
RELATIONSHIP WITH THE CONTROLLING SHAREHOLDERS

BACKGROUND OF CONTROLLING SHAREHOLDERS

Immediately following the completion of the Capitalisation Issue and the Global Offering, our Controlling Shareholders will together own approximately 75% of the enlarged issued share capital of the Company (assuming the Over-allocation Option is not exercised). As at the Latest Practicable Date, in addition to the interests in our Company, the Controlling Shareholders also held interests in ZhongShan Hong Liong. ZhongShan Hong Liong was incorporated in PRC on 9 August 1999 and is principally engaged in the manufacture of cotton/chemical fibre blend fabrics for industrial shoes and bags. ZhongShan Hong Liong is wholly owned by Everprofuse which is an investment holding company. Mr. Shao Ten-Po, the executive Director and our Chairman is also the director of Everprofuse. Everprofuse is owned as to 95% by Lucky Dragon and as to 5% interest by an independent third party. Lucky Dragon is owned by Ms. Hu Chin-Shu, Ms. Chen Li-Chuan, Ms. Huang Szu-Ching, Ms. Hsu Fu-Mei, Ms. Hsuh Hui-Chen, Mr. Tseng Chung-Cheng and Mr. Liao Chin-Yi, each holding a 16%, 16%, 16%, 16%, 16%, 10% and 10% interest, respectively before completion of the Reorganisation. The director of Lucky Dragon is Mr. Liao Chin-Yi, our executive Director, as well as our CEO.

To the best of our Directors' knowledge, information and belief save as disclosed herein, our Directors have confirmed that our Controlling Shareholders and our Directors have no interests in businesses other than our Group's businesses which may directly or indirectly compete against the businesses of our Group.

COMPARISON OF OUR BUSINESS AND THE BUSINESS OF ZHONGSHAN HONG LIONG

Our Directors consider that there is clear business delineation and that there is no competition between ZhongShan Hong Liong and our Group for the following reasons:

(a) *Products and target customers*

We are a vertically-integrated manufacturer of chemical fibre knitted fabrics (化纖類) with primary focus on functional fabrics which are used for the manufacturing of sportswear. Functional fabrics are fabrics of complex construction using polyester or other polymer-based raw materials with single or multiple special function(s), for example, higher elasticity, water repellent and/or quick drying function and are used primarily for the manufacturing of sportswear which demands for such special functions. Our target customers include renowned sportswear manufacturers in China including Decathlon, Anta, Mizuno and Li Ning. To the best of Directors' knowledge information and belief, our Directors confirmed that ZhongShan Hong Liong is principally engaged in the manufacture of cotton/chemical fibre blend fabrics which mix cotton and chemical yarns in the manufacturing process and are commonly used in everyday clothing and for other applications such as industrial shoes and bags. ZhongShan Hong Liong's target customers are primarily industrial shoes and travelling and computer bags manufacturers. There is no overlapping of major customers between our Group and ZhongShan Hong Liong. Our Directors consider that ZhongShan Hong Liong is not a competitor to our Group because it is engaged in different lines of fabric products which target different markets and customers. Our Group will focus on fabrics for sportswear clothing after Listing while ZhongShan Hong Liong are not engaged and will not engage in the manufacture of sportswear clothing fabrics after our Listing pursuant to the Deed of Non-Competition.

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(b) *Design and design technology*

Our in-house design team handles all our design activities for our chemical fibre knitted fabrics independently from ZhongShan Hong Liong's design team that handles the design of cotton/chemical fibre blend fabrics. Whilst our in-house design team has its own design database, technology and know-how for our business, to the best of the Directors' knowledge information and belief, ZhongShan Hong Liong relies on its own designers and its design database, technology and know-how.

(c) *Production process*

As disclosed in the section headed "Business — Manufacturing Facilities" of this prospectus, we have our own fabric manufacturing facility independent of ZhongShan Hong Liong's for the manufacture of our products. We may also outsource some of our manufacturing requirements to third-party subcontractors as disclosed in the section headed "Business — Third Party Outsourcing".

(d) *Sales network and pricing of products*

Our target customers include sportswear and leisure apparel manufacturers in China. ZhongShan Hong Liong's major customers include manufacturers of industrial shoes and travelling and computer bags.

(e) *Revenue model*

Our business derives revenues from the sales of chemical fibre knitted fabrics (化纖類) with primary focus on complex and value-added fabrics, fabrics for sportswear and leisure apparel and apparel for various domestic and foreign premium apparel brands in China. To the best of the Directors' knowledge information and belief, ZhongShan Hong Liong mostly derives revenues from the sales of cotton/chemical fibre blend fabrics to industrial shoe manufacturers and manufacturers of travelling and computer bags in Taiwan and China.

(f) *Composition of board members*

None of our Directors, our management team and staff holds a position on the board of directors or the management team of ZhongShan Hong Liong. None of the members of the board of directors of ZhongShan Hong Liong has any management or executive role in our Group. There is no overlapping between the management and operation of our Group and that of ZhongShan Hongliong in any aspects. Therefore, our Directors are of the view that competition between ZhongShan Hong Liong and our Group does not exist.

Reason for exclusion

As confirmed by the Directors, ZhongShan Hong Liong was not included into our Group for the following reasons: First, it is the nature of the fabric business that the characteristics of consumers and markets differ according to the type of fabrics, apparel and applicability. Second, our Group's primary business focus and strategy is related to complex and value-added fabrics for sportswear and leisure apparel manufacturers in China. ZhongShan Hong Liong is principally engaged in the manufacture of

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cotton/chemical fibre blend fabrics for industrial shoes and bags. However, as confirmed by the Directors, less than 10% in terms of revenue and quantity of the fabrics produced by ZhongShan Hong Liong are used for the production of casual wear. ZhongShan Hong Liong will only manufacture cotton/chemical fibre blend fabrics for industrial shoe and bags, they will not manufacture casual wear after our Listing pursuant to the terms of the Deed of Non-Competition. As a result, ZhongShan Hong Liong is outside the scope of our business and hence was not included into our Group. We believe that our Group's focus on complex and value-added fabrics has been important to our success in this market segment but that our Group's expertise and experience in the PRC would not necessarily translate into success in other market in which ZhongShan Hong Liong is specialised. Third, we believe that substantial opportunity exists for our continued expansion within our existing business segment. We presently have no plan to develop the cotton/chemical fibre blend fabrics market in the near future and intend to focus on our market share with primary focus on complex and value-added fabrics for sportswear and leisure premium apparel brands in the PRC. Hence, our Controlling Shareholders do not consider it appropriate to inject the business of ZhongShan Hong Liong into our Group. As ZhongShan Hong Liong is not engaged in the manufacture of products which are similar to those of our Group, and that the major customers of our Group and ZhongShan Hong Liong are different, and the raw materials used for the manufacture of the products of our Group are different from those used by ZhongShan Hong Liong for its manufacture of cotton/chemical fibre blend fabrics, the Directors consider that there is no competition among the Group and ZhongShan Hong Liong. Pursuant to the Deed of Non-Competition, ZhongShan Hong Liong has undertaken with the Company that, so long as our Controlling Shareholders remain interested in 30% or more of the voting rights at general meeting of our Company, he/she/it and any companies controlled by him/her/it, as the case may be, will not compete with our Group in respect of the Core Business, including production of casual wear, conducted by our Group. For the definition of Core Business, please refer to the sub-section headed "Deed of Non-Competition" under this section.

SHAREHOLDERS' INTERESTS IN TAI WAN HONG LIONG

Each of Mr. Shao Ten-Po, Mr. Tseng Chung-Cheng and Mr. Liao Chun Yi is a director and a shareholder of Tai Wan Hong Liong Textile Co., Ltd. ("Tai Wan Hong Liong") holding approximately 35%, 6% and 8% interest in Tai Wan Hong Liong respectively. Tai Wan Hong Liong is principally engaged in the trading of weaving machineries, yarns and industrial fabrics for shoes, bags, tents and toys. Industrial fabrics are usually heavier, of higher tensile strength and can withstand longer wear and tear than fabrics for the manufacture of apparel. Our Group will focus on fabrics for sportswear clothing after Listing while Tai Wan Hong Liong are not engaged and will not engage in the manufacture of sportswear clothing fabrics after our Listing pursuant to the terms of the Deed of Non-Competition. As Tai Wan Hong Liong is engaged in a different product line, Tai Wan Hong Liong is not a competitor to our Group. Besides, as Tai Wan Hong Liong is not engaged in the manufacture of products which are similar to those of our Group, and that the customers of our Group and Tai Wan Hong Liong are different, the Directors consider that there is no competition among the Group and Tai Wan Hong Liong. Pursuant to the Deed of Non-Competition, Tai Wan Hong Liong has undertaken with the Company that, so long as our Controlling Shareholders remain interested in 30% or more of the voting rights at general meeting of our Company, he/she/it and any companies controlled by him/her/it, as the case may be, will not compete with our Group in respect of the core businesses conducted by our Group.

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DEED OF NON-COMPETITION

In order to avoid any future competition between us and ZhongShan Hong Liong and Tai Wan Hong Liong and between us and our Controlling Shareholders, the Deed of Non-Competition has been entered into between, among others, our Company, the Controlling Shareholders, Lucky Dragon, ZhongShan Hong Liong and Tai Wan Hong Liong. Pursuant to the terms of the Deed of Non-Competition, each of the Controlling Shareholders, Lucky Dragon, ZhongShan Hong Liong and Tai Wan Hong Liong (the “Covenantors”) has undertaken with the Company that, so long as our Controlling Shareholders remain interested in 30% or more of the voting rights at general meeting of our Company, he/she/it and any companies controlled by him/her/it, as the case may be, will not compete with our Group in respect of the core businesses conducted by our Group. For the purposes of the Deed of Non-Competition, our Group’s core businesses (the “Core Business”) are manufacturing of chemical fibre knitted fabrics, especially with focus on functional fabrics, manufacturing of garments on an OEM basis for oversea premium apparel brand and PRC apparel brand owners, and wholesaling of fashion and leisure apparel and accessory products.

The principal terms of the Deed of Non-Competition are as follows:

- each of the Covenantors will not, without our prior written consent, participate, conduct or operate any business or services that will compete directly or indirectly with the Core Business;
- each of the Covenantors will not directly or indirectly take any action which constitutes an interference with or a disruption of any of our Group’s business activities including, but not limited to, solicitation of our Group’s customers, suppliers or personnel of any member of our Group;
- each of the Covenantors will offer to our Company a right of first refusal in respect of the opportunity to participate or acquire any interest in future projects or joint ventures which are offered to any company controlled by any of the Covenantors which could or may compete with the Core Business (the “Business Opportunity”).

Right of first refusal in respect of a Business Opportunity

Our Company will have a right of first refusal in respect of a Business Opportunity to participate or acquire any interest in future projects or joint ventures which are offered to any company controlled by any Covenantor which could or may compete with the Core Business. In the event that any Covenantor is aware of a Business Opportunity, he/she/it shall procure that such Business Opportunity is first offered to our Company and our Company shall have a right of first refusal in respect of such Business Opportunity. In particular, each Covenantor will:

- (i) direct to our Company any such Business Opportunity;
- (ii) provide to our Company (subject to such confidentiality requirements as may be applicable) all information and documents possessed by it or its associates in respect of the Business Opportunity to enable our Company to evaluate the merit of the Business Opportunity and to secure the Business Opportunity.

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The Business Opportunity will be reviewed by our executive Directors, who shall make their recommendation on whether or not to take up the Business Opportunity referred to us under the terms of the Deed of Non-Competition to our INEDs within seven days after a Covenantor notifies our Company of such Business Opportunity in writing. Our INEDs will be responsible for deciding whether or not to take up a Business Opportunity referred to us under the terms of the Deed of Non-Competition, without the attendance by a Director who have management responsibilities in any company controlled by any Covenantor (except as invited by our INEDs to assist them).

A Covenantor will not pursue the Business Opportunity, unless and until our independent non-executive Directors (a) resolve that our Company will not pursue such Business Opportunity; or (b) do not resolve whether or not to pursue such Business Opportunity within a reasonable period of time (which is normally one month unless the parties agree otherwise) after he/she/it notifies our Company of such Business Opportunity in writing. Our Company is of the view that the one-month period for our INEDs to consider whether our Company shall pursue such Business Opportunity is reasonable as it allows sufficient time for our executive Directors to make their recommendation to our INEDs and for our INEDs to review the information relating to the Business Opportunity and (where necessary) to employ, at our Company's cost, an independent financial adviser as they consider necessary to advise our INEDs on the Business Opportunity.

In considering whether our Group will exercise the right of first refusal, our INEDs will take into account the written proposal prepared by the management of our Company regarding such Business Opportunity, the business strategy and financial condition of our Group, the potential of the Opportunity and whether the terms of the Business Opportunity are fair and reasonable and on normal commercial terms, with reference to the then prevailing market prices of the Business Opportunity. Our INEDs may, at our Company's cost, employ an independent financial adviser as they consider necessary to advise them on the terms of any such Business Opportunity.

Our independent non-executive Directors will also review, at least on annual basis, the pre-emptive rights or first rights of refusal, if any, provided by our Controlling Shareholders on the Business Opportunity and decide whether to exercise these rights.

In addition, to ensure our INEDs are able to conduct the above decision-making process, each of our Controlling Shareholders has undertaken in the Deed of Non-competition to provide and to procure the provision to us of all information necessary for the enforcement of the undertakings contained therein. Each of our Controlling Shareholders has further undertaken to make a statement in our annual report confirming their compliance and that of their respective affiliates with the terms of the Deed of Non-competition.

We will disclose in our annual report on how the undertakings in the Deed of Non-competition were complied with and enforced in accordance with the principles of making voluntary disclosures in the Corporate Governance Report as defined in Appendix 23 of the Listing Rules.

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INDEPENDENCE OF THE GROUP

The Directors are satisfied our Group is capable of carrying on its business independently from the Controlling Shareholders after Listing. This conclusion is based on, among others, the following:

Operational independence

We conduct our business independently from our Controlling Shareholders. Our Group has personnel and capabilities to handle all operational functions including power generation, procurement, safety control, finance and accounting, human resources and information technology.

There is no sharing of property, plant and equipment between the Group and the Controlling Shareholders. We do not share any of our employees with the Controlling Shareholders or their affiliates.

Although we entered into the connected transactions with companies controlled by our Controlling Shareholders as set out in the section headed “Connected Transactions” of this prospectus, we believe that our purchases and sales can be easily replaced by other comparable alternative supplies and customers without causing any material disruption to our operations. As such, our Directors confirm that we are able to operate independently despite the existence of such transactions and can carry on our business independently of our Controlling Shareholders and their associates.

For the purchase of raw yarns from Poly Luck Enterprise Limited (“Poly Luck”), we entered into a framework purchase agreement (the “First Raw Yarns Purchase Agreement”) with Poly Luck on 27 November 2009, whereby Poly Luck has agreed to supply raw yarns to our Group from time to time on a non-exclusive basis. Such raw yarns serve as our Group’s raw materials for the production of our fabric products. We expect the above transaction will continue upon Listing. For the three years ended 31 December 2008, the aggregate amount of the purchase of raw yarns from Poly Luck amounted to approximately RMB23.7 million, RMB10.1 million and RMB1.0 million, representing approximately 7.9%, 2.3% and 0.2% of our total raw materials purchase costs, respectively.

For the purchase of raw yarns from Sum Vision Company Corp. (“Sum Vision”), we entered into a framework purchase agreement (the “Second Raw Yarns Purchase Agreement”) with Sum Vision on 27 November 2009, whereby Sum Vision has agreed to supply raw yarns to our Group from time to time on a non-exclusive basis. Such raw yarns serve as our Group’s raw materials for the production of our fabric products. We expect the above transaction will continue upon Listing. For the three years ended 31 December 2008, the aggregate amount of the purchase of raw yarns from Sum Vision amounted to approximately RMB1.1 million, RMB7.3 million and RMB5.3 million, representing approximately 0.4%, 1.6% and 1.0% of our total raw materials purchase costs, respectively.

For the purchase of greige fabric, chemicals and dye auxiliaries (原絲半成品／染料助劑物料) (“Auxiliary Materials”) from Vicko Enterprises Limited (“Vicko Enterprises”) and raw yarns and fabric materials (“Fabric Materials”, together with the Auxiliary Materials, the “Materials”) from Keytrack Development Inc. (“Keytrack Development”), we entered into a framework purchase agreement (the “Material Purchase Agreement”) with Vicko Enterprises and Keytrack

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Development on 27 November 2009, whereby Vicko Enterprises and Keytrack Development have agreed to supply the Materials to our Group from time to time on a non-exclusive basis. Such Materials are necessary for the production of our fabric products. We expect the above transaction will continue upon Listing. For the three years ended 31 December 2008, the aggregate amount of the purchase of the Materials from Vicko Enterprises and Keytrack Development amounted to approximately RMB12.4 million, RMB7.4 million and RMB3.7 million, representing approximately 4.1%, 1.7% and 0.7% of our total raw materials purchase costs, respectively.

Management independence

The Group has an independent team of technical, managerial, financial and administrative professionals independent from the Controlling Shareholders to handle the day-to-day operations of the Group.

Financial independence

We have an independent financial system and makes financial decisions according to our Group's business needs.

All non-trade balances due from/to the Controlling Shareholders and their associates will be fully settled before listing.

During the Track Record Period, save as disclosed in the Accountants' report in Appendix I of this prospectus, the Controlling Shareholders, through entities either controlled or partly-owned by them, had not provided loans to our Group or bank guarantee to secure bank loans of our Group.

We have sufficient capital to operate our business independently, and have adequate internal resources and a strong credit profile to support our daily operations. We had our own finance department and has established its own financial reporting system independent of the Controlling Shareholders. We have our own bank account, makes its own tax registrations and has employed a sufficient number of dedicated financial accounting personnel.

Corporate Governance Measures

Our Directors believe that there are adequate corporate governance measures in place to manage any potential conflicts of interest between the Controlling Shareholders, the Directors and the Company. In order to avoid potential conflicts of interests, we have implemented the following measures:

- As part of our preparations for the Global Offering, we have amended our Articles of Association to comply with the Listing Rules. In particular, our Articles of Association provide that, unless otherwise provided, a Director shall not vote on any resolution approving any contract or arrangement or any other proposal in which such Director or any of his/her associates have a material interest nor shall such Director be counted in the quorum present at the meeting.

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- A Director with material interests shall make full disclosure in respect of matters that conflict or potentially conflict with our interest and absent himself/herself from the board meetings on matters involving the Group and/or matters in which such Director or his/her associates have a material interest, unless the attendance or participation of such Director at such meeting of the Board is specifically requested by a majority of the independent non-executive Directors.
- We are committed that our Board should include a balanced composition of executive and non-executive Directors (including INEDs). We have appointed three INEDs. We believe our INEDs possess sufficient experience and they are free of any business or other relationship which could interfere in any material manner with the exercise of their independent judgment and will be able to provide an impartial, external opinion to protect the interests of our public shareholders.
- We have appointed Mega Capital as our compliance advisor, which will provide advice and guidance to us in respect of compliance with the applicable laws and the Listing Rules including various requirements relating to directors' duties and corporate governance.
- As required by the Listing Rules, our INEDs shall review any connected transactions annually and confirm in our annual report that such transactions have been entered into in our ordinary and usual course of business, are either on normal commercial terms or on terms no less favorable to us than available to or from independent third parties and on terms that are fair and reasonable and in the interests of our shareholders as a whole.

In addition, if our INEDs consider it necessary or desirable, they may also engage professional advisors (including an independent financial advisor) at the costs of the Company to advise them on matters relating to the Deed of Non-Competition or on any business opportunities which may be referred to us by the Controlling Shareholders.