement") between Beijing Li Ning and 北京一動體育發展有限公司 (Beijing Edo Sports Development Co., Ltd.) ("Beijing Edo Sports")*

Beijing Edo Sports is a limited company established in the PRC, which is owned as to 80% by 上海寧晟企業管理有限公司 (Shanghai Ning Sheng Corporate Management Co., Ltd.) ("Shanghai Ning Sheng"). By reason of the interests of Mr. Li Ning (an Executive Director and Chairman of the Company) and his family members in Shanghai Ning Sheng, Beijing Edo Sports is an associate of Mr. Li Ning and, hence, a connected person of the Company for the purposes of the Listing Rules.

Beijing Li Ning entered into the Sports Organizing Agreement dated 1 January 2004 with Beijing Edo Sports for a term of three years commencing from 1 January 2004, under which Beijing Li Ning engaged Beijing Edo Sports to carry out joint promotion of sports events in return for organizing fees payable to Beijing Edo Sports.

Payments from Beijing Li Ning to Beijing Edo Sports for the year ended 31 December 2005 amounted to an aggregate of RMB3,250,000, which was below the relevant annual cap approved by the Hong Kong Stock Exchange as disclosed in the Company's listing prospectus dated 15 June 2004 ("Listing Prospectus").

Report of the Directors

2. *Non-exclusive distributorship arrangement of KAPPA brand products by 北京動感九六體育用品有限公司 (Beijing Dong Gan Jiu Liu Sporting Goods Co., Ltd.) ("Dong Gan Jiu Liu")*

Dong Gan Jiu Liu is a limited company established in the PRC, which is owned as to 70% by Mr. Chen Yi Liang (a brother of Mr. Chen Yi Hong, an Executive Director of the Company before his resignation on 1 September 2005) and as to 30% by a company beneficially owned by the family members of Mr. Chen Yi Hong. Dong Gan Jiu Liu is an associate of Mr. Chen Yi Hong and, hence, a connected person of the Company for the purposes of the Listing Rules.

On 1 January 2004, Beijing Dong Xiang (as supplier) and Dong Gan Jiu Liu (as non-exclusive distributor) entered into a non-exclusive distributorship framework agreement for the sale of KAPPA brand products for a term of three years commencing from 1 January 2004. In August 2005, the Group disposed its entire 80% interest in Beijing Dong Xiang to a company controlled by Mr. Chen Yi Hong and Beijing Dong Xiang has ceased to be a subsidiary of the Company as a result of the disposal.

Transaction value for the distribution of licensed products between Beijing Dong Xiang and Dong Gan Jiu Liu for the year ended 31 December 2005 amounted to an aggregate of RMB9,663,000, which was below the relevant annual cap approved by the Hong Kong Stock Exchange as disclosed in the Listing Prospectus.

3. *Non-exclusive distributorship arrangement of LI-NING brand products by 北京動感競技經貿有限公司 (Beijing Dong Gan Jing Ji Trading Co., Ltd.) ("Dong Gan Jing Ji")*

Dong Gan Jing Ji is a limited liability company established in the PRC, which is owned as to 60% by Mr. Chen Yi Liang and 40% by Mr. Chen Yi Yong. Both of Mr. Chen Yi Liang and Mr. Chen Yi Yong are brothers of Mr. Chen Yi Hong, an Executive Director of the Company before his resignation on 1 September 2005. Dong Gan Jing Ji is an associate of Mr. Chen Yi Hong and, hence, a connected person of the Company for the purposes of the Listing Rules.

On 1 January 2004, Beijing Li Ning (as supplier) and Dong Gan Jing Ji (as non-exclusive distributor) have entered into a non-exclusive distributorship agreement for the sale of LI-NING brand products at a retail shop in Beijing for a term of three years commencing from 1 January 2004.

Transaction value for the distribution of products between Beijing Li Ning and Dong Gan Jing Ji for the year ended 31 December 2005 amounted to an aggregate of RMB345,000, which was below the relevant annual cap approved by the Hong Kong Stock Exchange as disclosed in the Listing Prospectus.

The Directors, including the Independent Non-Executive Directors, have reviewed the above continuing connected transactions made during the year ended 31 December 2005 and confirmed that these transactions were entered into:

- (1) in the ordinary and usual course of business of the Group;
- (2) on normal commercial terms or on terms no less favourable to the Company than terms available to or from independent third parties; and
- (3) in accordance with each of the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

PricewaterhouseCoopers, the auditors of the Company, has confirmed to the Board of Directors in writing that the continuing connected transactions made during the year ended 31 December 2005:

- (1) have received the approval of the Board of Directors of the Company;
- (2) are in accordance with the pricing policies of the Group;
- (3) have been entered into in accordance with the relevant agreements governing the transactions; and
- (4) have not exceeded the annual cap as disclosed in the Listing Prospectus.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S SHARES

The Company had not redeemed any of its listed shares during the year ended 31 December 2005. Neither the Company nor any of its subsidiaries had purchased or sold any of the Company's shares during the year.

SUFFICIENCY OF PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the Directors, throughout the year ended 31 December 2005 and up to the date of this report, the Company has maintained a sufficient public float of more than 25% of the Company's issued shares as required under the Listing Rules.

Report of the Directors

CORPORATE GOVERNANCE

The Company has complied with the corporate governance practices as set out in Appendix 14 of the Listing Rules which came into effect on 1 January 2005. Principal corporate governance practices adopted by the Company are set out in the Corporate Governance Report on pages 36 to 45 of this annual report.

AUDITORS

PricewaterhouseCoopers will retire as auditors of the Company and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of PricewaterhouseCoopers as auditors of the Company is to be proposed at the forthcoming annual general meeting.

By order of the Board

LI Ning

Chairman

Hong Kong, 22 March 2006