

Report on Corporate Governance

CORPORATE GOVERNANCE PRACTICES

The board of directors (the "Board") of the Company fully acknowledges its responsibilities to act in the best interests of all shareholders and to maximise shareholder value. The Board also attaches great importance to constantly improving the Company's corporate governance policies and practices. A good illustration is that the Company has volunteered to announce its quarterly financial results to enhance transparency of the Company's operation and performance.

The Company became listed on the main board of The Stock Exchange of Hong Kong Limited (the "Exchange") on 7 April 2006. Nevertheless, long before the Company's listing on the Exchange, the Board had commenced establishing a range of policies and practices consistent with those required by the Exchange's Code on Corporate Governance Practices (the "Code") in relation to, amongst others, the appointment, removal and remuneration of the directors, responsibilities, composition and meetings of the Board and its committees, segregation of duties between the Chairman of the Board and the President who is the head of the executive management. In some areas, such policies and practices exceed the mandatory requirements of the Code. For instance, in order to regulate both corporate and individual behaviour for the purpose of ensuring achievement of corporate goals, the Board has adopted a set of General Business Principles and a Code of Conduct and requires all employees above certain grades to certify their compliance therewith annually.

Furthermore, to remove any gaps between its established corporate governance policies and practices and the requirements of the Code, the Board has, acting itself or through the management, adopted additional policies, such as the policy on securities dealings by the directors, supervisors, management and other relevant employees of the Company.

For the period from 7 April 2006 to 31 December 2006 (the "Reporting Period"), the Company complied with all the code provisions of the Code, except for the following instances:

Code provision A.1.7

The code provision A.1.7 of the Code provides that there should be a procedure agreed by the Board to enable directors, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the issuer's expense.

The Board did not adopt such a written procedure until 10 November 2006. However, the directors are of the view that their right of access to independent professional advice had never been prejudiced by the delayed adoption of such a procedure.

Code provision A.5.4

The Code provision A.5.4 of the Code provides, among other things, that the Board should establish written guideline on no less exacting terms than the model code for relevant employees in respect of their dealings in the securities of the issuer.

The Board adopted an employee Code of Conduct on 1 November 2005 which provides, among other things, that all employees must not deal in the securities of the Company if they are in possession of any non-public price-sensitive information with regard to the Company. To comply fully with the Code, the Board established further written guidelines on no less exacting terms than the Model Code (as defined below) for the relevant employees in respect of their dealings in the securities of the Company on 27 July 2006.

DIRECTORS' SECURITIES TRANSACTIONS

As mentioned above, the Company has adopted the Model Code (the "Model Code"), as set forth in Appendix 10 to the Rules Governing the Listing of Securities on the Exchange (the "Listing Rules"), as its code of conduct regarding securities transactions by its directors and supervisors.

In addition, the Company has adopted an employee share dealing code to regulate securities transactions by the management and other relevant employees who, because of their office or employment, are likely to be in possession of unpublished price-sensitive information of the Company.

One month before each of the three meetings scheduled to approve the Company's results for the three months ended 31 March 2006, six months ended 30 June 2006 and nine months ended 30 September 2006, respectively, the company secretary notified the directors, supervisors, management and other relevant employees of the restriction period for securities transactions.

The Company, having made specific enquiry of all its directors and supervisors, confirms that its directors and supervisors complied with the required standards set out in the Model Code throughout the Reporting Period.

BOARD OF DIRECTORS

The Board is charged with promoting the success of the Company by directing and supervising its affairs in a responsible and effective manner. Each director has a duty to act in good faith and in the best interests of the Company. The directors are aware of their collective and individual responsibilities to all shareholders for the manner in which the affairs of the Company are managed, controlled and operated.

The Board operates mainly by way of regular meetings which are held at least four times a year and supplemented by interim meetings and circulated written resolutions as and when necessary. In the Reporting Period, the Board held three Board meetings. Details of directors' attendance at the meetings of the Board and its committees held during the Reporting Period are set out in Table 1 of this report.

The types of decisions which are to be taken by the Board include those relating to the Company's strategic direction, objectives, business plans, audited and unaudited financial statements, profit distribution proposals, proposals of changes to the share capital, proposals of amendments to the Articles of Association, appointment and remuneration of senior officers. The management is responsible for the implementation of the overall strategy of the Company and its daily operations and administration in accordance with the business plans approved by the Board from time to time. The Board has adopted detailed rules concerning the authority delegated to the management and a list of matters reserved for its own decision.

The directors fully acknowledge their responsibility for reviewing and approving the accounts prepared by the management for each financial period which shall give a true and fair view of the state of affairs of the Company and of the results and cash flows for that period. The directors are currently not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern.

During the Reporting Period, the Board comprised 11 directors as follows:

Executive Directors

Mr. Tony Yuhai LIU
Ms. CHENG Jianyu

Independent Non-executive Directors

Mr. Thaddeus Thomas BECZAK
Mr. James Arthur WATKINS
Mr. SHEN Weijia

Non-executive Directors

Mr. RUAN Yanhua, Chairman
Mr. ZHU Jian
Mr. Petrus Antonius Maria VAN BOMMEL
Mr. Anthony LEAR
Mr. ZHU Peiyi
Mr. ZHOU Weiping

Subsequent to the balance sheet date, the above-mentioned directors for the first session of the Board served terms until 1 March 2007. Mr. Tony Yuhai LIU, Ms. CHENG Jianyu, Mr. Thaddeus Thomas BECZAK, Mr. James Arthur WATKINS, Mr. SHEN Weijia, Mr. RUAN Yanhua, Mr. ZHU Jian, Mr. Petrus Antonius Maria VAN BOMMEL, Mr. Ajit MANOCHA, Mr. ZHU Peiyi and Mr. XIAO Yongji were elected as directors of the second session (with effect from 2 March 2007 to 1 March 2010) of the Board at the Company's extraordinary general meeting held on 29 January 2007.

All directors (with the exception of the two executive directors) are non-executive and independent of the management, thereby promoting critical review and control of the management process. The Board includes three influential and active independent non-executive directors to whom shareholder concerns can be conveyed. The non-executive members of the Board also bring a wide range of business and financial experience to the Board, which contributes to the effective direction of the Company.

Biographic details of all directors are given from pages 11 to 20 of the Annual Report. Relationships (including financial, business, family or other material/relevant relationships), if any, among members of the Board are also disclosed. There is no such relationship as between the Chairman of the Board and the President.

During the Reporting Period, the Board at all times complied with the requirements of the Listing Rules relating to the appointment of at least three independent non-executive directors, and one director with appropriate professional qualifications or accounting or related financial management expertise, on the Audit Committee.

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Pursuant to the requirements of the Listing Rules, the Company has received written confirmation from each independent non-executive director of his independence to the Company. The Company considers all of the independent non-executive directors to be independent.

The Board has access to the management of the Company to discuss enquiries, to the joint company secretaries on regulatory and compliance matters and to external professionals for advice when necessary. The joint company secretaries continuously advise all directors on continuing obligations under the Listing Rules and other applicable laws and regulations to ensure the Company's compliance therewith.

NOMINATION AND APPOINTMENT OF DIRECTORS

Pursuant to the PRC company law and the Company's Articles of Association, directors shall be elected by the Company's general meetings each for a term of three years and, upon expiry of their term, may offer themselves for re-election.

To comply strictly with this statutory requirement and safeguard the shareholders' right in this respect, the Company convened an extraordinary general meeting on 29 January 2007 for the purpose of the election of the second session of the Board and supervisory committee.

The Board has not established any nomination committee and nominated candidates for the second session of the Board and supervisory committee by reference to the following criteria: requirements of applicable laws and the Listing Rules concerning composition of the Board and supervisory committee; a balance of skills and experience required for promoting the success of the Company and for directing and supervising the Company's affairs; and recommendations from eligible shareholders.

CHAIRMAN AND PRESIDENT

The posts of the Chairman of the Board and the President (as head of the executive management) are held separately by Mr. RUAN Yanhua and Mr. Tony Yuhai LIU. This segregation ensures a clear distinction between the Chairman's responsibility to manage the Board and the President's responsibility to manage the Company's business. The respective responsibilities of the Chairman and President are set out in the Company's Articles of Association.

NON-EXECUTIVE DIRECTORS

Each of the non-executive directors of the Company has been appointed for a term of no more than three years and is subject to re-election or removal at the Company's general meetings in accordance with the Articles of Association of the Company.

BOARD COMMITTEES

The Board has appointed two Board committees, namely, the Audit Committee and Remuneration Committee, to oversee particular aspects of the Company's affairs.

Membership of the Audit Committee

During the Reporting Period and until 1 March 2007, the Audit Committee of the first session of the Board comprised Mr. James Arthur WATKINS (chairman), Mr. Thaddeus Thomas BECZAK, Mr. SHEN Weijia, Mr. Anthony LEAR and Mr. ZHU Peiyi.

The Audit Committee of the second session (from 2 March 2007 to 1 March 2010) of the Board comprises Mr. James Arthur WATKINS (chairman), Mr. Thaddeus Thomas BECZAK, Mr. SHEN Weijia, Mr. Petrus Antonius Maria VAN BOMMEL and Mr. ZHU Peiyi.

All of its members were appointed from the independent non-executive directors and non-executive directors, with Mr. Thaddeus Thomas BECZAK and Mr. Petrus Antonius Maria VAN BOMMEL having appropriate professional qualifications and experience in financial matters.

Role and function of the Audit Committee

The terms of reference of the Audit Committee are aligned with those set out in code provision C.3.3 of the Code, including monitoring of the relationship with the Company's external auditors, review of financial information of the Company and oversight of the Company's financial reporting system and internal controls procedures. The detailed terms of reference are disclosed on the Company website.

It is the practice of the Audit Committee to meet in person immediately preceding each of the meetings of the full Board scheduled to consider and approve financial results. Special meetings may be called at the discretion of the chairman of the Audit Committee to review significant control or financial issues. Details of member attendance at the meetings of the Audit Committee held during the Reporting Period are set out in Table 1 of this report.

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Work of the Audit Committee

During the Reporting Period, the Audit Committee of the first session of the Board met on three occasions and discharged its responsibilities in its review of the Company's financial information and system of internal controls, and its other duties as set out in the terms of reference. The work performed by the Audit Committee included, among other things:

- (1) review of the Company's financial results, respectively, for the three months ended 31 March 2006, for the six months ended 30 June 2006 and for the nine months ended 30 September 2006, with recommendations to the Board for approval;
- (2) review of presentations and management letters from the Company's external auditors concerning matters arising from their audit or review of the financial results for the respective financial periods; and
- (3) review of quarterly reports from the management concerning financial matters, internal control, risk management and compliance.

Membership of the Remuneration Committee

During the Reporting Period and until 1 March 2007, the Remuneration Committee of the first session of the Board comprised Mr. RUAN Yanhua (chairman), Mr. James Arthur WATKINS and Mr. SHEN Weijia.

The chairman and members of the Remuneration Committee of the second session (with effect from 2 March 2007 to 1 March 2010) of the Board are the same as those of the first session.

A majority of the members of the Remuneration Committee were independent non-executive directors.

Role and function of the Remuneration Committee

The terms of reference of the Remuneration Committee are aligned with those set out in code provision B.1.3 of the Code, including recommendations on the Company's policy and structure for remuneration of the directors, supervisors and management, determination of specific remuneration packages of the senior officers, and review and approval of performance-based remuneration by reference to corporate goals and objectives. The detailed terms of reference are disclosed on the Company website.

It is the practice of the Remuneration Committee generally to hold meetings by way of correspondence to discharge its duties under its terms of reference. Details of directors' attendance at the meetings of the Remuneration Committee held during the Reporting Period are set out in Table 1 of this report.

Work of the Remuneration Committee

During the Reporting Period, the Remuneration Committee of the first session of the Board held two correspondence meetings and performed, among other things, the following work:

- (1) review and approval of the year 2005 management bonuses for senior officers and year 2006 performance appraisal targets and management bonuses ranges for senior officers;
- (2) review and approval of specific remuneration packages for two newly appointed senior officers;
- (3) review and approval of the proposed service contracts and remuneration for the directors and supervisors of the second session (with a recommendation for the Board's approval); and
- (4) determining the policy for the remuneration of the executive Directors

Table 1

Directors	Meetings Attended / Held		
	Board	Audit Committee	Remuneration Committee
<i>Executive Directors</i>			
Mr. Tony Yuhai LIU	3/3		
Ms. CHENG Jianyu	3/3		
<i>Non-executive Directors</i>			
Mr. RUAN Yanhua	3/3		2/2
Mr. ZHU Jian	3/3		
Mr. Petrus Antonius Maria VAN BOMMEL	3/3		
Mr. Anthony LEAR	3/3	3/3	
Mr. ZHU Peiyi	3/3	3/3	
Mr. ZHOU Weiping	2/3		
<i>Independent Non-executive Directors</i>			
Mr. Thaddeus Thomas BECZAK	3/3	3/3	
Mr. James Arthur WATKINS	3/3	3/3	2/2
Mr. SHEN Weijia	3/3	3/3	2/2

EXTERNAL AUDITORS' REMUNERATION

The Company's external auditors are Ernst & Young. In order to maintain their independence, the Company has set a policy that the Company may engage the external auditors for non-audit services if such services would have no adverse effect on their independence, are approved by the Audit Committee and, in terms of financial limits, are capped at no more than 50% of the audit fees in a given year.

During the Reporting Period, the Company, with the prior approval by the Audit Committee, engaged Ernst & Young to conduct an entity-level internal control review of the Company, assist in an initial risk assessment and conduct certain agreed upon procedures on process-level controls in relation to certain business processes.

Total remuneration paid or payable to the Company's external auditors amounted to RMB3,200,000 in 2006, which is broken down as follows:

Table 2

	(RMB)
Audit services	2,400,000
Non-audit services	800,000
Total	3,200,000

INTERNAL CONTROLS

The Board acknowledges its responsibility to ensure that a sound and effective internal control system is maintained, which includes a defined management structure with specified limits of authority, to achieve business objectives and safeguard assets against unauthorised use or disposition; to ensure the maintenance of proper accounting records for the provision of reliable financial information for internal use or for publication; and to ensure compliance with the relevant legislation and regulations.

The system is designed to provide reasonable, but not absolute, assurance against material misstatement or loss and to manage rather than eliminate risks of failure in operational systems, and to ensure achievement of the Company's objectives.

Internal Control Framework

The Company operates within an established framework of internal controls, which is consistent with the principles outlined in the COSO (the Committee of Sponsoring Organisations of the Treadway Commission) framework and encompasses five inter-related components that include control environment, risk assessment, control activities, information and communication, and monitoring. The internal control framework also serves to monitor the effectiveness of the internal control system in supporting the achievement of objectives in the three separate but overlapping areas: effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations.

Under the Company's framework, management is primarily responsible for the design, implementation, and maintenance of internal controls, while the Board and the Audit Committee oversee the actions of management and monitor the effectiveness of the controls that have been put in place.

General Business Principles and Code of Conduct

The Board has adopted a set of General Business Principles and a Code of Conduct for employees. The Company gives frequent orientation and refresher training on the General Business Principles and Code of Conduct to all employees, and requires all employees above certain grades to certify their compliance therewith annually.

In the Code of Conduct, the Company has established procedures for handling employees' complaints and alerts of wrongdoings. Complaints may be submitted on an anonymous basis. Such complaints should normally be reported or directed to the compliance officer and, in the event of involvement of a senior officer, to the Chairman of the Board directly. Any employee who in good faith reports a breach (or alleged breach) by another employee of the Code of Conduct will be protected from retaliation.

The role of the Audit Committee

The Audit Committee, primarily through the agency of the internal auditor department, is responsible for ensuring the existence and effectiveness of internal controls and discharges its responsibilities mainly by receiving and reviewing periodic reports from the external auditors, financial management, internal auditor and compliance officer.

The role of the internal audit department

The internal audit department has been established during the Reporting Period. It plays an important role in monitoring the internal governance of the Company. Its tasks include:

- unrestricted access to review all aspects of the Company's activities, records, information and assets which it considers necessary to fulfil its responsibilities;
- review the effectiveness of material internal controls on a regular basis to ensure that the internal controls are carried out appropriately and functioning as intended;
- special reviews of areas of concern identified by the management or the Audit Committee;
- provision of reports to the Audit Committee with its findings and recommendations to improve the internal control system of the Company.

The department has also conducted special investigations in relation to violations of the Company's General Business Principles and Code of Conduct. Any breaches identified have been the subject of appropriate disciplinary action together with corrective actions taken by the management, and have been reported to the Audit Committee.

With the guidance of the Audit Committee, the department is in the process of devising and implementing improved procedures for the systematic monitoring of internal controls and compliance therewith.

The internal audit manager reports directly to the Audit Committee on audit matters and to the President on administrative matters. The internal audit manager has the right to consult the Audit Committee without reference to management.

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Review of system of internal controls

The Audit Committee, on behalf of the Board, has conducted a review of the internal controls to ensure that the controls in place are adequate and effective.

The Audit Committee has engaged Ernst & Young to assist with its review, by conducting an entity-level control review, assisting in an initial risk assessment and conducting a review of certain agreed-upon procedures on process-level controls in relation to certain selected business processes.

A three-year (2007-2009) internal audit plan has been formulated with a view to ensuring a systematic coverage of all auditable areas. The plan will be revised annually to reflect organisational or environmental changes as well as new services and operations introduced. Using risk-ranking methodology, the internal audit department schedules its internal audit programmes annually based on the three-year plan.

Conclusion

Nothing has come to the attention of the Board during the course of the activities described above that would cause it to believe that the internal controls in place are inadequate or that there have been any breaches which would have a material negative effect on the business or financial condition of the Company.