

# REPORT OF THE DIRECTORS

The directors of the Company (“Directors”) present their report and the audited financial statements of the Company and the Group for the year ended 31 December 2006.

## PRINCIPAL ACTIVITIES

The Group is principally engaged in the production, sale and distribution of cotton yarn, grey fabric and denim. There were no significant changes in the nature of the Group’s principal activities during the year ended 31 December 2006.

## RESULTS AND DIVIDENDS

The Group’s operating results for the year ended 31 December 2006 and the financial position of the Group and the Company as at 31 December 2006 are set out in the audited financial statements on pages 51 to 53 and pages 58 to 59.

The Directors recommended the payment of a final dividend of RMB0.44 per share for the year ended

31 December 2006, to shareholders of the Company on the register of members at the close of business on 4 May 2007. There was no arrangement under which a shareholder of the Company has waived or agreed to waive any dividends. This recommendation has been incorporated in the audited financial statements as an allocation of retained profits within the capital and reserves section of the balance sheet.

## SUMMARY FINANCIAL INFORMATION

A summary of the consolidated results, assets and liabilities of the Group for the last five financial years, as extracted from the accountants’ report for the three years ended 31 December 2002 in the Prospectus, and from the audited consolidated financial statements of the Group for the year ended 31 December 2003 and the year ended 31 December 2004, and from the audited consolidated financial statements of the Group for the year ended 31 December 2005 and the year ended 31 December 2006 on pages 51 to 53, is set out below:

## Results

	For the year ended 31 December				
	2002 RMB'000	2003 RMB'000	2004 RMB'000	2005 RMB'000	2006 RMB'000
Turnover	4,380,923	6,560,470	11,088,224	13,584,389	<b>19,826,154</b>
Cost of sales	(3,729,267)	(5,350,157)	(9,231,047)	(11,340,259)	<b>(16,503,064)</b>
Gross profit	651,656	1,210,313	1,857,177	2,244,130	<b>3,323,090</b>
Other incomes	49,303	74,120	159,022	189,536	<b>350,250</b>
Sales and distribution costs	(78,565)	(148,375)	(275,899)	(344,868)	<b>(358,816)</b>
Administrative expenses	(40,189)	(89,703)	(143,524)	(151,059)	<b>(177,341)</b>
Other operating expenses	(19,641)	(35,116)	(59,509)	(81,788)	<b>(109,609)</b>
Financial cost	(101,506)	(157,797)	(290,383)	(420,167)	<b>(720,003)</b>
Profit before tax	461,058	853,442	1,246,884	1,435,784	<b>2,307,571</b>
Taxation	(169,627)	(305,674)	(420,405)	(187,390)	<b>(616,745)</b>
Profit before minority interests	291,431	547,768	826,479	1,248,394	<b>1,690,826</b>
Minority interests	(3,191)	(6,096)	(944)	(5,921)	<b>(5,421)</b>
Net profit from daily operations attributable to shareholders	288,240	541,672	825,535	1,242,473	<b>1,685,405</b>

## Assets and liabilities

	As at 31 December				
	2002 RMB'000	2003 RMB'000	2004 RMB'000	2005 RMB'000	2006 RMB'000
Total assets	5,538,972	11,339,925	16,388,853	24,704,766	26,140,632
Total liabilities	3,939,219	6,682,539	10,228,695	14,783,418	14,018,831

### PROPERTY, PLANT AND EQUIPMENT

Details of movements in the property, plant and equipment of the Company and the Group during the year ended 31 December 2006 are set out in Note 15 to the financial statements.

### SHARE CAPITAL AND SHARE OPTION SCHEME

Details of movements in the Company's share capital during the year ended 31 December 2006, together with the reasons therefore, are set out in Note 32 to the financial statements.

Details of the placing of H Shares are set out on page 15 in this annual report.

The Company does not have any share option scheme.

### PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Articles of Association or the Company Law of the PRC which oblige the Company to offer new shares on a pro rata basis to existing shareholders.

### PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

Neither the Company has redeemed, purchased or sold any of its own listed securities during the year ended 31 December 2006, nor any of its subsidiaries purchased, or sold any of the Company's listed securities during the year ended 31 December 2006.

### RESERVES

Details of movements in the reserves of the Company and the Group during the year ended 31 December 2006 are set out in Note 33 to the financial statements and in the consolidated statement of changes in equity, respectively.

### DISTRIBUTABLE RESERVES

As at 31 December 2006, in accordance with the PRC Company Law and the PRC Accounting Standards and Regulations, an amount of about RMB6,778 million stood to the credit of the Company's capital reserve account, and an amount of about RMB772 million stood to the credit of the Company's statutory reserve funds. In addition, according to the Company's Articles of Association, the Company had retained profits of about RMB3,081 million for distribution as dividend.

### MAJOR CUSTOMERS AND SUPPLIERS

During the year ended 31 December 2006, sales to the Group's five largest customers accounted for 10.4% of the Group's total sales for the year ended 31 December 2006. Sales to its largest customer accounted for 4.0% of the Group's total sales for the year ended 31 December 2006.

During the year ended 31 December 2006, purchases from the Group's five largest suppliers accounted for 18.7% of the Group's total purchases for the year

## Report of the Directors

ended 31 December 2006. During the year ended 31 December 2006, purchases from the Group's largest supplier accounted for 7.2% of the Group's total purchases for the year ended 31 December 2006.

The Group has sold and purchased certain products to and from certain companies with the same ultimate controlling shareholder of the Company, details of which are set out in the section headed "Connected Transactions" below.

### INDEPENDENT NON-EXECUTIVE DIRECTORS

The Company has received from each of the independent non-executive Directors an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules and the Board considers each of the independent non-executive Directors to be independent.

### EMOLUMENTS OF DIRECTORS

There was no arrangement under which a Director has waived or agreed to waive any emoluments. Details of emoluments of Directors are set out in Note 8 to the financial statements.

### DIRECTORS' AND SUPERVISORS' SERVICE CONTRACTS AND LETTERS OF APPOINTMENT

Each of the executive Directors and Supervisors of the Company (excluding the independent Supervisors) has entered into a service contract with the Company for a term of three years. Each of the non-executive Directors, independent non-executive Directors and independent Supervisors has entered into a letter of appointment with the Company for a term of three years. Pursuant to the Company's Articles of Association, each Director and Supervisor is eligible for re-election upon expiration of his/her term of office.

Save as mentioned above, the Company has not entered into any service contract with any of the Directors and Supervisors which is terminable by the Company within one year without payment of compensation other than statutory compensation.

The Directors and Supervisors as at the date of this report and their respective term of office are as follows:

#### Executive Directors:

Zhang Hongxia	Until 6 June 2009
Zhang Yanhong	Until the date of annual general meeting in 2008
Qi Xingli	Until 6 June 2009
Zhao Suwen	Until 6 June 2009

#### Non-executive Directors:

Zhang Shiping	Until 6 June 2009
Wang Zhaoting	Until 6 June 2009

#### Independent non-executive Directors:

Wang Naixin	Until 6 June 2009
Xu Wenyong	Until 27 June 2009
Chan Wing Yau, George	Until 6 June 2009

#### Supervisors:

Liu Mingping	Until 6 June 2009
Lu Tianfu (Note)	Until 6 June 2009
Wang Wei (Note)	Until 6 June 2009

Note: Independent Supervisor

### DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Except for Ms. Zhang Yanhong, all above Directors and Supervisors were re-elected as Directors or Supervisors in the annual general meeting held on 6 June 2006, and have taken office as Directors and Supervisors during the whole year. Ms. Zhang Yanhong is a newly appointed executive Director. Her appointment was formally passed and effective in the extraordinary general meeting held on 6 November 2006.

The biographies of each of the Directors and Supervisors are set out on page 21 to page 25 in this annual report.

## DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

Save for those transactions described in Note 37, headed "Related Party Transactions", to the financial statements and the section headed "Connected Transactions" below, none of the Directors or Supervisors had a material interest, directly or indirectly, in any contract of significance to which the Company or any of its subsidiaries was a party during or at the end of 2006.

## CONTRACTS OF SIGNIFICANCE

Save for those transactions described in Note 37, headed "Related Party Transactions", to the financial statements and the section headed "Connected Transactions" below, there is no contract of significance between the Company (or any of its subsidiaries) and its controlling shareholder (or any

of its subsidiaries) or among the controlling shareholders of the Company (or any of its subsidiaries), and there is no contract of significance for the provision of services to the Company (or any of its subsidiaries) by a controlling shareholder of the Company (or any of its subsidiaries).

## SUBSTANTIAL SHAREHOLDERS

As at 31 December 2006, so far as known to any Directors, Supervisors or chief executive of the Company the following persons (other than a Director, Supervisor or chief executive of the Company) had, or were deemed or taken to have interests or short positions in the shares or underlying shares of the Company which would fall to be disclosed to the Company and The Stock Exchange of Hong Kong Limited ("Stock Exchange") under the provisions of Divisions 2 and 3 of Part XV of the Securities and Futures Ordinance ("SFO") or, who were, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other member of the Group or had any option in respect of such capital:

### Long positions in the domestic shares of the Company ("Domestic Shares")

Shareholders	Number of Domestic Shares <i>(Note 1)</i>	Approximate percentage of total issued domestic share capital as at 31 December 2006 (%)	Approximate percentage of total issued share capital as at 31 December 2006 (%)
Shandong Weiqiao Chuangye Group Company Limited (山東魏橋創業集團有限公司) ("Holding Company")	697,781,600 <i>(Note 2)</i>	89.37	58.42
Zouping County Supply and Marketing Corporation Union (鄒平縣供銷合作社聯合社) ("ZCSU")	697,781,600 <i>(Note 3)</i>	89.37	58.42

## Report of the Directors

Long positions in the H Shares (“H Shares”) of the Company:

	Number of H Shares <i>(Note 4)</i>	Approximate percentage of total issued H share capital as at 31 December 2006 <i>(%)</i>	Approximate percentage of total issued share capital as at 31 December 2006 <i>(%)</i>
Brandes Investment Partners L.P.	70,680,500 <i>(Note 5)</i>	17.08	5.92
UBS AG	32,327,626 <i>(Note 6)</i>	7.82	2.71

Notes:

1. Unlisted shares.
2. These 697,781,600 Domestic Shares are directly held by Holding Company.
3. These 697,781,600 Domestic Shares are deemed corporate interests under the SFO indirectly held through Holding Company, in which ZCSU had a controlling interest.
4. Shares listed on the Main Board of the Stock Exchange.
5. 70,680,500 H Shares were held by Brandes Investment Partners L.P. in its capacity as investment manager.
6. 11,796,040 H Shares were directly held by UBS AG, while 20,531,586 H Shares were directly held by certain companies under the control of UBS AG.

Save as disclosed above, so far as is known to the Directors, Supervisors or chief executive of the Company, no other person (not being a Director, Supervisor or chief executive of the Company) had any interests or short positions in the shares or underlying shares of the Company which would fall to be disclosed to the Company and the Stock Exchange,

under the provisions of Divisions 2 and 3 of Part XV of the SFO or, who were, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other member of the Group or had any option in respect of such capital.

## DIRECTORS' AND SUPERVISORS' INTERESTS IN SHARES

As at 31 December 2006, the interests of the Directors, Supervisors or chief executive of the Company in the shares, underlying shares or debentures of the Company and any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be (a) notified to the Company and the Stock Exchange pursuant to

Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO) or (b) entered in the register required to be kept by the Company pursuant to Section 352 of the SFO, or (c) notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies as set out in appendix 10 to the Listing Rules, were as follows:

### Long positions in the Domestic Shares:

Type of interest		Number of Domestic Shares (Note 1)	Approximate percentage of total issued domestic share capital as at 31 December 2006 (%)	Approximate percentage of total issued share capital as at 31 December 2006 (%)
Zhang Hongxia (Executive Director)	Personal	17,700,400	2.27	1.48
Qi Xingli (Executive Director)	Personal	8,052,500	1.03	0.67
Zhang Shiping (Non-executive Director)	Personal	5,200,000	0.67	0.44

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Long positions in the shares of the Company's associated corporations (within the meaning of Part XV of the SFO):

	<b>Name of associated corporation</b>	<b>Type of interest</b>	<b>Approximate percentage of total issued share capital as at 31 December 2006 (%)</b>
Zhang Shiping (Non-executive Director)	Holding Company	Personal	4.53

Note:

1. Unlisted shares

Save as disclosed above, as at 31 December 2006, none of the Directors, Supervisors or the chief executive of the Company had an interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which was required to be (a) notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO; or (b) entered in the register required to be kept by the Company pursuant to Section 352 of the SFO; or (c) notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

## MANAGEMENT CONTRACTS

No contract concerning the management and administration of the whole or any substantial part of the business of the Company were entered into by the Company or existed during the year ended 31 December 2006.

## CONNECTED TRANSACTIONS

Related party transactions as set out in Note 37 to the financial statements also constituted connected transactions under the Listing Rules, and required to be disclosed under Rule 14A of the Main Board Listing Rules.

Details of the connected transactions of the Group for the year ended 31 December 2006 are set out below. The Company has made relevant announcements strictly in accordance with the Listing Rules, except for the continuing connected transactions regarding the supply of cotton yarn and grey fabric by the Group to Parent Group and the supply of cotton yarn and grey fabric by the Group to Itochu, the announcement for which was issued late.

During the year ended 31 December 2006, certain transactions were entered into between the Group and the following connected persons of the Company:

1. Holding Company is one of the promoters and the controlling shareholder of the Company. It therefore constitutes a connected person of the Company under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (“Listing Rules”).
2. Weiqiao Bleach is 45.02% owned by Holding Company. Weilian Print is a 73% owned subsidiary of Holding Company. Weiqiao Dyeing is a 60% owned subsidiary of Holding Company. Shandong Hengfu Knitting Co., Ltd. is a 60% owned subsidiary of Holding Company. Shandong Weiqiao Hongyuan Home Textile, Ltd. is a 60% owned subsidiary of Holding Company. Shandong Weiqiao Tekuanfu Co., Ltd. is a 90% owned subsidiary of Holding Company. Shandong Weiqiao Clothes Co., Ltd. is a 67.32% owned subsidiary of Holding Company. Shandong Weiqiao Chuangjie Clothes Co., Ltd. is a 55% owned subsidiary of Holding Company. As the above 8 companies are associates of a promoter/substantial shareholder of the Company, each of them constitutes a connected person of the Company under the Listing Rules.
3. Itochu Corporation (“Itochu”) is the holder of 10.2% interests in Luteng Textile, a 75% owned subsidiary of the Company, and the holder of 25% interests in Binteng Textile, a 75% owned subsidiary of the Company. As it is a substantial shareholder of the above subsidiaries of the Company, it constitutes a connected person of the Company under the Listing Rules.

Under the Listing Rules, the transactions between the Company and the above connected persons constituted connected transactions of the Company.

## **NON-EXEMPT CONNECTED TRANSACTIONS**

Set out below is a summary of the non-exempt connected transactions under the Listing Rules (“Non-Exempt Connected Transactions”):

### **SUPPLY OF COTTON YARN AND GREY FABRIC BY THE GROUP TO HOLDING COMPANY, ITS SUBSIDIARIES AND ASSOCIATES (“PARENT GROUP”)**

On 25 August 2003, the Company and Holding Company entered into a supply of products, raw materials and processing services agreement with a term of three years commencing from 25 August 2003 (“Supply Agreement”). In September 2003, the Stock Exchange granted the Company a waiver from strict compliance with the announcement and independent shareholders’ approval requirements in respect of the supply of cotton yarn and grey fabric by the Group to Parent Group under the Supply Agreement. The waiver was granted for a term of three financial years ended 31 December 2005. Pursuant to the automatic renewal mechanism of the Supply Agreement, it was renewed for a further three years on 25 August 2006, pursuant to which the Company agreed to supply or procure its subsidiaries to supply cotton yarn and grey fabric to Parent Group for the production of downstream cotton textile products. The prices of cotton yarn and grey fabric supplied by the Group to Parent Group were determined by reference to the prices at which comparable types of cotton yarn and grey fabric were supplied by the Group to independent third parties under normal commercial terms in the ordinary course of its business in the PRC. An announcement regarding the above continuing connected transaction was issued on 28 December 2006.



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### **SUPPLY OF COTTON YARN AND GREY FABRIC BY THE GROUP TO ITOCHU**

The Group supplied cotton yarn and grey fabric to Itochu on normal commercial terms in order to maintain a close business relationship with Itochu. In September 2003, the Stock Exchange granted the Company a waiver from strict compliance with the announcement and independent shareholders' approval requirements in respect of the supply of cotton yarn and grey fabric by the Group to Itochu under the arrangement as disclosed in the Prospectus. The waiver was granted for a term of three financial years ended 31 December 2005. The Company entered into a raw material supply agreement with Itochu on 28 December 2006, pursuant to which both parties ratified and confirmed the supply cotton yarn and grey fabrics by the Group to Itochu since 1 January 2006, and the Company agreed to continue to supply or procure its subsidiaries to continue to supply cotton yarn and grey fabrics to Itochu. The prices at which cotton yarn and grey fabric were supplied by the Group to Itochu were determined by reference to the prices at which comparable types of cotton yarn and grey fabric were sold by the Group to independent third parties under normal commercial terms in the ordinary course of its business. An announcement regarding the above continuing connected transaction was issued on 28 December 2006.

### **SUPPLY OF ELECTRICITY AND STEAM BY HOLDING COMPANY TO THE GROUP**

On 25 August 2003, the Company and Holding Company entered into a supply of electricity and steam agreement pursuant to which Holding Company agreed to supply electricity and steam to the Group for a term of 10 years commencing from the date of the agreement. The Group was therefore able to obtain a stable supply of energy for its operations. The price at which electricity was provided to the Group by Holding Company was the lower of either RMB0.35 per kWh or the market price. The price at which steam was provided to the Group by Holding Company was the lower of either RMB60 per ton or the market price.

On 13 May 2005, the Company and Holding Company entered into a supplemental agreement for the purpose of specifying the pricing bases under the above supply of electricity and steam agreement.

### **PROVISION OF PROCESSING SERVICES BY PARENT GROUP TO THE GROUP**

On 25 August 2003, the Company and Holding Company entered into a supply of products, raw materials and processing services agreement with a term of three years commencing from 25 August 2003. Pursuant to the automatic renewal mechanism of the agreement, it was renewed for a further three years on 25 August 2006, pursuant to which Parent Group has not provided and will not provide cotton yarn and grey fabric downstream processing services (e.g. dyeing, bleaching and printing) to the Group. There has been no provision of processing services by Parent Group to the Group for the year of 2006.

## ACQUISITION OF THERMAL POWER ASSETS FROM HOLDING COMPANY BY THE COMPANY

On 13 August 2005, the Company entered into the asset transfer agreement with Holding Company, pursuant to which the Company has agreed to acquire the thermal power assets (the “Thermal Power Assets”) from Holding Company for an aggregate consideration of RMB3,000,000,000 (equivalent to about HK\$2,879,000,000). The acquisition was completed in October 2005. After the acquisition, the Group owns and operates by itself the Thermal Power Assets, which have an installed capacity of about 660 MW and steam generation capacity of about 1,240 tons per hour, respectively.

## LEASE OF LAND USE RIGHTS BY HOLDING COMPANY TO THE COMPANY (EXCLUDING THE LAND USE RIGHTS IN RESPECT OF THE THERMAL POWER ASSETS)

The Company and Holding Company entered into seven leasing agreements pursuant to which, Holding Company agreed to lease to the Company land use rights in respect of land respectively located at No. 34 Qidong Road and west of Xiwaihuan Road, Weiqiao Town, Zouping County, Shandong Province, the PRC, and the land use rights in respect of land located to the east of Zouping County in the economic development zone of Zouping County, Shandong Province, the PRC, for the Company’s operations, with a right of renewal exercisable by the Company. The principal terms of the agreements are as follows:

- (i) Land use rights lease agreement dated 27 December 2000 with the commencement date and expiry date on 27 December 2000 and 27 December 2020, respectively, at an annual rental expense of RMB454,900 for the land relating to the First Production Area.
- (ii) Land use rights lease agreement dated 10 May 2001 with the commencement date and expiry date on 10 May 2001 and 10 May 2021, respectively, at an annual rental expense of RMB868,000 for the land relating to the First Production Area.
- (iii) Land use rights lease agreement dated 30 September 2002 with the commencement date and expiry date on 30 September 2002 and 30 September 2022, respectively, at an annual rental expense of RMB888,700 for the land relating to the Second Production Area.
- (iv) Land use rights lease agreement dated 14 May 2003 with the commencement date and expiry date on 14 May 2003 and 14 May 2023, respectively, at an annual rental expense of RMB1,503,000 for the land relating to the Third Production Area.
- (v) Land use rights lease agreement dated 17 October 2003 with the commencement date and expiry date on 17 October 2003 and 17 October 2023, respectively, at an annual rental expense of RMB2,167,000 for the land relating to the Zouping Economic Development Zone, a new production area established during the year.
- (vi) Land use rights lease agreement dated 17 October 2003 with the commencement date and expiry date on 17 October 2003 and 17 October 2023, respectively, at an annual rental expense of RMB994,100 for the land relating to the Zouping Economic Development Zone.
- (vii) Land use rights lease agreement dated 17 October 2003 with the commencement date and expiry date on 17 October 2003 and 17 October 2023, respectively, at an annual rental expense of RMB2,000,000 for the land relating to the Zouping Economic Development Zone.

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The rent chargeable by Holding Company to the Company was determined by reference to the market rent, namely the rent payable for leasing land use rights in respect of similar properties from independent third parties under normal commercial terms in the ordinary course of their business in Zouping County, Shandong Province, the PRC.

### **ESTABLISHMENT OF SHANDONG WEIQIAO CHUANGYE FINANCE COMPANY LIMITED**

On 17 March 2005, the Company entered into a promoters' agreement with Binzhou Industrial Park, Weihai Weiqiao, Holding Company, Weiqiao Dyeing, and Weilian Print, to establish Shandong Weiqiao Chuangye Finance Company Limited ("SWCF"), for the purpose of providing financial services to Holding Company and its subsidiaries, subject to approval by China Banking Regulatory Commission ("CBRC").

The registered capital of SWCF would be RMB400,000,000 (approximately HK\$398,000,000).

The establishment of SWCF is subject to the obtaining of the relevant approval of CBRC and registration with the local administration for industry and commerce. Upon establishment, SWCF will be owned as to 6.25% by the Company, 3.75% by Binzhou Industrial Park, 2.5% by Weihai Weiqiao, 68.75% by Holding Company, 12.5% by Weiqiao Dyeing, and 6.25% by Weilian Print.

### **LEASE OF LAND USE RIGHTS BY HOLDING COMPANY TO THE COMPANY IN RESPECT OF THE THERMAL POWER ASSETS**

The Company and Holding Company entered into the leasing agreement pursuant to which, Holding Company has agreed to lease to the Company land use rights in respect of the four pieces of land on which the Thermal Power Assets are located,

comprising of two pieces of land with a total area of about 199,453 sq.m. in Weiqiao Town, Zouping County, Shandong Province, a piece of land with an area of about 152,001 sq.m. in the Economic Development Zone of Zouping County, Shandong Province, and a piece of land with an area of about 98,355 sq.m. in the Economic Development Zone of Binzhou City, Shandong Province, respectively.

The lease commenced on 31 October 2005 for a term of 20 years at a total annual rental expense of RMB2,699,000 (subject to annual adjustments).

### **SUPPLY OF EXCESS ELECTRICITY BY THE COMPANY TO HOLDING COMPANY**

The Company and Holding Company entered into the supply of excess electricity agreement pursuant to which the Company has the right to supply electricity which is in excess of the Group's actual electricity consumption, to Holding Company for a term commencing from 31 October 2005 and ending on 31 December 2007 (both dates inclusive).

The price at which excess electricity is supplied to Holding Company by the Company shall be RMB0.45 per kWh or the price then at which a power plant in Shandong Province would sell its electricity produced to the relevant power grid, whichever is higher. If any applicable mandatory price for the supply of electricity is prescribed by the government, it would be adopted instead.

Further details of the Non-Exempt Connected Transactions are set out in the Prospectus and the Company's announcements dated 17 October 2003, 17 March 2005, 13 May 2005, 13 August 2005 and 28 December 2006, respectively.

## FIGURES FOR THE YEAR ENDED 31 DECEMBER 2006

Below is a table setting out the aggregate value for each of the Non-Exempt Connected Transactions for the year ended 31 December 2006:

Transaction nature	Aggregate value for the year ended 31 December 2006 <i>(RMB'000)</i>
1. Supply of cotton yarn and cotton fabric	
(a) by the Group to Parent Group	<b>633,768</b>
(b) by the Group to Itochu	<b>189,763</b>
2. Supply of electricity and steam by Holding Company to the Group	<b>75,051</b>
3. Lease of land use rights by Holding Company to the Group (excluding the land use rights in respect of the land of the Thermal Power Assets and the newly added projects of District III in Park One, District III in Park Two and Park Three in the Zouping Production Base)	<b>8,875</b>
4. Lease of land use rights by Holding Company to the Company in respect of the Thermal Power Assets	<b>2,699</b>
5. Supply of excess electricity by the Company to Holding Company	<b>206,372</b>

### CONFIRMATION BY THE INDEPENDENT NON-EXECUTIVE DIRECTORS

The Independent non-executive Directors have reviewed the Non-Exempt Connected Transactions and confirmed that each of the Non-Exempt Connected Transactions was:

- (i) entered into in the ordinary and usual course of business of the Group;
- (ii) conducted either on normal commercial terms or, if there were not sufficient comparable transactions to judge whether it was on normal

commercial terms, on terms that were fair and reasonable so far as the shareholders of the Company are concerned;

- (iii) entered into either in accordance with the relevant agreement governing such transactions or where there were no such agreements, on terms no less favourable than those available to or from independent third parties, as applicable; and
- (iv) was within the relevant annual cap which had been agreed with the Stock Exchange.

# Report of the Directors

## RETIREMENT SCHEME

Details of the retirement scheme of the Group are set out in Note 7 to the financial statements.

## CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted a code for securities transactions on terms equivalent to the required standard of the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set out in Appendix 10 of the Listing Rules.

Having made specific enquiries with the Directors, the Company has confirmed that each of the Directors complied with the required standard set out in the Model Code regarding securities transactions by the Directors.

## CODE ON CORPORATE GOVERNANCE

Except for the deviation as set out from page 42 to 43 of this annual report, the Company has applied the principles of the Code of Corporate Governance Practices as set out in Appendix 14 of the Listing Rules, and has been in compliance with all the code provisions for the year ended 31 December 2006.

## PUBLIC FLOATING

Pursuant to the information that is publicly available to the Company, and so far as the Directors are aware as at the latest practicable date prior to the issue of this annual report, the Company has sufficient public floating as required under Rule 8.08 of the Listing Rules.

## AUDIT COMMITTEE

The Company has established an audit committee ("Audit Committee") in compliance with the Code of Best Practices for the purposes of reviewing and providing supervision over the Group's financial reporting process and internal controls. The Audit Committee is composed of the three independent non-executive Directors. An audit committee meeting was held on 30 March 2007 to review the Group's annual report and financial statements and provide advice and recommendations to the board of directors of the Company.

## INTERNATIONAL AUDITORS

Ernst & Young was the Company's international auditors for the year ended 31 December 2006. A resolution for the reappointment of Ernst & Young as the international auditors of the Company will be proposed at the forthcoming annual general meeting.

The Company has not changed the auditors for the three years ended 31 December 2006.

On Behalf of the Board of Directors

**Zhang Hongxia**  
*Chairman*

Shandong, the PRC  
30 March 2007