



Corporate Governance Report

A. General Corporate Governance

During the Reporting Period, the Company has complied with the relevant laws and regulations including the Company Law, the Securities Law and the Code of Corporate Governance Practice promulgated by the Stock Exchange of Hong Kong Limited ("SEHK"). In accordance with documents relating to corporate governance and proper operation issued by China Securities Regulatory Commission ("CSRC"), and the requirements of the Listing Rules of SEHK and Shanghai Stock Exchange, the Company continues to improve its corporate governance system as a corporate legal person, set up a modern corporate system, enhance internal control and management and standardize the operation of the Company.

During the Reporting Period, the Company mainly carried out the following task in relation to corporate governance:

1. The Company put more efforts in satisfaction of the non-operating funds appropriated by its controlling shareholders and subsidiaries in accordance with the "Notice on Expediting Loan Settlement" (《關於進一步加快推進清欠工作的通知》) (Zheng Jian Gong Si Zi [2006] No. 92) issued by CSRC on 26 May 2006 and the "Notice on Further Improvement of Loan Settlement" (Su Zheng Jian Gong Si Zi [2006] No.40) issued by Securities Regulatory Commission of Jiangsu Province on 6 March 2006. Loan settlement plan was executed as planned on a monthly basis during the Reporting Period. As at 31 December 2006, its controlling shareholders and subsidiaries have settled all of the non-operating funds appropriated by them. (Please refer to Section 10 of this report headed "Significant Events" for details"
2. The Company initiated a process of Share Segregation Reform on 26 June 2006 in accordance with the relevant regulations stipulated in the "Guidance Opinions on Share Segregation Reform of the Listed Companies" (Zheng Jian Fa[2005] No.80) (《關於上市公司股權分置改革的指導意見》) and the "Administrative Measures on Share Segregation Reform of the Listed Companies" (Zheng Jian Fa[2005] No.86) (《上市公司股權分置改革管理辦法》) issued by CSRC, and the Guidelines on the Practice and Operation of the Share Segregation Reform of the Listed Companies (《上市公司股權分置改革業務操作指引》) issued by Shanghai Stock Exchange. The Company published two announcements relating to the Share Segregation Reform Proposal and the Revised Share Segregation Reform Proposal on 30 June 2006 and 7 July 2006 respectively. The revised Share Segregation Reform Proposal was approved by voting at the relevant A Shareholders' meeting held on 28 July 2006. Upon approval granted by relevant government authorities, the Share Segregation Reform Proposal was implemented on 11 September 2006.
3. The Board of Directors reviewed the effectiveness of the internal control systems of the Company and its subsidiaries. In order to improve its internal control, the Company has, on 2 March 2006, formally retained Horwath Risk Advisory Services Limited ("Horwath RA") to conduct an overall examination of internal control system of the Company. (Please refer to the relevant announcements published in China Securities Journal, Shanghai Securities News, Hong Kong Ta Kung Pao and The Standard on 22 March 2006 for details.) Horwath RA issued a Review Report on Internal Control in June 2006.

Horwath RA identified the following two main problems during the audit period:

- (1) No concrete measures have been put in place in the internal information reporting system of the Company to fully comply with the requirements of information disclosure under the Listing Rule.
- (2) Relevant officers and departments of the Company failed to report significant discloseable events or matters to the Chairman and Secretary to the Board of Directors in strict compliance with the requirements of internal information reporting system on a timely basis.



A. General Corporate Governance (Continued)

Based on the problems above, Horwath RA recommended certain improvement measures to the Company, including

- (1) The Company should establish an internal information reporting system based on the guidelines of its system so as to ensure its full compliance with the regulations of the Listing Rules.
- (2) Relevant officers and departments of the Company should report significant discloseable events and matters, including but not limited to, substantial connected transactions, in writing to the Chairman and Secretary to the Board of Directors on a timely basis. The relevant departments should file the relevant information for verification, follow up the aforesaid matters and report the progress to the Chairman and Secretary to the Board.
- (3) The Company should make arrangement for better communication between the Secretariat of the Board and other departments with a view of ensuring the verification and timely reporting of discloseable matters and full compliance with the requirements of the Listing Rules.
- (4) The Company should provide training to managerial staff to make them familiar with accounting systems and relevant Listing Rules.

The Company has implemented the following measures based on recommendations in the aforesaid Review Report on Internal Control issued by Horwath RA:

- (1) To conduct a thorough review of the Internal Information Reporting System and adopt improvement measures to ensure full compliance with the regulations of the Shanghai Stock Exchange and SEHK.
- (2) To promote a better communication between the Secretary to the Board and other departments for a timely reporting of any discloseable matters.
- (3) To set up a system in which price-sensitive information should be kept confidential before disclosure to the public.
- (4) To clarify and strengthen the responsibility of the audit department of the Company.
- (5) To improve the existing accounting control system.

The Company will implement all remaining measures recommended in the Review Report on Internal Control by Horwath RA as soon as possible.

4. Pursuant to Rule 3.24 of the Listing Rules of the Stock Exchange, the Company is required to engage a qualified accountant who meets the requirement of Rule 3.24 of the Listing Rules. The Company was granted by the Stock Exchange a conditional wavier commencing from 16 February for a term of three years (the "Wavier") from strict compliance with the requirement of Rule 3.24. The Company complied with the conditions of the wavier, the Company during the Reporting Period, appoint Mr. Wu Liu Lin as its qualified accountant and Ms. Wong Wan Lung, being a fellow member of HKICPA, to assist Mr. Wu for fulfillment of his duties as a qualified accountant during the period of wavier. SEHK granted a waiver to the Company on 16 February 2006.
5. As the waiver in respect of continuing connected transactions granted to the Company by SEHK expired in 2004, and as of the end of the Reporting Period, the Company's failure to comply with the reporting, announcement and independent shareholders' approval requirements in respect of its all continuing connected transactions since 1 January 2005, the failure constituted a breach of Rule 14A.35 of the Listing Rule. The breach was caused by the negligence but not inadvertent omission of the management. The Company strongly believed it was its liability to comply with the Listing Rules. In respect of its continuing connected transactions from 2007 to 2009 ("Future Continuing Connected Transactions"), the Company has complied with the Listing Rules requirements of reporting, announcement and independent shareholders approval. The future continuing connected transactions was considered and approved at the extraordinary general meeting convened in 3 April 2007.



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A. General Corporate Governance *(Continued)*

6. Amendments were made to the articles of association of the Company in accordance with the relevant requirements under the "Guidelines on Amendments to Articles of Association of Listed Companies (amended in 2006)" (《上市公司章程修改指引》(2006年修訂)) issued by CSRC, based on the changes in the shareholdings after the implementation of Share Segregation Reform Proposal. The amendments were considered and approved at the extraordinary general meeting held on 31 December 2006.

B. Directors' Securities Transaction

During the Reporting Period, the Company adopted and applied Model Code for Security Transactions by Directors of Listed Issuers ("Model Code") as set out in the Appendix 10 of the Listing Rules of Securities of the Stock Exchange of Hong Kong for the code of securities transactions by the directors.

Having made specific enquiry to all Directors of the Company, all Directors have expressed that they have complied with the required standard set out in the Model Code.

C. Board of Directors

(1) Board composition

The Board comprises nine Directors and three of them are independent non-executive Directors and at least one of them have appropriate professional qualifications, or accounting or related financial management expertise.

The Board members of the year ended 31 December 2006 were as follows and the brief biographies of each Director are set out in Section 4 headed "Profiles of Directors, Supervisors, Senior Management and Staff".

Executive Directors:

Mr. Li Anjian (*Chairman*)

Non-executive Directors:

Mr. Xu Guofei

Ms. Liu Ailian

Mr. Zhu Lifeng

Mr. Shi Qiusheng

Mr. Lu Qing

Independent Non-executive Directors:

Ms. Wan Hui

Mr. Cai Lianglin

Mr. Ma Chung Lai, Lawrence

The Company has received from each of the Independent Non-Executive Directors an annual confirmation of his/her independence pursuant to Rule 3.13 of the Listing Rules. The Company still considers all Independent Non-Executive Directors meet the independence guidelines set out in Rule 3.13 of the Listing Rules and are independent in accordance with the terms of the guidelines. The term of appointment of the Non-Executive Directors are 3 years.



C. Board of Directors *(Continued)*

(2) Nomination of Directors

The Board has, on 12 May 2004, established the 5th session of nomination committee which comprised Mr. Zhang Zuzhong, Ms. Wan Hui, Mr. Cai Lianglin. Mr. Cai Lianglin, the Independent Non-Executive Director, was the Chairman. At the 8th meeting of the 5th session of the Board held on 20 April 2006, it was resolved that Mr. Zhang Zuzhong be resigned from his position of member of nomination committee for reason of age and Mr. Xu Guofei be elected as a member of nomination committee.

The main roles and functions of nomination committee include studying and giving recommendation to the candidates of directors and senior management of the Company, and nomination criteria and procedure.

During the Reporting Period, the nomination committee convened the first meeting on 20 June 2006 in accordance with the Articles of Association and rules of procedures of nomination committee. All members of the nomination committee attended this meeting, at which it was resolved to propose the appointment of Mr. Wu Liulin as the qualified accountant and Ms. Wong Wan Lung, who meets the requirements under Rule 3.24 of the Listing Rules, to assist Mr. Wu for fulfillment of his duties. The proposal was submitted to the Board for discussion.

All members of the nomination committee attended its second meeting in 2006 held on 19 April 2006, at which it was resolved to nominate Mr. Lu Qing as a candidate of Director, Mr. Wu Liulin as the General Manager, Mr. Shen Jianlong as the chief accountant and a candidate of the Secretary to the Board. The proposal was submitted to the Board for discussion.

(3) Chairman and Chief Executive Officer

The main duties of Chairman of the Board are presiding the shareholder's meeting and convening Board meeting, and inspecting the actual implementation of the resolution of the Board. (Details are set out in the Article 134 of Chapter 10 of the Articles of Association.)

General Manager (Chief Executive Officer) is responsible to the Board. His duties are presiding the production, operation and management meeting of the Company, organizing and implementing resolutions of the board, organizing and implementing annual operation plan and investment proposal. (Details set out in the Article 152 of chapter 12 of the Articles of Association.)

Mr. Li Anjian holds positions of Chairman and General Manager (Chief Executive Officer) which is deviated from the code provision A.2.1 of the Code of Corporate Governance Practice.

(4) Board Practices

The Board is collectively responsible for the management of the business and affairs of the Group with the objective of enhancing shareholders value.

The Board is responsible to shareholders. Its duties are convening shareholder's meeting and reporting the work to shareholders meetings, implementing resolutions of the shareholder's meeting, deciding the operation plan and investment proposal of the Company, recruiting and removing the General Manager and senior management of the Company. (Details are set out in the Article 126 of Chapter 10 of the Articles of Association of the Company.)



Corporate Governance Report

C. Board of Directors (Continued)

(4) Board Practices (Continued)

The Board held 6 meetings during the year ended 31 December 2006 (details are set out in Section 8 headed "Report of Board of Directors" of this report) and attendance of each director are as follows:

Name of independent directors	Required attendances at the Board meetings	Attending in person (times)	Attending by proxy (times)	Absence (times)
Li Anjian	6	6	0	0
Zhang Zuzhong	3	3	0	0
Xu Guofei	6	6	0	0
Liu Ailian	6	6	0	0
Zhu Lifeng	6	6	0	0
Shi Qiusheng	6	6	0	0
Lu Qing	3	3	0	0

5. Independent Directors and their duties

- (1) The Company diligently carried out their duties in accordance with the relevant laws, regulations and the Articles of Association of the Company. They participated in Board Meetings for the decision-making on material events. With their professional knowledge and experience, Independent Directors advised the Company on its operation and management; provided independent opinion on the impartiality and fairness of connected transactions and on whether the Company has complied with the wavier conditions granted by SEHK in respect of its connected transactions, offer independent advice on transfer of debts, transfer of equity interest, repayment of debts by way of asset and continuing connected transactions during the Reporting Period. They also participated in the work of audit committee to audit the Company's financial statements. Independent directors have contributed to protect the overall interests of the Company and the legal rights of shareholders as a whole and promote the development of the Company.
- (2) The Board held 6 meetings during the year ended 31 December 2006 and attendance of each Independent Director at Board Meetings were as follows:

Name of independent directors	Required attendances at the Board meetings	Attending in person (times)	Attending by proxy (times)	Absence (times)
Wan Hui	6	5	1	0
Cai Liang Lin	6	6	0	0
Ma Chung Lai, Lawrence	6	4	2	0

- (3) The descending opinions of Independent Directors on the relevant matters of the company
During the Reporting Period, the independent directors of the Company had not proposed any descending opinions to the resolutions of the Board of Directors and other meetings for the year.



C. Board of Directors *(Continued)*

6. Directors' Responsibility for the Financial Statements

The Directors acknowledge their responsibility for preparing the financial statements of the Group. The statement of the auditors of the Company about their reporting responsibility on the financial statements of the Group is set out in the "Report of the Auditors".

7. Remuneration of Directors

The Board has, on 12 May 2004, established the 5th session of remuneration committee which comprised Ms. Liu Ailian, Mr. Ma Chung Lai, Lawrence and Ms. Wan Hui. Mr. Ma Chung Lai, Lawrence was the Chairman.

Role and function of remuneration committee include formulating and reviewing remuneration policies and proposal of directors and senior management and formulating relevant appraisal standards and conducting appraisals. The remuneration committee has not convened any meeting during the Reporting Period. The remuneration of directors is set out in the "Profiles of Directors, Supervisors and Senior Management Staff".

D. Audit Committee

The Board of the Company has set up an Audit Committee in accordance with the requirements of Rule 3.21 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited.

The Board has, on 12 May 2004, established the 5th session of audit committee which comprised Ms. Liu Ailian, Ms. Wan Hui and Mr. Cai Liang Lin and. Ms. Wan Hui was the Chairman.

Major role and functions of the Audit Committee include review and approval of the financial statements of the Company audited by PRC and international auditors.

During the Reporting Period, the Audit Committee convened two meetings in accordance with the provisions of Articles of Association of the Company and Rules of Procedure of the Audit Committee:

- (1) The first meeting of 2006 was convened on 19 April 2006. All members of the Audit Committee attended the meeting to review the financial report 2005, and agreed to submit the report to the Board for discussion.
- (2) The second meeting of 2006 was convened on 23 August 2006. All members of the Audit Committee attended the meeting to review the interim financial report 2006, and agreed to submit the report to the Board for discussion.

The Audit Committee has reviewed the financial report for year 2006.



Corporate Governance Report

E. Separation of the Company's staff, asset, finance, organization and business from its controlling shareholder

- (1) Staff: The staff of the Company is independent from the controlling shareholder. The Company has independent management in labour, personnel and wages, and established the relevant management systems. Senior management members such as general manager and deputy general manager receive salaries from the Company. Save for the position of director, they do not hold any other positions in the controlling shareholder.
- (2) Asset: The Company has its own supply, production and sale systems, ancillary production system and facilities. The Company holds intangible assets such as trademark ownership, industrial property right, and non-patent technology.
- (3) Finance: The Company has set up its own finance department, accounting system, financial management system and its own bank accounts.
- (4) Organization structure: The Company established a healthy organizational system in which the Board of Directors, Supervisory Committee and other internal departments operate and function independently of each other. The Company is not subordinate to its controlling shareholder in term of its duties and departmental functions.
- (5) Business scope: The Company has a highly independent and complete business and operation ability. The Company has signed a "Non-competition and First Right of Refusal Agreement" with its controlling shareholder in order to avoid competition within the same industry.

F. Review on the performance of the senior management and incentive systems

During the Reporting Period, the Company conducted a comprehensive review on basis of duties of respective positions and performance of senior management. Incentive rewards are made according to the results of the review.

G. Auditor's Remuneration

The Horwath Hong Kong CPA Limited and Yue Hua Certified Public Accountants were appointed as the Company's international and PRC auditors respectively in 2006. Remuneration payable by the Company to the two Certified Public Accountants for the audit services was RMB1,942,600 (2005 was RMB1,734,400). Traveling and other expenses will not be borne by the Company.



H. General Meeting

Shareholders' general meeting is the authority of the Company for exercising its duties and authorities in accordance with the laws to decide the significant issues of the Company. The Annual General Meeting or Extraordinary General Meeting of the Company offers a channel for direct communications between the Board and shareholders of the Company. The Company is in strict compliance with the Company Laws and Rules of General Meeting to regulate the convening, holding and procedure of voting of the general meetings. The general meeting will be witnessed by lawyers and scrutinized by auditors, in order to ensure all shareholders, both majority and minority shareholders, to rank pari passu in exercising shareholders' rights.

The notice of general meeting and a circular to shareholders will be dispatched 45 days before the holding of each general meeting to encourage all shareholders to attend the meeting, with directors, supervisors and senior management attending the meeting at their convenience. The meeting is presided over by the Chairman or Deputy Chairman of the Company. Representatives of auditors, audit committee, remuneration committee and nomination committee would also attend the meeting to answer questions raised by shareholders.

During the Reporting Period, the Company has convened four general meetings, including Annual General Meetings and three Extraordinary General Meetings. Details of which is set out in Part 6 "Shareholders' General Meeting" in this annual report.

I. Communication with Shareholders and Investor Relations

The Board recognizes its accountability to shareholders for the performance and activities of the Group. The Board strived to maintain effective communication with shareholders. The Company has established different communication channels with its Shareholders and investors:

- (1) the annual and extraordinary general meetings held during the Reporting Period provide a forum for shareholders to raise comments and exchange views with directors;
- (2) the annual and interim reports which are sent to its Shareholders and interested investors contain a full financial review and an operational review;
- (3) discharge obligations of information disclosure by disclosing financial results and various transactions in various quarterly and annual reports, various announcements and circulars (if applicable).