

# Directors' Report

Dear shareholders,

The board of directors of China Coal Energy Company Limited (the "**Company**") (the "**Board**") is pleased to present their first directors' report of the Company and the audited consolidated financial statements of the Company and its subsidiaries (together, the "**Group**") for the year ended 31 December 2006 prepared in accordance with International Financial Reporting Standards.

## (1) Principal operations

The Group is principally engaged in coal production, sales and trading, coking operations, coal mining equipment manufacturing and other related operations in China. Our coking operations include the production and sale of coke and coal-based chemicals. Our coal mining equipment operations include design, research and development, and after-sales services. Other operations include provision of coal mine design services.

## (2) Operating results

The financial and operating results of the Group for the year ended 31 December 2006 are set out in the section headed "Financial Statements".

## (3) Dividends

In accordance with the "Provisional Regulations Relating to Corporate Reorganization of Enterprises and Related Management of State-owned Capital and Financial Treatment" issued by the MOF, the Company is required to make a distribution to China National Coal Group Corporation ("**China Coal Group**") in the amount of RMB54 million, which is equivalent to the difference between the Company's net asset value as at 1 October 2005 (the date following the Company's last valuation basis date), and as at 21 August 2006 (the date immediately prior to the date on which the Company was incorporated).

At the first extraordinary general meeting of the Company convened on 23 August 2006, the shareholders of the Company considered and approved the distribution of a special dividend in the amount of RMB1.021 billion to China Coal Group for the period between 22 August 2006 and 30 November 2006. Pursuant to the same resolution, three directors of the Company, namely, Mr. Jing Tianliang, Mr. Yang Lieke and Mr. Peng Yi, were authorized to implement the aforesaid distribution, details of which are set out in Note 34 to the consolidated financial statements.

The Board decides not to recommend payment of a dividend in respect of the balance of the net profit of RMB148 million (net of 10% set aside for the statutory common reserve fund) of the Company for the period between 1 December 2006 and 31 December 2006.

## (4) Distributable Profits

The Board has proposed on 17 April 2007 that the balance of the net profit after deducting 10% set aside for the statutory common reserve amounting to RMB148 million of the Company for the period between 1 December 2006 and 31 December 2006 will be carried forward together with the profit available for distribution for 2007. The profit distribution plan is subject to shareholders' approval at the 2006 annual general meeting.



## (5) Directors and senior management of the Company

The table sets out the information on directors and senior management of the Company as at the date of this report:

Name	Age	Position held in the Company	Date of appointment
Jing Tianliang	61	Chairman, executive director	18 August 2006
Zhang Baoshan	53	Non-executive director Vice-chairman	18 August 2006 21 November 2006
Yang Lieke	49	Executive director, president	18 August 2006
Peng Yi	44	Executive director, executive vice-president and chief financial officer	18 August 2006
Gao Shangquan	77	Independent non-executive director	23 August 2006
Zhang Ke	53	Independent non-executive director	23 August 2006
Peng Ru Chuan	58	Independent non-executive director	23 August 2006
Wu Rongkang	67	Independent non-executive director	21 November 2006
Li Yanmeng	62	Independent non-executive director	21 November 2006
Gao Jianjun	48	Vice-president	18 August 2006
Li Fuyou	51	Vice-president	18 August 2006
Qi Hegang	48	Vice-president	18 August 2006
Niu Jianhua	44	Vice-president	18 August 2006
Zhou Dongzhou	48	Secretary to the Board and joint company secretary	18 August 2006

For details of directors and senior management of the Company, please refer to pages 28 to 32 in this report.

The term of office of executive directors, non-executive directors and independent non-executive directors is three years.

The Company has received annual confirmations from all the independent non-executive directors with respect to their independence. As at the date of this report, the Company considers that all the independent non-executive directors are still independent as defined in Rules Governing Listing of Securities on the Stock Exchange of Hong Kong Ltd. (the "Listing Rules").

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## (6) Supervisors of the Company

The table sets out the information on supervisors of the Company as at the date of this report:

Name	Age	Position held in the Company	Date of appointment
Du Ji'an	45	Chairman of the Supervisory Committee	18 August 2006
Zhou Litao	46	Supervisor	18 August 2006
Chen Xiangshan	51	Employee Representative Supervisor	18 August 2006

For details of supervisors of the Company, please refer to pages 30 to 31 of the annual report.

## (7) Share capital

As at 31 December 2006, the structure of the share capital of the Company is as follows:

Type of shares	Number of shares	Percentage (%)
Domestic shares	7,626,667,000	65.00
H shares	4,106,663,000	35.00
Total	11,733,330,000	100.00

Details of movement in the Company's share capital during the year are also set out in Note 21 to the consolidated financial statements.

## (8) Shareholdings of substantial shareholders

The details of substantial shareholders of the Company as defined under the Securities and Futures Ordinance are set out in the section headed "Corporate Governance Report".

## (9) Directors' and Supervisors' Interests and Short Positions in the Shares, Underlying Shares and Debentures of the Company

As at 31 December 2006, none of our directors and supervisors had any interests or short positions in shares, underlying shares of equity derivatives or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance) as recorded in the register of interests required to be kept by the Company pursuant to Section 352 of the Securities and Futures Ordinance, or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "**Stock Exchange**") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

As at 31 December 2006, the Company had not granted any rights to any directors, supervisors of the Company or their spouses or children under 18 years of age to acquire shares or debentures of the Company or its associated corporations nor did they exercise any such rights to acquire the aforesaid shares or debentures.



## (10) Public float

Based on the public information available to the Company and to the best knowledge of the directors, as at the date of this report, the Company had maintained the public float requirement as set out in the Listing Rules.

## (11) Service contracts of directors and supervisors

Each of the directors and supervisors of the Company has entered into a service contract with the Company on 1 December 2006. According to the terms of the service contract, each of the directors and supervisors agreed to be appointed as directors and supervisors of the Company for a period of three years. These contracts are renewable in accordance with the Company's Articles of Association and the relevant Listing Rules and terminable in accordance with the terms of the contract prior to the expiry of the contract.

Save as disclosed above, none of our directors or supervisors has entered into a service contract with the Company which is not terminable by the Company within one year without payment of compensation, other than statutory compensation.

## (12) Directors' and supervisors' interests in contracts

Other than the service contracts, for the year ended 31 December 2006, no director or supervisor had any direct or indirect material interest in any contract of significance entered into by the Company or any of its holding companies or any of its subsidiaries or fellow subsidiaries.

## (13) Remuneration of directors and supervisors

The details of the remuneration of directors and supervisors of the Company for the year ended 31 December 2006 are set out in Note 35 to the consolidated financial statements.

For the year ended 31 December 2006, no directors or supervisors of the Company had agreed to waive any remuneration.

The remuneration package of directors is determined by the remuneration committee and is subject to approval of the Board and shareholders' approval at the forthcoming annual general meeting. When determining the remuneration package, the remuneration committee and the Board will take into account directors' duties, responsibilities and performance as well as the operating results of the Group.

## (14) Purchase, sale or redemption of shares of the Group

For the year ended 31 December 2006, the Company and its subsidiaries had not purchased, sold or redeemed any securities (the term "securities" has the meaning ascribed to it under the Listing Rules) of the Group.

## (15) Use of Proceeds

The net proceeds from the Company's initial public offering, after deduction of related expenses, amounted to RMB14.68 billion. The net proceeds have been applied for the year ended 31 December 2006 in accordance with the proposed applications as set out in the Company's prospectus.

## (16) Property, plant and equipment

The details of the changes in the property, plant and equipment of the Company and of the Group for the year ended 31 December 2006 are set out in Note 7 to the consolidated financial statements.

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## (17) Donation

For the year ended 31 December 2006, the charitable and other donations made by the Group amounted to RMB3.4868 million.

## (18) Subsidiaries and associates

The details of subsidiaries and associates of the Company as at 31 December 2006 are set out in Note 40 to the consolidated financial statements.

## (19) Employee retirement plan

To comply with applicable regulations, the Group has participated in retirement plans set by the municipal and provincial government. The details are set out in Note 31 to the consolidated financial statements.

## (20) Pre-emptive rights and share option arrangement

There are no provisions for pre-emptive rights under the Company's Articles of Association or relevant laws of the People's Republic of China which would entitle the shareholder of the Company to subscribe for shares on a pro rata basis. The Company does not currently have any share option arrangement.

## (21) Major customers and suppliers

For the year ended 31 December 2006, the revenue derived by the Group from the largest customer and the top five largest customers accounted for approximately 7.1% and 26.4% of the operating revenue of the Group respectively.

For the year ended 31 December 2006, the purchases made by the Group from the top five largest suppliers represented less than 30% of the total purchases made by the Group during the year.

To the knowledge of the Company, the directors of the Company and its associates and any shareholders holding more than 5% of the issued share capital of the Company have not held any interests in any of the above customers and suppliers.

## (22) Contract of Significance

The Company has entered into various contracts of significance with the controlling shareholder during the year. The details are set out in the section headed "Connected Transactions".



## (23) Connected transactions

### 1. Connected transactions

#### (A) Restructuring Agreement

On 5 September 2006, China Coal Group and the Company entered into a restructuring agreement pursuant to which, China Coal Group has made various representations and warranties in relation to the business, assets, liabilities and interests transferred to the Company as part of the restructuring of the Company and has agreed to be responsible for all tax liabilities associated with such transferred businesses, assets, liabilities and interests incurred before the Company's restructuring. China Coal Group has also agreed to indemnify the Company against claims, losses or expenses incurred by the Company in connection with various matters, including, without limitations, the business, assets, liabilities and interests retained or held by the China Coal Group following the restructuring, any title defect in respect of properties being acquired by the Company prior to its restructuring, events or circumstances occurring before the effective date of restructuring in relation to businesses, assets, liabilities and interests transferred to our company under the restructuring.

#### (B) Non-Competition Agreement

The Company entered into the non-competition agreement with China Coal Group on 5 September 2006. Pursuant to the agreement, China Coal Group has undertaken to the Company that except in certain limited circumstances, for so long as the agreement remains effective, it shall not, and shall procure its associates (excluding the Company) not to, directly or indirectly, engage, participate or be interested in, or provide support to, any business or activity which competes or may compete with the current or future core businesses of the Company. China Coal Group has also granted the Company an option and pre-emptive rights to acquire certain interests retained by China Coal Group following the restructuring of the Company and certain future business. .

For the year ended 31 December 2006, save as disclosed in the prospectus dated 6 December 2006, none of the directors and independent non-executive directors of the Company has decided to exercise the option.

### 2. Continuing connected transactions

Major continuing connected transactions of the Company for the year ended 31 December 2006 are set out below:

#### (1) Coal Export and Sales Agency Framework Agreement

On 5 September 2006, the Company entered into an export agency agreement ("Export Agency Agreement") in respect of the export of coal products by China Coal Group for the Company for three years with effect from 22 August 2006. Pursuant to the agreement, the Company has appointed China Coal Group to act as non-exclusive coal export sales agent of the Company.

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The main terms of the Export Agency Agreement are as follows: (a) China Coal Group shall ensure that from the coal export quotas allocated to it, there are sufficient quotas to satisfy the Company's coal exports; (b) agency services provided by China Coal Group shall include export contracts signing, application for export licence and foreign exchange settlement; (c) the Company shall select its overseas customers for its coal products, and determine the price, quantity and other contractual provisions. China Coal Group shall consult with the Company before entering into specific coal export contracts; (d) China Coal Group shall receive from the Company's overseas customers the proceeds pursuant to coal export contracts and shall remit the proceeds received from overseas customers to the Company's designated bank account within five days of receipt; (e) the Company shall be responsible for all expenses incurred in transporting the coal products to the port and the associated on-board packaging for exports. In case the relevant export contract incorporates CFR and CIF terms, the Company shall also be responsible for all shipping freight incurred and CIF insurance charges needed; (f) The agency services provided by China Coal Group shall be made on terms no less favorable to the Company than those available from other agents. If the terms offered by other coal export licence holders are more favorable than those offered by China Coal Group, the Company expects that it will not be difficult for the Company to enter into export agency arrangement with such export licence holders; (g) In respect of export sales to the Taiwan, China market, China Coal Group may engage its offshore wholly-owned subsidiaries to complete the relevant export agency sales services.

The annual cap for the coal export agency fee paid to China Coal Group for the year ended 31 December 2006 was RMB70 million. The actual agency fee incurred was RMB37 million.

## *(2) Coal Supplies Framework Agreement*

On 5 September 2006, China Coal Group and the Company entered into a coal supplies framework agreement ("Coal Supplies Framework Agreement").

The principal terms of the Coal Supplies Framework Agreement are as follows: (a) the agreement shall be effective from 5 September 2006 until 31 December 2008 and may be renewed upon agreement by both parties; (b) China Coal Group will procure that all coal products produced from the mines which are under restructuring be supplied exclusively to the Company, and has undertaken not to sell any such coal products to any third party; (c) the Company and China Coal Group shall within the last quarter of each calendar year devise a 12-month coal products supply schedule for the next calendar year. The Company (or its relevant subsidiary) shall enter into separate contracts with China Coal Group (or its relevant associate) to set out the specific terms and conditions of supplying coal products according to the principles, and within the parameters, provided for under the Coal Supplies Framework Agreement; (d) if the coal products supplied by the mines which are under restructuring under the Coal Supplies Framework Agreement cannot satisfy the Company's requirements, including quality or quantity, the Company is entitled to choose the relevant coal products supplied by third parties.

Under the Coal Supplies Framework Agreement, the Company (or its relevant subsidiaries) shall purchase from China Coal Group (or its relevant associate) coal products produced from the mines which are under restructuring according to the following pricing principles: (a) market price, which is determined by reference to the prevailing market rates for comparable coal products as are available on an arm's length basis from independent coal producers located in the region or surrounding areas of the mines which are under restructuring; (b) where there is no market price, a price to be agreed between the parties, which the agreed price will be calculated based on the price costs incurred in supplying the relevant coal products plus 5% profits reasonably earned. In setting the price, the parties may refer to prices for previous related transactions if available; (c) the purchase prices are payable by the Company within 30 days upon receipt of the coal products.

The annual cap of the fee as at the year end of 2006 paid by the Company to China Coal Group in respect of the supply of coal products produced at the coal mine under restructuring by China Coal Group to the Company for the year ended 31 December 2006 amounted to RMB400 million. The actual expenses incurred were RMB55 million.



### *(3) Integrated Materials and Services Mutual Provision Framework Agreement*

The Company and China Coal Group entered into an integrated materials and services mutual provision framework agreement ("Integrated Materials and Services Mutual Provision Agreement") on 5 September 2006.

The principal terms of the Integrated Materials and Services Mutual Provision Agreement are as follows: (a) the agreement shall take effect from 5 September 2006 until 31 December 2008 and may be renewed upon agreement by both parties; (b) China Coal Group and its associates shall provide to the Company production material supplies and ancillary services on the principles set out in the agreement: (i) production materials including explosives; mining accessories; construction materials; electricity cables and paint and other related or similar production supplies; transportation services (including cars and trucks); electricity and heat supplies; testing and equipment maintenance services; equipment leasing; communications services; (ii) social and support services: security services; staff training; school; medical care and emergency services, etc.; (c) production material supplies and ancillary services to be provided by the Company to China Coal Group include coking coal, hydraulic roof support and ancillary services; related production supplies; electricity supplies; transportation and loading services; gas supply; machinery maintenance; labour; tendering services; water and heat, etc.; (d) the provision of the above raw materials and services by either party shall be made on terms no less favorable than those available to or from independent third party under comparable conditions. Otherwise, either party is entitled to engage such other supplier(s) for the raw materials and services required; (e) the parties shall enter into separate contracts to set out the specific terms and conditions of providing the relevant raw materials and/or services according to the principles, and within the parameters, provided for under the Integrated Materials and Services Mutual Provision Agreement; (f) the Company shall provide to China Coal Group and its associates related coal export services for the export of coal by China Coal Group for third parties. Such services shall include organizing product supplies; performing coal blending; coordinating logistics and transportation; providing port related services; arranging for inspection and quality verification; and providing services relating to product delivery.

For the year ended 31 December 2006, (1) the annual cap of the expenses incurred as a result of production materials and ancillary services provided by China Coal Group to the Company for 2006 was RMB1.076 billion and the actual expenses incurred were RMB799 million; (2) the annual cap of the income generated as a result of integrated materials and services provided to China Coal Group by the Company for 2006 was RMB35 million and the actual income was RMB35 million; (3) the annual cap of the service fee receivable in respect of coal export related services provided by the Company to China Coal Group was RMB160 million and the actual fee generated was RMB49 million.

### *(4) Mine Construction and Design Framework Agreement*

The Company and China Coal Group entered into a mine construction and design framework agreement ("Mine Construction and Design Agreement") on 5 September 2006.

The principal terms of the Mine Construction and Design Agreement are as follows: (a) the agreement shall take effect from 22 August 2006 until 31 December 2008 and may be renewed upon agreement by both parties; (b) (i) the Company shall provide mining design services to support the ancillary businesses of China Coal Group and its associates; (ii) China Coal Group and its associates shall provide construction services to the Company for construction of coal mines and related mining facilities; (iii) China Coal Group and its associates shall provide construction services required from the Company in respect of projects the Company undertake under sub-contracting contract arrangement with third parties that involve construction of coal mines and related mining facilities; (c) the Company (or its relevant subsidiary) and China Coal Group (or its relevant associate) shall enter into separate contracts to set out the specific terms and conditions of providing the relevant services according to the principles, and within the parameters, provided for under the Mine Construction and Design Framework Agreement.

For the year ended 31 December 2006, (1) the annual cap of the expenses for 2006 incurred by the Company in respect of the mine construction services provided by China Coal Group and its associates amounted to RMB570 million; the actual expenses incurred were RMB527 million; (2) the annual cap of the income generated as a result of providing coal mine design services to China Coal Group and its associates by the Company in 2006 amounted to RMB30 million; the actual income generated was nil.



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### *(5) Property Leasing Framework Agreement*

The Company and China Coal Group entered into a property leasing framework agreement ("Property Leasing Agreement") on 5 September 2006 to regulate their relationship in this regard. The Property Leasing Agreement sets out the particulars of each property subject to the agreement.

The principal terms of the Property Leasing Agreement are as follows: (a) The agreement shall take effect for 10 years commencing from 22 August 2006 and may be renewed upon agreement by both parties; (b) the properties leased to the Company (or its relevant subsidiaries) from China Coal Group and its associates comprise 476 properties occupying an aggregate gross floor area of approximately 0.21 million square metres and are mostly for production and operation uses; (c) the Company (or its relevant subsidiary) and China Coal Group (or its relevant associate) shall enter into separate agreements to set out the specific terms and conditions in respect of the relevant properties leased according to the principles, and within the parameters, provided for under the Property Leasing Agreement; (d) in respect of properties for which China Coal Group or its relevant associate(s) have not yet obtained property ownership certificates, China Coal Group grants a licence for the Company (or its relevant subsidiaries) to use such properties, and has undertaken to obtain the requisite property ownership certificates within one year from the date of the Company's incorporation; (f) the Company is entitled to lease additional properties from China Coal Group during the term of the Property Leasing Agreement; (g) China Coal Group has agreed to indemnify the Company against any loss or damage the Company may suffer or incur from the use of such properties with title defect; (h) if China Coal Group or its relevant associate(s) intend to sell any property leased to the Company under the Property Leasing Agreement, the Company shall have the pre-emptive right to purchase such property under the same terms offered to third parties; (i) either party may, at any time before the Property Leasing Agreement expires, by giving not less than 6 months' notice, terminate any lease made pursuant to and comprised under the agreement, and the rentals will accordingly be reduced.

The annual cap for 2006 of property rentals paid by the Company to China Coal Group and its associates for the year ended 31 December 2006 amounted to RMB71 million. The actual rentals incurred were RMB52 million.

### *(6) Land Use Rights Leasing Framework Agreement*

The Company and China Coal Group entered into a land use rights leasing framework agreement ("Land Use Rights Leasing Agreement") on 5 September 2006 to regulate their relationship in this regard. Under the Land Use Rights Leasing Agreement, the land use rights leased to the Company from China Coal Group and its associates comprise land use rights in respect of 93 parcels of land occupying an aggregate area of approximately 2.1 million square metres, mostly for production and operation uses. The Land Use Rights Leasing Agreement sets out the particulars of each parcel of land subject to the agreement.

The principal terms of the Land Use Rights Agreement are as follows: (a) the Land Use Rights Leasing Agreement shall take effect for 20 years commencing from 22 August 2006 and may be renewed; (b) the Company (or its relevant subsidiary) and China Coal Group (or its relevant associate) shall enter into separate leases to set out the specific terms and conditions in respect of the relevant parcel(s) of lands leased according to the principles, and within the parameters, provided for under the Land Use Rights Leasing Agreement; (c) if China Coal Group or its relevant associate(s) intend to transfer any land use rights leased to the Company under the Land Use Rights Leasing Agreement, the Company shall have the pre-emptive right to acquire such land use rights under the same terms offered to third parties; (d) upon expiry of the Land Use Rights Leasing Agreement, if China Coal Group or its relevant associate(s) intends to continue any lease, the Company shall also have the pre-emptive right to lease the relevant land use rights under the same terms offered to third parties, even if it has not exercised its right of renewal; (e) the Company is entitled to lease additional land use rights from China Coal Group during the term of the Land Use Rights Leasing Agreement.

The annual cap for 2006 of the land use rights rental paid by the Company to China Coal Group and its associates for the year ended 31 December 2006 amounted to RMB9 million. The actual rental incurred was RMB8.82 million.



### *(7) Coal/Coke Product Sales Framework Agreements*

Datong Coal Industry Co. Ltd., Shanxi Longquan Foundry Coke Company Limited, Shuozhou Shuocheng Liu Jia Kou Coal Transportation Terminal, Lingshi Jiuxin Coal Preparation Company Limited and Shaanxi Yulin Coal Import & Export Group Corporation, all of which are substantial shareholders of the Company's subsidiaries are all joint venture partners of the Company, in respect of its coal and coking operations. The Company will continue to purchase and sell coal / coke products from these five substantial shareholders of the Company's subsidiaries. The Company has therefore entered into a coal/coke product sales framework agreement ("Coal/Coke Product Sales Agreement") with each of the substantial shareholder of the Company's subsidiaries.

The terms of each of the Coal/Coke Product Sales Agreements are substantially the same, the principal terms of which are as follows: (a) the Coal/Coke Product Sales Agreements shall take effect from 22 August 2006 until 31 December 2008; (b) the Company (or its relevant subsidiary) shall purchase from and sell to the five substantial shareholders of the Company's subsidiaries, coal/coke products as the parties may from time to time mutually agree; (c) the Company (or its relevant subsidiary) shall enter into separate purchase and sales contracts with each of the five substantial shareholders of the Company's subsidiaries to set out the specific terms and conditions of sale and purchase of coal/coke products according to the principles, and within the parameters, provided for under the Coal/Coke Product Sales Agreements.

For the year ended 31 December 2006, (1) the annual cap for 2006 of the expenses incurred by the Company for purchasing coal/coke products from the substantial shareholders of the Company's subsidiaries amounted to RMB1.003 billion; the actual expenses incurred were RMB998 million; (2) the annual cap for 2006 of the income generated from sales of coal/coke products by the Company to the substantial shareholders of the relevant subsidiaries amounted to RMB216 million and the actual income generated was RMB190 million.

### *(8) Railway Leasing and Management Entrustment Service Framework Agreement*

Shuozhou Pingshuo Luda Railway Transportation Co., Ltd. ("Pingshuo Luda") is a subsidiary of Datong Luda Railway Transportation Co., Ltd. ("Datong Luda") which holds 62.5% interests stake in Pingshuo Luda. Shuozhou China Coal Pingshuo Energy Co., Ltd. is one of the subsidiaries of the Company and is owned as to 51% by the Company and as to 19% by Datong Luda. Pursuant to the Listing Rules, Pingshuo Luda has become a connected party of the Company. The Company and Pingshuo Luda entered into a railway leasing and management entrustment service agreement ("Railway Leasing and Management Entrustment Service Agreement") on 5 September 2006.

The principal terms of the Railway Leasing and Management Entrustment Service Agreement are as follows: (a) Pingshuo Luda shall lease railway from the Company (or relevant subsidiaries of the Company) and provide management entrustment services to the Company's relevant subsidiaries, Pingshuo Antaibao Mine and Anjialing Open-pit Coal Mine; (b) each party shall enter into written service contracts to set out the specific terms, conditions and price for the provision of each type of railway and management services according to the principles, and within the parameters, provided for under the Railway Leasing and Management Entrustment Service Agreement; (c) the quality of the railway leasing and management entrustment services provided by Pingshuo Luda under the Railway Leasing and Management Entrustment Service Agreement shall be in accordance with the standards of services specified in the written agreements and shall be based on a reasonable price. Where the standards are specified by rules or regulations, the services provided shall be in accordance with such standards; (d) the parties shall set the standards of services to be provided under the agreement and shall amend such standards from time to time in accordance with the market conditions.

The annual cap for 2006 of the total railway leasing fees paid by Pingshuo Luda to the Company for the year ended 31 December 2006 amounted to RMB99 million. The actual income generated were RMB98.7 million. The annual cap for 2006 of the total railway management entrustment service fees paid by the relevant subsidiaries of the Company to Pingshuo Luda for the same period amounted to RMB264 million. The actual fees incurred were RMB241 million.

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The independent non-executive directors of the Company have reviewed the above continuing connected transactions and have confirmed that these continuing connected transactions were entered into (i) in the usual course of business of the Company; (ii) on normal business terms; and (iii) in accordance with the relevant agreements governing them and on terms that are fair and reasonable and in the interest of shareholders of the Company as a whole.

## (24) Employees of the Group

As at 31 December 2006, the Group has a total of 52,137 employees (the total number of employees in 2005 was 51,230). The number of employees in different departments and the percentage are as follows:

	Number of employees	Percentage
Management, finance and administration	4,982	9.56
Research and development and technical support	9,043	17.34
Sales and marketing	902	1.73
Others (including frontline production)	37,211	71.37
Total	52,137	100.0

The remuneration of the Group's employees mainly comprises post wages and performance wages. In addition, the Group has emphasized professional skills training for employees and has adopted various training approaches to improve the quality and capability of the core staff team.

## (25) Compliance with the Code on Corporate Governance Practice

The directors confirm that the Company has complied with the code provisions of the "Code on Corporate Governance Practice" as set out in appendix 14 of the Listing Rules for the year ended 31 December 2006 since the listing of the Company. The Board also confirms that the annual results of the Group for the year ended 31 December 2006 have been reviewed by the Audit Committee of the Company.

## (26) Material Legal Proceeding

As at 31 December 2006, the Company had not been involved in any material litigations or arbitrations, and to the best knowledge of the Company, there was no pending, likely or settled material litigation or claim against the Company as at 31 December 2006.

## (27) Auditors

The financial statements for the year prepared in accordance with International Financial Reporting Standards have been audited by PricewaterhouseCoopers and the financial statements prepared in accordance with the accounting principles and financial regulations of the PRC have been audited by YueHua CPAs (岳華會計師事務所). The resolution regarding the reappointment of PricewaterhouseCoopers and YueHua CPAs as the Company's international auditor and domestic auditor for the year ending 31 December 2007 respectively will be proposed at the forthcoming annual general meeting of the Company to be held on 15 June 2007.



## (28) Tax

For the year ended 2006, expatriate shareholders who were not Chinese residents were not required to pay any individual or enterprise income tax, capital gains tax, stamp duty or estate duty in respect of the shares of the Company held by them. Shareholders are advised to seek opinions from their tax consultants on the implications of China, Hong Kong and other taxes in respect of the ownership and disposal of H shares.

## (29) Post balance sheet events

Details of the post balance sheet events of the Group are set out in Note 42 to the consolidated financial statements.

By Order of the Board

**Jing Tianliang**

*Chairman*

Beijing, China

17 April 2007

As at the date of the issuance of the directors' report, the directors of the Board include: Executive director Mr. JING Tianliang (Chairman), non-executive director Mr. ZHANG Baoshan (Vice-chairman), executive director Mr. YANG Lieke, executive director Mr. PENG Yi; and independent non-executive directors Mr. GAO Shangquan, Mr. ZHANG Ke, Mr. PENG Ru Chuan, Mr. WU Rongkang and Mr. Li Yanmeng.