



# Corporate Governance Report

The Company has always been dedicated to improving the quality of its management, and to maximizing long-term shareholder value by increasing the Group's accountability and transparency through strict implementation of corporate governance.

## I Corporate Governance Practices

The Company places great emphasis on the authority, dependability and prudence of its corporate governance. For the reporting period ended 31 December 2006, the Company has adopted the principles contained in the Code on Corporate Governance Practices set out in Appendix 14 of the Listing Rules. Except for a deviation from clause A.5.4 of the CG Code (Standard code which must be complied with in securities transactions of Directors), the Company has complied with all other provisions of the CG Code.

The Company's Board of Directors makes every effort to comply with the CG Code in order to protect and enhance shareholder interest. As the Company continues to grow, in order to ensure compliance with relevant regulations and standards, the Company will monitor and, when necessary, revise its corporate governance policy on an ongoing basis.

In accordance with relevant laws and regulations, the Company has set up a structure in which corporate mechanisms such as shareholders' general meetings, the Board of Directors, special committees under the Board of Directors, the Supervisory Committee and powers of the management check and balance each other. The division of responsibilities between the shareholders' general meeting, the Board of Directors, special committees under the Board of Directors, the Supervisory Committee and the management are distinct, and each of them is assigned with clearly defined responsibilities. The Company will continue to perfect its corporate governance mechanism, exercise discipline in the fulfilment of corporate duties, and strengthen the disclosure of information concerning its operations.

## II Securities Transactions by Directors

As of the end of the reporting period, the Company had not adopted a code of practice contained in the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 of the Listing Rules regarding securities transaction by its Directors. The main reason why the Company did not adopt this Model Code was the fact that its listing took place on 20 December 2006, and none of its securities was in circulation in the market prior to that date. Even though it had not formally instituted a code of practice, the Company made specific enquiries to its Directors about whether they had complied with the Model Code in their securities transactions. The Company confirms that all its Directors complied with the standards for securities transactions by directors as set out in the Model Code during the reporting period. In order to comply with the Listing Rules, it was resolved at the Ninth Meeting of the first term of the Board of Directors, held on 23 April 2007, that the Model Code be adopted as the Company's code of practice for securities transactions by Directors.

### III Board of Directors

#### 1. Composition of the Board of Directors

The Board of Directors consists of ten Directors, among whom Mr. Liao Bin is the Chairman of the Board and Mr. Tian Lei is its Deputy Chairman; Messrs. Ding Rongjun and Lu Penghu are executive Directors; Mr. Ma Yunkun is a non-executive Director; and Messrs. Zhou Heliang, Gao Yucai, Chan Kam Wing, Pao Ping Wing and Tan Xiao'ao are independent non-executive Directors.

Under the terms of their service contracts, Messrs. Liao Bin, Tian Lei, Ding Rongjun, Lu Penghu and Ma Yunkun will retire on the date of the 2008 Annual General Meeting; whereas, Messrs. Zhou Heliang, Gao Yucai, Chan Kam Wing, Pao Ping Wing and Tan Xiao'ao will retire on the date of the 2007 Annual General Meeting. Being eligible, they can offer themselves for re-election.

The Company's Directors have strictly complied with their undertakings, and have been honest, trust-worthy and diligent in the performance of their duties. The number of Directors and the composition of the Board comply with relevant laws and regulatory requirements. There is no relationship between the members of the Board (especially between the Chairman and the Chief Executive), including any financial, business, familial or other material relevant relationship.

The Company has received annual confirmation from Messrs. Zhou Jeliang, Gao Yuchai, Chan Kam Wing, Pao Ping Wing and Tan Xiao'ao of their independence, and considers that they are still independent as of the date of this report.

#### 2. Board Meetings and Directors' attendances at Board Meetings

During the reporting period, the Company held seven Board Meetings, of which three were interim Board Meetings.

The following is the attendance record of Directors at Board Meetings held during the reporting period.

Name	Title	Number of Meetings that the Director should have attended	Number of Board Meetings attended by the Director	Attendance Rate	Remarks
Liao Bin	Chairman of the Board	7	7	100%	Attended the third interim Board Meeting in 2006 by proxy
Tian Lei	Deputy Chairman of the Board	7	7	100%	Attended the third interim Board Meeting in 2006 by proxy
Ding Rongjun	Executive Director	7	7	100%	Attended the third interim Board Meeting in 2006 by proxy
Lu Penghu	Executive Director	2	2	100%	Elected as a Director at the Sixth Meeting of the First Term of the Board in November 2006



Name	Title	Number of Meetings that the Director should have attended	Number of Board Meetings attended by the Director	Attendance Rate	Remarks
Ma Yunkun	Non-Executive Director	7	7	100%	Attended the third interim Board Meeting in 2006 by proxy
Zhou Heliang	Independent Non-Executive Director	2	2	100%	Elected as a Director at the Sixth Meeting of the First Term of the Board in November 2006. Attended the third interim Board Meeting in 2006 by proxy.
Gao Yucai	Independent Non-Executive Director	2	2	100%	Elected as a Director at the Third Meeting of the First Term of the Board in November 2006. Attended the third interim Board Meeting in 2006 by proxy.
Chan Kam Wing	Independent Non-Executive Director	7	7	100%	Attended the third interim Board Meeting in 2006 by proxy
Pao Ping Wing	Independent Non-Executive Director	7	7	100%	
Tan Xiao'ao	Independent Non-Executive Director	4	4	100%	Elected as a Director at the Fifth Meeting of the First Term of the Board in June 2006. Attended the third interim Board Meeting in 2006 by proxy.

### **3. Proceedings at Board Meetings**

The Board of Directors is responsible to the Shareholders' General Meetings in relation to the leadership and management of the Company. The Board convened Regular and Interim Meetings according to legal procedures and complied strictly with the laws, legal regulations and Articles of Association in the exercise of its authority, with an emphasis on protecting the interests of the Company and its Shareholders.

All Directors are given not less than 10 days' advance notice of Regular Board Meetings, and reasonable advance notice of Board Meetings other than Regular Meetings.

The Secretary to the Board records and prepares documents concerning all matters that are discussed during the Board Meetings. Draft minutes of every Board Meeting are circulated to all the directors for their review. After finalization, the Board minutes are signed by all Directors who have attended the meeting, the Secretary to the Board and the minutes recording person. These documents are permanently kept as an important record of the Company on the Company's premises.

The Board of Directors is responsible to the Shareholders, and it principally exercises the following authorities:

- (1) Convening Shareholders' General Meetings, and reporting on its work to Shareholders' General Meetings;
- (2) Executing resolutions of the Shareholders' General Meeting;
- (3) Making decisions on operational plans and investment schemes;
- (4) Formulating the annual financial budget and final accounts;
- (5) Formulating the profit distribution scheme and scheme for loss compensation;
- (6) Proposing schemes for major investments, major acquisitions or disposals, mergers, divisions or dissolution of the Company; and
- (7) Proposing amendments to the Company's Articles of Association.

All Directors have access to the advice and services of the Company Secretary. The Company provides all Directors with the necessary information and data to enable them to make scientific, timely and prudent decisions. Any Director can request the Chief Executive, or, through the Chief Executive, request the Company's relevant department to provide him with any necessary information to enable him to make scientific, timely and prudent decisions. If any of the independent Directors consider necessary, an independent institution can be engaged to provide independent opinions to assist his decision-making. The expenses of engaging such an independent institution will be borne by the Company.

Director(s) with a vested interest in any transaction cannot participate in the vote that the Board of Directors takes with respect to that particular transaction. If a resolution cannot be passed due to the Director(s) exclusion from voting, the resolution will be submitted directly to the Shareholders' General Meeting for consideration by the shareholders.



#### 4. Specialised Committees of the Board

The Company has established separate strategy, audit, risk management and remuneration committees. The function of each specialised committee is to study pertinent issues in its area of expertise and to provide opinions and suggestions for consideration by the Board of Directors. The Company has not yet set up a nomination committee.

##### a Strategy committee

The Company's strategy committee was established in October 2005. It currently consists of five Directors, two of whom are independent non-executive Directors. The members of the strategy committee are Messrs. Liao Bin, Tian Lei, Ding Rongjun, Zhou Heliang and Pao Ping Wing. Mr. Liao Bin is the strategy committee's chairman.

The main responsibilities of the strategy committee are:

- (1) to provide study reports to the Board of Directors in respect of governmental policies and industrial trends;
- (2) to conduct strategic research concerning the Group;
- (3) to review and assess major investment and financial strategies;
- (4) to review major capital expenditure projects.

The strategy committee did not convene any meetings during the reporting period. However, the Board of Directors considered and approved the Company's annual investment plan and feasibility reports on all major investment projects.

##### b Audit committee

The Company's audit committee was established in October 2005. It currently consists of five Directors, four of whom are independent non-executive Directors. The committee's members are Messrs. Chan Kam Wing, Zhou Heliang, Gao Yucai, Ma Yunkun and Tan Xiao'ao. Mr. Chan Kam Wing is the audit committee's chairman.

The main responsibilities of the audit committee are: to consider and supervise financial reporting processes and internal control procedures, to exercise its authority to guide and supervise internal audits, and to make suggestions about the appointment or change of external audit firm.

The audit committee held seven meetings during the reporting period. These meetings mainly discussed issues concerning the Company's annual results, half yearly results, audit work carried out for the Company's initial public offering, communication with the Stock Exchange of Hong Kong concerning the review of listing application documents, internal audit and internal controls related issues, etc. Following is the record of attendance of committee members.

Committee member	Attendance rate for meetings held during the year ended 31 December 2006
Chan Kam Wing	6/7
Zhou Heliang	1/1*
Gao Yucai	1/1*
Ma Yunkun	5/7
Tan Xiao'ao	6/6*

\*Note: Messrs. Zhou Heliang and Gao Yucai were both appointed as independent non-executive Directors of the Company on November 2006. Mr. Tan Xiao'ao was appointed an independent non-executive Director of the Company in June 2006.

The Company has established an audit division with internal audit functions. The audit division is under the supervision of the audit committee.

#### **c Risk management committee**

The Company's risk management committee was established in June 2006. It currently consists of five Directors, three of whom are independent non-executive Directors. The members of the strategy committee are Messrs. Tian Lei, Chan Kam Wing, Ma Yunkun, Pao Ping Wing and Tan Xiao'ao. Mr. Tian Lei is the risk management committee's chairman.

The main responsibility of the risk management committee is to formulate, assess and revise risk management strategies.

The risk management committee did not hold any meetings during the reporting period. In spite of this, members of the risk management committee participated in the discussion of risk management and internal control related issues with Company management and with the Company's sponsors for its initial public offering, during and after the Company's initial public offering.

#### **d Remuneration committee**

The Company's remuneration committee was established in October 2005. It currently consists of five Directors, three of whom are independent non-executive Directors. The committee members are Messrs. Pao Ping Wing, Gao Yucai, Ding Rongjun, Chan Kam Wing and Lu Penghu. Mr. Pao Ping Wing is the remuneration committee's chairman.

The main responsibilities of the remuneration committee are to consider the remuneration and benefits of Directors and senior management, and to make recommendations to the Board of Directors about any related adjustments.

Since the Company did not make any major changes in its remuneration scheme during the reporting period, the remuneration committee did not hold any meetings. However, all the remuneration and benefits of the Directors and senior management members, and their service contracts were considered and approved by the Board of Directors.

### **IV Chairman and Chief Executive**

The offices of the Chairman and the Chief Executive of the Company are held by Mr. Liao Bin and Mr. Ding Rongjun, respectively. The division of responsibilities between them has been clearly established and set out in writing. The Chairman is responsible for running the Board and chairing Board meetings whereas the Chief Executive is responsible for the Company's day-to-day operations.

According to the Articles of Association, the Chairman exercises the following authorities:

- (1) To preside over Shareholders' General Meetings, and to convene and preside over Board Meetings;
- (2) To monitor the implementation of the Board's resolutions;
- (3) To sign securities issued by the Company; and
- (4) Other authorities conferred on him by the Board of Directors.



The Chief Executive is responsible to the Board of Directors. The Chief Executive and the management team under his leadership have the following authorities:

- (1) Management of the Company's manufacturing and sales operations and the implementation of the Board's resolutions;
- (2) Implementation of the Company's annual operational plan and investment strategies;
- (3) To establish the Company's internal management mechanisms;
- (4) Establishment of the Company's basic management systems;
- (5) Formulation of the Company's basic regulations;
- (6) Proposing the appointment and dismissal of Deputy Chief Executive, Chief Supervisor and assistant to the Chief Executive of the Company;
- (7) Appoint or dismissing management staff, except those who should be appointed or dismissed by the Board of Directors; and
- (8) Making proposals concerning wages, benefits, bonuses and penalties for employees, and deciding on the appointment and dismissal, promotion or demotion, increases or decreases in salary, appointment, employment, termination of employment or dismissal of employees.

## V Non-executive Directors

According to the Articles of Association, the Company's non-executive Directors are elected by Shareholders' General Meetings for a term of three years. Upon retirement, non-executive Directors are eligible for re-election.

## VI Nomination of Directors

Directors are elected by the Shareholders' General Meetings in accordance with its articles of association. Written notice of intention to nominate a candidate for the post of Director and the candidate's agreement to be nominated must be given to the Company after the date of the notice of the Annual General Meeting and at least seven days prior to the convening of the Annual General Meeting.

## VII Remuneration of the auditors

During the year ended 31 December 2006, the Company appointed Ernst & Young as its reporting accountant for its initial public offering on the Main Board of the Stock Exchange of Hong Kong. Ernst & Young also provides annual audit services to the Company. Details of the external auditors' remuneration are as follows:

<b>Service provided:</b>	<b>For the year ended 31 December 2006 (RMB' 000)</b>
Annual audit	3,600
Reporting accountant for listing	10,550



## VIII Directors' responsibilities in respect of the financial reports

The Directors confirm that they are responsible for the preparation of financial reports, and to give a true and fair view of the Company's and the Group's financial status and operating results for the year ended 31 December 2006.

The Directors also confirm that there were no major unexpected events or conditions that would have a significant impact on the continuity of the Company's operations.

## IX Internal controls

The Directors are responsible for maintaining a reliable and effective internal control system. The Company has established an internal audit department. An audit committee and a risk management committee have also been established and are responsible to the Board of Directors. The Directors are in a position to supervise, assess and improve the Company's internal controls at all levels of management, so as to ensure that the Company can withstand changes in its operations and other external influences on its finance, operation and risk management, in order to safeguard the Company's assets and promote Shareholders' interests.

During the reporting period, in accordance with guidance note entitled "internal control and risk management - basic framework" issued by Hong Kong Institute of Certified Public Accountant, the Company employed an independent international risk consultancy firm to fully assess the Company's internal control system from entity and work flow perspectives. Risks are qualified and quantified, and the internal control system is examined with reference to guidance note "internal control - consolidated structure" issued by COSO which examines qualitative and quantitative factors. In relation to detected internal control weaknesses, the Company made appropriate changes, and established a new system of controls. These changes mainly dealt with internal controls in relation to procurement, sales, inventory, finance and connected transactions.

After instilling a new system of internal controls, the Company engaged the same risk consultancy firm to examine whether the new system is operating effectively. The results of the walk-through and entity level tests indicate there were no major detected internal control weaknesses. With reference to the conclusion reached by the risk consultancy firm, the Directors and Company management believe that issues concerning the Company's internal controls have been properly handled.

## X Compliance with the non-competition and indemnity agreements by the Controlling Shareholders

ZELRI, the controlling shareholder of the Company, and CSR Group, the ultimate controlling shareholder (hereinafter referred to as "Controlling Shareholders"), have each submitted their "explanations regarding the implementation of the non-competition and indemnity agreement in 2006" to the Company respectively, declaring that they had complied with the terms of the said agreements. The Company's independent non-executive Directors have also reviewed the implementation of the non-competition and indemnity agreements by the controlling shareholders in 2006. The independent non-executive Directors consider that the Parent Group and the CSR Group had complied with the terms of the non-competition and indemnity agreements. The respective businesses, of the Parent Group and the CSR Group were independent of the Group's business, employing different technologies, and have different customers, and will not result in any competition with the Group. The Directors were able to uphold the interests of the Company and the shareholders, and operated and managed the Company's business independently.