

Corporate Governance Report

CORPORATE GOVERNANCE

Maintaining an effective and solid corporate governance framework is one of the top priorities of the Company. This involves disclosure of our corporate practices to our shareholders in our annual report. We have complied with the code provisions of the “Code on Corporate Governance Practices” set out in Appendix 14 of the Listing Rules (the “CG Code”) throughout the accounting year ended 31st December, 2006, except for deviations from code provision A.4.1 which is explained in paragraph A.4 below.

The corporate governance principles of the Company emphasize a quality board, sound internal controls, and transparency and accountability to all shareholders.

A. DIRECTORS

A.1 The Board

We are governed by the Board which assumes the responsibility for leadership and control of the Company. Our directors are collectively responsible for promoting the success of the Company by directing and supervising the affairs of the Company.

The Board is responsible for the management of the business and affairs of the Group with the objective of enhancing shareholder value and presenting a balanced, clear and understandable assessment of the Company’s performance, position and prospects in its annual and interim reports, other price-sensitive announcements, other financial disclosures as required under the Listing Rules, and reporting to regulators any information required to be disclosed pursuant to statutory requirements.

The Board has a fiduciary duty and statutory responsibility towards the Group. Other responsibilities and matters reserved to the Board are set out in paragraph D.1 below.

The Board meets regularly, normally four times each year with a meeting scheduled at approximately three months intervals and additional meetings would be arranged if and when necessary. The dates of regular Board meetings for each year are normally made available to all directors at the beginning of the year to provide sufficient notice to give all directors an opportunity to attend. Special Board meetings will be held when necessary. Matters on transactions where directors are considered having a conflict of interest or material interests would not be dealt with by way of written resolutions and a separate Board meeting shall be held where independent non-executive directors who have no material interests should be present at the meeting. Directors having a conflict of interest or material interests in a transaction before the meeting of the Board will declare his interest therein in accordance with the bye-laws of the Company, shall abstain from voting on the resolution and shall not be counted in the quorum present at the Board meeting.

Notices are given to all the directors for attending regular Board meetings approximately fourteen (14) days before the meetings. For other Board meetings, reasonable notices are generally given.

Board meetings involve the active participation, either in person or through other electronic means of communication, of a majority of directors. The Company Secretary assists the Chairman in preparing the meeting agenda, and each director may request the inclusion of items in the agenda. Directors are also consulted to suggest matters to be included in the agenda for all regular meetings of the Board.

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Minutes of the Board meetings are recorded in detail and draft minutes are circulated within a reasonable time after the meeting to all directors for review and comments before being approved by the Board. All the minutes of the meetings are properly kept by the Company Secretary and are available for inspection by the directors during normal office hours.

Participation of individual directors at Board meetings in 2006:

Number of meetings	8
<i>Executive directors:</i>	
Mr. Wu Xiao An	8/8 (100%)
Mr. Qi Yumin (<i>Note 1</i>)	8/8 (100%)
Mr. Lin Xiaogang (<i>Note 1</i>)	—
Mr. He Guohua	8/8 (100%)
Mr. Wang Shiping	8/8 (100%)
Mr. Lei Xiaoyang	7/8 (87.5%)
<i>Non-executive director:</i>	
Mr. Wu Yong Cun (<i>Note 2</i>)	3/3 (100%)
<i>Independent non-executive directors:</i>	
Mr. Xu Bingjin	5/8 (62.5%)
Mr. Song Jian	8/8 (100%)
Mr. Jiang Bo	7/8 (87.5%)
Average attendance rate	93.1%

Notes:

1. Mr. Lin Xiaogang resigned as an executive director effective 6th January, 2006 and Mr. Qi Yumin was appointed as an executive director in his place on 6th January, 2006. In 2006, no board meeting has been held prior to 6th January, 2006.
2. Mr. Wu Yong Cun retired as a non-executive director effective 23rd June, 2006, at the conclusion of the annual general meeting held on that date. Prior to 23rd June, 2006, the Company has held three board meetings in 2006.

During 2006, apart from the eight meetings of the Board, consent/approval from the Board has also been obtained via circulation of written resolutions on a number of issues.

The Company has taken out appropriate insurance cover for its directors in respect of legal actions taken against directors and officers. The Board reviews the extent of the insurance cover every year.

A.2 Chairman and Chief Executive Officer

Code provision A.2.1 of the CG Code stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual.

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The Company has segregated the roles of Chairman of the Board and Chief Executive Officer. Mr. Wu Xiao An is the Chairman of the Board and Mr. Qi Yumin is the Chief Executive Officer. On 20th June, 2005, the Board adopted a set of clear guidelines regarding the power and duties of the Chairman and the Chief Executive Officer, the particulars of which has been set out in the corporate governance report contained in the annual report of the Company for the year ended 31st December, 2005. No change has been made to the guidelines during the year ended 31st December, 2006.

A.3 Board composition

Currently the Board comprises eight directors: five executive directors and three independent non-executive directors. The current composition of the Board is as follows:

	Membership of Board Committee(s)
<i>Executive directors:</i>	
Mr. Wu Xiao An (<i>Chairman</i>)	Member of the Remuneration Committee
Mr. Qi Yumin (<i>Chief Executive Officer</i>)	Member of the Remuneration Committee
Mr. He Guohua	—
Mr. Wang Shiping	—
Mr. Lei Xiaoyang (<i>Chief Financial Officer</i>)	—
<i>Independent Non-executive directors:</i>	
Mr. Xu Bingjin	Chairman of the Audit Committee Chairman of the Remuneration Committee
Mr. Song Jian	Member of the Audit Committee Member of the Remuneration Committee
Mr. Jiang Bo	Member of the Audit Committee Member of the Remuneration Committee

The Listing Rules require every listed issuer to have at least three independent non-executive directors, at least one of whom must have appropriate professional qualifications, or accounting or related financial management expertise. Mr. Jiang Bo is an accountant, a certified public accountant and a certified public valuer in the PRC. Mr. Jiang has over ten years of experience in auditing financial statements of companies listed on the stock exchanges of the PRC, has participated in various listing projects of state-owned enterprises in the PRC and overseas and has experience in reviewing and analyzing the audited financial statements of companies listed in the PRC.

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. The Board has assessed the independence of all the independent non-executive directors and is satisfied of their independence.

The Board members do not have any family, financial or business relations with each other.

The biographies of our directors are set out on pages 9 and 10 of this annual report.

The list of directors is disclosed in all corporate communications issued by the Company pursuant to the Listing Rules from time to time.

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A.4 Appointments, re-election and removal of directors

Code provision A.4.1 of the CG Code stipulates that non-executive directors should be appointed for a specific term, subject to re-election.

Code provision A.4.2 stipulates that all directors appointed to fill a casual vacancy should be subject to election by shareholders at the first general meeting after their appointment. Every director, including those appointed for a specific term, should be subject to retirement by rotation at least once every three years.

Non-executive directors (including independent non-executive directors) of the Company do not have specific term of appointment. As the appointment of non-executive directors are subject to the retirement by rotation provisions in the bye-laws of the Company, the Board considers that it is not necessary to appoint the non-executive directors for a specific term. At every annual general meeting, one-third of the directors for the time being, or if their number is not three or in a multiple of three, the number nearest to but not greater than one-third, shall retire from office by rotation according to the bye-laws of the Company. All directors, including those appointed for a fixed term, are subject to the retirement by rotation provision in the bye-laws of the Company.

A director appointed by the Board to fill a casual vacancy shall hold office until the next following general meeting. A director appointed by the Board as an addition to the Board shall hold office until the next following annual general meeting.

The Board has not established a Nomination Committee for reviewing new appointments of directors and senior executives and management succession plans for executive directors and senior executives. The Board follows a formal, considered and transparent procedure for the appointment of new directors to the Board. The appointment of a new director is a collective decision of the Board, taking into consideration the candidate's qualification, expertise, experience, integrity and commitment to his/her responsibilities within the Group. In addition, all candidates to be selected and appointed as a director must be able to meet the standards set out in Rules 3.08 and 3.09 of the Listing Rules. A candidate who is to be appointed as an independent non-executive director must also meet the independence criteria set out in Rule 3.13 of the Listing Rules.

Mr. Qi Yumin was appointed as an executive director and the Chief Executive Officer on 6th January, 2006 to fill the vacancy created by the resignation of Mr. Lin Xiaogang on the same day. The appointment of Mr. Qi Yumin was approved by the Board by written resolutions dated 6th January, 2006 and Mr. Qi Yumin has retired and was re-elected by the shareholders at the special general meeting held on 10th February, 2006.

To comply with the code provision A.4.2 which states that every director should be subject to rotation requirement at least once every three years and in accordance with bye-law 99, Mr. Xu Bingjin and Mr. Lei Xiaoyang will retire by rotation at the forthcoming annual general meeting of the Company to be held on 22nd June, 2007.

A.5 Responsibilities of directors

Each newly appointed director is provided with a package of orientation materials setting out the required duties and responsibilities of directors under the Listing Rules and other relevant statutory requirements of Hong Kong. An orientation as to a director's duties and obligations under the Listing Rules and relevant legislations will be arranged for all newly appointed directors. Our directors are kept informed from time to time on the latest development of any changes to the regulatory requirements and the progress of compliance of applicable rules

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and regulations by the Company. Our Directors will also be updated from time to time on the business development and operation plans of the Company. All our directors are encouraged to participate in continuing professional development seminars and/or courses to update their skills and knowledge on the latest development or changes in the relevant statutes, Listing Rules and corporate governance practices.

The functions of non-executive directors include the functions as specified in code provision A.5.2(a) to (d) of the CG Code.

Every director is aware that he should give sufficient time and attention to the affairs of the Company.

The Company has adopted the standard set out in Appendix 10 — Model Code for Securities Transactions by Directors of Listed Issuers (the “Model Code”) of the Listing Rules, in relation to the dealings in securities of the Company by the directors.

Having made specific enquiry of all directors, during the year ended 31st December, 2006, the directors have complied with the standards set out in the Model Code.

The Company has also established on 17th June, 2005 written guidelines on no less exacting terms than the Model Code (the “Code for Securities Transactions by Employees”) for securities transactions by employees of the Company, its subsidiaries and its holding company (including directors of the Company’s holding company and its subsidiaries), who because of such office or employment, are likely to be in possession of unpublished price-sensitive information of the Company or its securities.

No incident of non-compliance of the Code for Securities Transactions by Employees by the employees during the year was noted by the Company.

A.6 Supply of and access to information

In respect to regular Board meetings, and so far as practicable in all other cases, an agenda and accompanying board papers are sent in full to all directors in a timely manner as permitted under the circumstances. Notices are given to all the directors for attending regular Board meetings fourteen (14) days before the meetings. For other Board meetings, reasonable notices are generally given. It has been the practice of the Board and accepted by all members of the Board that relevant information of Board meetings will be sent to all directors three (3) days in advance of the relevant meetings or any reasonable time before such meetings where it is not practicable to send out the information three (3) days in advance.

Members of the management have been reminded that they have an obligation to supply the Board and the Board committees with adequate information on a timely basis to enable each of them to make informed decisions. The Board and each director have separate and independent access to the Group’s senior management.

All directors are entitled to have access to board papers, minutes and related materials.

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B. REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT

B.1 The level of remuneration and disclosure

The Remuneration Committee was established on 17th June, 2005 in accordance with the CG Code. During 2006, the Remuneration Committee has met three times. The existing members of the Remuneration Committee comprise Mr. Xu Bingjin, Mr. Song Jian and Mr. Jiang Bo, all of whom are independent non-executive directors. Mr. Wu Xiao An and Mr. Qi Yumin, both of whom are executive directors, are also members of the Remuneration Committee. Mr. Xu Bingjin is the chairman of the Remuneration Committee. The Terms of Reference of the Remuneration Committee are adopted with reference to the CG Code, including the specific duties set out in code provision B.1.3(a) to (f) of the CG Code.

The Remuneration Committee is responsible for making recommendations to the Board regarding the Group's policy and structure for all remuneration of directors and senior management. The Remuneration Committee is authorised to seek any information it requires from any employee of the Group and has the power to request the executive directors and other persons to attend its meetings. The Remuneration Committee is also authorised to obtain outside professional advice and to secure the attendance of other persons with relevant experience and expertise if it considers as necessary.

Attendance of individual members at Remuneration Committee meetings in 2006:

Number of meetings	3
Mr. Xu Bingjin	2/3 (66.7%)
Mr. Song Jian	3/3 (100%)
Mr. Jiang Bo	3/3 (100%)
Mr. Wu Xiao An	3/3 (100%)
Mr. Qi Yumin (<i>Note</i>)	3/3 (100%)
Mr. Lin Xiaogang (<i>Note</i>)	—
Average attendance rate	93.3%

Note: Mr. Lin Xiaogang resigned as a member of the Remuneration Committee on 6th January, 2006 and Mr. Qi Yumin was appointed as a member of the Remuneration Committee in his place on 6th January, 2006. In 2006, no Remuneration Committee meeting has been held prior to 6th January, 2006.

The work performed by the Remuneration Committee during 2006 included:

- considered and approved a set of “Policy and Guidelines of The Remuneration Committee” for recommendation to the Board for its formal adoption;
- reviewed and approved the terms of the service agreements of two executive directors of the Company;
- conducted a review on the “Policy and Guidelines of The Remuneration Committee”;

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- reviewed and approved the annual director fees of the directors (including the three independent non-executive directors) of the Company and the remuneration package of the senior management of the Company;
- reviewed the director services agreements or employment contract for senior technician/management previously entered into between three executive directors and the Company; and
- considered and approved the grant of share options under the New Share Option Scheme for recommendation to the Board for its formal approval.

During the process of consideration, no individual director will be involved in decisions relating to his own remuneration.

Full minutes of the Remuneration Committee meetings are kept by the Company Secretary. Draft and final versions of the minutes of the Remuneration Committee meetings are sent to all members of the Remuneration Committee for comments and approval.

The Remuneration Committee will make available its Terms of Reference, explaining its role and the authority delegated to it by the Board, on request. The Terms of Reference are also available on the website of the Company.

C. ACCOUNTABILITY AND AUDIT

C.1 Financial reporting

Management shall provide such explanation and information to the Board as will enable the Board to make an informed assessment of the financial and other matters put before the Board for approval.

The directors are responsible for overseeing all financial aspects of the Company and for keeping proper accounting records and preparing financial statements of each financial period, which give a true and fair view of the state of affairs of the Group and of the results and cash flow for that period. In preparing the financial statements for the year ended 31st December, 2006, the directors have:

- adopted all applicable Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants;
- selected and applied consistently appropriate accounting policies;
- made judgments and estimates that are prudent and reasonable; and
- prepared the accounts on a going concern basis.

The Board is accountable to its shareholders for a clear and balanced assessment of the Company's financial position and prospects. In this regard, the directors' responsibility to present a balanced, clear and understandable assessment extends to annual and interim reports, other price-sensitive announcements and other financial disclosures required under the Listing Rules, and reports to regulators as well as to information required to be disclosed pursuant to statutory requirements.

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Financial results of the Group are announced in a timely manner in accordance with all statutory requirements, particularly the timeframe stipulated in Rule 13.49(1) and (6) of the Listing Rules.

All directors acknowledge their responsibility for preparing the financial statements for the year ended 31st December, 2006.

The Group's external auditors are Moores Rowland Mazars (the "Auditors").

For the year ended 31st December, 2006, the Auditors' remuneration paid or payable in respect of the audit services and other non-audit services provided by the Auditors to the Group amounted to RMB2,800,000 and RMB1,900,000, respectively. Such non-auditing services mainly included conducting agreed-upon procedures on the 2006 interim consolidated financial statements and professional services in connection with the issue of the Convertible Bonds 2011.

The statement of the Auditors about their reporting responsibilities on the financial statements of the Group is set out in the Independent Auditors' Report on pages 42 and 43 of this annual report.

C.2 Internal controls

The Board is entrusted with the overall responsibility of devising the Company's system of internal controls and conducting an annual review of its effectiveness. This ensures that the Board oversees and monitors the Group's overall financial position so that the interests of the shareholders are well protected and covered.

The Company has established an internal audit department and adopted an Internal Audit Charter for the internal audit department. The internal audit department has adopted the framework of internal controls proposed by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) and identified nine major operating subsidiaries/functions of the Company and a number of areas for review.

As stated in the interim report of the Company for the six months ended 30th June, 2006, the internal audit department had preliminarily completed the documentation of the internal controls of the subsidiaries/functions and identified key risks along with controls required to mitigate those risks as of 30th June, 2006.

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During the year of 2006, the management of the Company completed their annual assessment of the effectiveness of the Group's internal control over financial reporting as of 31st December, 2006 in respect of the following areas: control environment, revenue cycle, purchases and inventory management, warranty claim procedures, expenses and payments, bank receipts and payments, human resources management, property, plant and equipment and intangible assets as well as maintenance of the general ledger. Certain deficiencies were identified and the management has designed correction policies to overcome such deficiencies. The major deficiencies identified and the recommended measures for improvements are summarized as follows:

Area for improvement	Recommended improvement measures
— Assessment of potential investments	— Sufficient information should be obtained for evaluating the expected returns, potential risks, resources and funding requirements, etc. of investments — Significant investments should be approved by the board of directors of both the Company and the relevant subsidiary
— Evaluation of creditworthiness of potential customers	— Sufficient information, including background information, financial statements and past trading record, should be obtained to assess the creditworthiness of potential customers
— Monitoring credits risk	— Delivery should only be made after checking the available credit limit of the customer with credit limit granted
— Monitoring prepayment by the Group	— Responsible personnel should be assigned to monitor the status of prepayment — Ageing analysis should be reviewed regularly with follow-up actions for recoverability for long outstanding amounts

The result of the review and recommendations for improvement were presented to the Audit Committee, which adopted the recommendations and presented the recommendations for improvements to the Board for implementation.

The internal control team of the Company is supervising staff from various departments of the Group to implement the corrective policies and measures. Once the corrective measures are in place, trial testing of the effectiveness of such measures will be conducted. The internal control team of the Company will continue with the review of the Group's internal control and testing of the implementation of the controls measures to assess their effectiveness.

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With respect to procedures and internal controls for the handling of and dissemination of price-sensitive information:

- the Group is fully aware of its obligations under the Listing Rules;
- the Group conducts its affairs with close regard to the “Guide on Disclosure of Price-sensitive Information” issued by the Stock Exchange; and
- through channels such as financial reporting and public announcements, the Group has implemented and disclosed its policy on fair disclosure by pursuing broad and non-exclusionary distribution of information to the public.

C.3 Audit Committee

The Audit Committee was established on 20th December, 1999 with reference to “A Guide for the Formation of an Audit Committee” issued by the Hong Kong Institute of Certified Public Accountants. The existing Terms of Reference of the Audit Committee was revised on 27th September, 2004 and 17th June, 2005, respectively. The Terms of Reference of the Audit Committee have included the duties set out in code provision C.3.3(a) to (n) of the CG Code. The existing members of the Audit Committee comprise Mr. Xu Bingjin, Mr. Song Jian and Mr. Jiang Bo, all of whom are independent non-executive directors. Mr. Xu Bingjin is the chairman of the Audit Committee. The Audit Committee does not have as a member a former partner of the Group’s existing audit firm.

During 2006, the Audit Committee met on two (2) occasions and discharged its responsibilities. Attendance of individual members at Audit Committee meetings in 2006:

Number of meetings	2
Mr. Xu Bingjin	2/2 (100%)
Mr. Song Jian	2/2 (100%)
Mr. Jiang Bo	1/2 (50%)
Average attendance rate	83.3%

During 2006, apart from the two meetings of the Audit Committee, consent/approval from the members of the Audit Committee has also been obtained via circulation of written resolutions on a number of issues.

The principal duties of the Audit Committee included reviewing the Company’s financial controls, internal control and risk management system, annual report and accounts and half-year report.

The following is a summary of the work performed by the Audit Committee during 2006:

- approved the appointment of Chief Internal Auditor and Internal Audit Charter for the internal audit department;
- reviewed the Auditor’s management letter and management’s response;

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- reviewed and considered the recently issued accounting standards and the adoption of new accounting standards;
- reviewed the audited financial statements and final results announcement for the year ended 31st December, 2005;
- reviewed the interim report and the interim results announcement for the six months ended 30th June, 2006;
- met with the Auditors to go through any significant audit issues or key findings noted during the audit of the Group's final results;
- met with the Auditors to go through any significant key findings on the internal control and financial reporting matters based on the agreed-upon procedures performed for the Group's unaudited interim results;
- went through various reports by the management for 2006; and
- approved the provision of certain non-audit services provided by the Auditors.

In 2007, the Audit Committee also approved the provision of services in respect of the audit of the Group's 2006 final results and agreed-upon procedures for the 2007 half-yearly results by the Auditors and the relevant fee proposals.

All issues raised by the Audit Committee have been addressed by the management. The work and findings of the Audit Committee have been reported to the Board. During 2006, no issues brought to the attention of the management and the Board were of sufficient importance to require disclosure in this annual report.

Full minutes of the Audit Committee meetings are kept by the Company Secretary. Draft and final versions of the minutes of the Audit Committee meetings are sent to all members of the Audit Committee for comments and approval.

The Audit Committee will make available its Terms of Reference, explaining its role and the authority delegated to it by the Board, on request. The Terms of Reference are also available on the website of the Company.

This annual report has been reviewed by the Audit Committee.

D. DELEGATION BY THE BOARD

D.1 Management functions

In general, the Board oversees the Company's strategic development and determines the objectives, strategies and policies of the Group. The Board also monitors and controls operating and financial performance and sets appropriate policies for risk management in pursuit of the Group's strategic objectives. The Board delegates the implementation of strategies and day-to-day operation of the Group to the management. The reserved power of the Board was set out in the annual report of the Company for the year ended 31st December, 2005 and there has been no change to the power of the Board during the year 2006.

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D.2 Board committees

Apart from the Audit Committee (as described under paragraph C.3) and the Remuneration Committee (as described under paragraph B.1), the Board has not established any other committee of the Board.

E. COMMUNICATION WITH SHAREHOLDERS

E.1 Effective communication

The Company attaches great importance to communications with shareholders. Information on the Group's activities, business, strategies and developments is provided in the Company's annual reports and interim reports. Shareholders of the Company are encouraged to attend the annual general meetings of the Company which offer a valuable forum for dialogue and interaction with management.

At the annual general meeting and special general meetings held in 2006, a separate resolution was proposed by the Chairman in respect of each issue to be considered at the meetings, including the re-election of directors. At the forthcoming annual general meeting to be held on 22nd June, 2007, a separate resolution will be proposed by the Chairman in respect of each issue to be considered at that annual general meeting, including the re-election of directors.

In accordance with the code provision E.1.2 set out in the CG Code, Mr. Wu Xiao An, the Chairman of the Board, and Mr. Xu Bingjin, the chairman of both the Audit Committee and Remuneration Committee, have attended the 2006 annual general meeting. Mr. Zha Jianping, the then Chief Financial Officer, has represented all members of an independent board committee to attend the special general meeting held on 10th February, 2006, at which approval was sought from the shareholders in respect of certain continuing connected transactions, and to answer questions raised by the shareholders, if any.

The Chairman of the Board, the chairman of the Audit Committee and the chairman of the Remuneration Committee, or in their absence, another member of the relevant committee or an appointed representative, will attend the forthcoming annual general meeting to answer questions of shareholders.

E.2 Voting by poll

The procedures for demanding a poll by the shareholders were incorporated in all circulars sent to shareholders and will be explained during the proceedings of meetings. Whenever voting by way of a poll is required, the detailed procedures for conducting a poll will be explained. Poll results will be published in newspapers on the business day following the shareholders' meetings and posted on the website of the Stock Exchange.

At the annual general meeting and special general meetings held in 2006, the Chairman has provided an explanation of the procedures for demanding poll by shareholders at the commencement of the meetings.