

# Report of Directors

The Board is pleased to present their annual report and the audited accounts of the Group for the year ended 31 December 2006.

## Principal Activities

The principal activities of the Group are the provision of construction service, manufacture and distribution of building materials and property development. The activities of the Company's subsidiaries are set out in note 11 to the consolidated financial statements. There were no significant changes in the nature of the Group's principal activities during the year.

## Financial Positions and Results

The financial positions of the Group and the Company as at 31 December 2006 are set out in the balance sheets of the consolidated financial statements prepared in accordance with HKAS on pages 58 to 60.

The results of the Group for the year ended 31 December 2006 prepared in accordance with HKAS are set out in the consolidated income statement on page 61.

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 5 of this annual report.

## Reserves

Details of movements in reserves of the Group and the Company during the year are set out in the note 20 to the consolidated financial statements.

## Distributable Reserves

According to the relevant laws and regulations in the PRC, the reserves of the Company available for distribution to shareholders amounted to RMB219,628,000 as at 31 December 2006 (2005: RMB105,133,000).

## Dividends

At the board meeting held on 16 April 2007, the Board declared a final dividend of RMB0.07 (2005: RMB0.12) per ordinary share for the year ended 31 December 2006. The proposed dividend is not reflected as a dividend payable in these consolidated financial statements of 2006, but will be reflected as an appropriation of retained earnings for the year ending 31 December 2007.

## Report of Directors *(continued)*

### Segment Information

The Group is principally engaged in the following three main business segments:

- Construction – provision of construction services
- Building materials – manufacture and distribution of building materials
- Property development – development and sale of properties

The primary reporting of business segments for the year ended 31 December 2006 is set out in note 5 to the consolidated financial statements.

### Major Customers and Suppliers

During the year, sales to the five largest customers and purchases from the five largest suppliers of the Group accounted for less than 30% of the Group's aggregate revenue and purchases respectively.

None of the directors, their associates or any shareholders (which, to the knowledge of the directors own more than 5% interests of the Company's share capital) had any interest in the above major suppliers or customers.

### Fixed Assets

Details of the movements in fixed assets of the Group during the year are set out in note 7 to the consolidated financial statements.

### Purchase, Sale or Redemption of Shares of the Company

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

Report of Directors *(continued)***Directors and Supervisors**

The directors and supervisors of the Company for 2006 are as follows:

**Directors***Executive Directors*

Mr. Pang Baogen (*Chairman*)

Mr. Gao Jiming

Mr. Gao Lin

Mr. Zhou Hanwan

*Non-executive Director*

Mr. Hu Shaozeng

Mr. Wu Weimin (resigned on 25 January 2006)

*Independent Non-executive Directors*

Mr. Wang Youwei

Mr. Yi Deqing

Mr. Dennis Yin Ming Chan

**Supervisors***Supervisors*

Mr. Sun Guofan (*Chairman*)

*Independent Supervisors*

Mr. Chen Xinquan

Mr. Li Yongsheng

Mr. Zhang Xindao

Report of Directors *(continued)*

## Changes of Directors, Supervisors and Senior Management

Mr. Wu Weimin resigned as a non-executive director on 25 January 2006.

## Biographical Details of Directors, Supervisors and Senior Management

Brief biographical details of directors, supervisors and senior management of the Group are set out on pages 40-44 of the annual report.

## Remuneration of Directors

The remuneration of directors of the Company is disclosed on an individual named basis in note 28(b) to the consolidated financial statements.

## Highest Paid Individuals

During the year, the relevant information of the five individuals with the highest remuneration of the Group is disclosed in note 28(c) to the consolidated financial statements.

## Independence of Independent Non-executive Directors

The Board has obtained written confirmations from all independent non-executive directors concerning their independence in accordance with Rule 3.13 of the Listing Rules. The Board is in the opinion that the existing independent non-executive directors are independent based on the guidelines set out in Rule 3.13 of the Listing Rules.

## Report of Directors (continued)

## Interests of Directors, Supervisors and Senior Management

As at 31 December 2006, the interests and short positions of each director, supervisor and senior management of the Company in the shares, underlying shares or debentures of the Company or any associated corporations within the meaning of Part XV of the SFO which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, to be notified to the Company and the HKEx were as follows:

Director/ Supervisor/ Senior management	Name of the company	Capacity	No. of domestic shares held (Long position)	Approximate percentage of the total registered capital
<i>Directors</i>				
Mr. Pang Baogen	The Company	Personal	198,753,054	29.98%
Mr. Gao Jiming	The Company	Personal	13,024,647	1.96%
Mr. Gao Lin	The Company	Personal	9,544,775	1.44%
Mr. Zhou Hanwan	The Company	Personal	8,233,510	1.24%
<i>Supervisor</i>				
Mr. Suo Guofan	The Company	Personal	11,705,283	1.77%
<i>Senior Management</i>				
Mr. Xu Jianbiao	The Company	Personal	7,524,884	1.14%
Mr. Wang Rongfu	The Company	Personal	7,147,039	1.08%
Mr. Gao Jun	The Company	Personal	5,794,259	0.87%
Mr. Lou Zhonghua	The Company	Personal	5,633,172	0.85%
Mr. Wang Rongbiao	The Company	Personal	2,647,911	0.40%

Report of Directors *(continued)*

## Directors' and Supervisors' Service Contract

Approved in the 2004 annual general meeting of the Company, all the appointed directors and supervisors signed their respective service contracts with the Company on 20 May 2005 all of which last until the conclusion of the 2007 annual general meeting of the Company. No directors or supervisors have service contracts with the Company, which are not terminable by the Company within one year without payment of compensation other than statutory compensation.

## Directors' and Supervisors' Interests in Contracts

No contracts of significance in relation to the Company's business to which the Company or its subsidiaries was a party and in which the directors or the supervisors of the Company have material interests, whether direct or indirect, subsisted at any time during the year (excluding directors' service contracts).

## Directors' and Supervisors' Rights to Acquire Shares or Debentures

At no time during the year did the Company or any of its subsidiaries make any arrangement to enable the directors, the supervisors and their respective spouses or children under 18 years of age to benefit from acquisition of the shares, or debentures of the Company or any other corporation.

## Interests of Directors in Competing Business

During the year and up to the date of this report, none of the directors has any interest in business, which competes or may compete with the business of the Group under the Listing Rules.

## Details of Share Offering and Placing

	IPO	The 1st placement of H shares	The 2nd placement of H shares	The 3rd placement of H shares
Class of shares listed	H share	H share	H share	H share
Listing place	Main Board of the HKEx.	Main Board of the HKEx.	Main Board of the HKEx.	Main Board of the HKEx.
Offer/placing price	HK\$1.43 per H share	HK\$4.05 per H share	HK\$4.85 per H share	HK\$10.88 per H share
Listing date	30 June 2003	21 January 2005	24 December 2005	2 February 2007
Number of issued H shares	180,684,000	36,136,800	43,364,160	52,036,992

Report of Directors *(continued)*

## Share Capital

As at 31 December 2006, there was a total share capital of 610,927,013 shares of the Company, which includes:

	Number of shares	Approximate percentage of total share capital
Domestic Shares	350,742,053	57.41%
H shares	260,184,960	42.59%
<b>Total</b>	<b>610,927,013</b>	<b>100%</b>

## Public Float

Based on the publicly available information and to the best knowledge of the Board, the Company has maintained sufficient public float as at the latest practicable date prior to the date of this annual report.

## Substantial Shareholders

As at 31 December 2006, so far as was known to the directors, the following person, other than the directors, supervisors and senior management of the Company, has an interest in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the SFO:

Name	Number of H shares of the Company held (Long position)	Approximate percentage of the total issued H shares	Approximate percentage of the total share capital
Goldman Sachs (Asia) Finance <i>(Note 1)</i>	43,364,160	13.89%	6.54%
Atlantis Investment Management Limited <i>(Note 2)</i>	34,500,000	11.05%	5.20%
Tiger Global, L. P. <i>(Note 3)</i>	52,036,992	16.67%	7.85%

**Note:**

1. The 43,364,160 H shares are held by Goldman Sachs (Asia) Finance. Goldman Sachs (Asia) Finance is held as to 1% by Goldman Sachs Global Holdings (L.L.C.) and 99% by Goldman Sachs (Asia) Finance Holdings L.L.C.
2. Atlantis Investment Management Limited, as the investment manager, held 34,500,000 shares.
3. The Company entered into the share subscription agreement with Tiger Global on 13 December 2006, the closing of the share subscription agreement was completed on 2 February 2007. Details of which are shown in "Subsequent Event" on P.53 of this 2006 annual report.

## Report of Directors (continued)

## Human Resources

As at 31 December 2006, the Group had approximately 1,987 permanent employees, including 400 employees from the newly acquired Hubei Construction Group (2005: approximately 1,488). There are approximately 51,000 construction site workers (2005: approximately 45,000) who are not permanent employees of the Group. Total staff costs amounted to RMB875,497,000 (2005: RMB790,849,000) for the year ended 31 December 2006. Remuneration is determined by reference to market terms as well as the performance, qualifications and experience of individual employee. Employee benefits provided by the Group include pension and medical insurance. The Group highly values human resources management, and devotes to establishing a high quality team to support its long term business development. The Board intends to implement a more effective employee incentive plan.

## Closure of Register of Members

The register of members of the Company will be closed from 26 May 2007 to 25 June 2007, both days inclusive, during which period no transfer of shares will be registered. In order to qualify for the abovementioned final dividend, all transfer forms, accompanied by the relevant share certificates must be lodged with the Company's H Shares registrar in Hong Kong, Tengis Limited at 26/F, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong (for holders of the Company's H Share) no later than 4:00 pm on 25 May 2007.

## Connected Transactions

During the year ended 31 December 2006, the Group had no connected transactions that would require disclosure under the Listing Rules.

## Pre-Emptive Rights

There are no provisions for pre-emptive rights under the articles of association of the Company and related laws of HK and the PRC, which would oblige the Company to offer new shares on pro-rata basis to the existing shareholders of the Company.

## Policies on Income Tax

The Company and its subsidiaries basically paid PRC corporate income tax at a rate of 33% of its assessable profits according to the relevant laws and regulations in the PRC. Details of the Group's income tax are disclosed in note 30 to the consolidated financial statements.

## External Guarantee and Fulfilment

	2006 RMB'000	2005 RMB'000
Guarantee given to banks in respect of mortgage facilities granted to third parties	19,800	67,500
Guarantee given to banks in respect of bank loans of third parties	20,000	–
	<b>39,800</b>	<b>67,500</b>

The Group has issued performance guarantees in respect of mortgage facilities granted by certain banks relating to the mortgage loans arranged for certain purchasers of property projects developed by the subsidiaries of the Group. The bank will release such guarantee only upon the building ownership certificates of such properties are delivered to the banks as securities.

Report of Directors *(continued)*

## Litigation and Arbitration

As at the date of this report, the Group had no material litigation and arbitration.

## Entrusted Deposits and Overdue Time Deposits

As at the date of this report, the Group did not have any entrusted deposits placed with financial institutions in the PRC. All of the Group's bank balances were deposited in commercial banks in the PRC in accordance with the applicable laws and regulations. The Group had no bank deposits which cannot be withdrawn upon maturity.

## Code on Corporate Governance Practices

The Group has complied with the Code on Corporate Governance Practices as set out in Appendix 14 of the Listing Rules throughout the year. For details, please refer to the Corporate Governance Report as set out in this 2006 Annual Report.

## Auditors

PricewaterhouseCoopers is appointed as the Company's international auditor, and Shine Wing CPAs Co., Ltd ("Shine Wing") is appointed as the Company's statutory auditor. The financial statements contained in this annual report were prepared in accordance with Hong Kong Financial Reporting Standards and have been audited by PricewaterhouseCoopers.

The remuneration of the auditors in the year 2006 is set out as follows:

	2006		2005	
	Audit fees	Other fees	Audit fees	Other fees
PricewaterhouseCoopers (HK\$'000)	2,800	100**	1,800	50*
Shine Wing (RMB'000)	350	50*	300	20*

\* mainly travel expenses

\*\* mainly capital verification fee and travel expenses

A resolution will be submitted at the forthcoming annual general meeting to re-appoint PricewaterhouseCoopers and Shine Wing as the Company's international auditor and statutory auditor respectively.

## Subsequent Event

On 13 December 2006, the Company entered into the subscription agreement with Tiger Global in relation to the subscription of 52,036,992 new H shares of the Company at HK\$10.88 per share, representing approximately 20% and 16.67% of the existing H shares in issue and the entire issued share capital of the Company as enlarged by the subscription respectively. The net proceeds of the subscription were approximately HK\$563,000,000. With the approval from China Securities Regulatory Commission and HKEx, and having satisfied the conditions precedent in the subscription agreement, the closing of the subscription agreement was completed on 2 February 2007.

Report of Directors *(continued)*

## Appreciation

The Board would like to take this opportunity to express gratitude to our shareholders, customers, suppliers, banks, professional parties and employees of the Company for their continuous patronage and support.

By order of the Board

**Pang Baogen**

*Chairman*

Baoye Group Company Limited

Zhejiang, the PRC

16 April 2007