

*You should read the whole document before you decide to invest in our Offer Shares, and you should not rely solely on key or summarized information. The financial information in this section has been extracted without material adjustment from “Appendix I – Accountants’ report of our Group”.*

## **OVERVIEW**

We were the second largest BDO producer in China in terms of domestic sales volume in 2009 with a market share of approximately 16.0%, according to the Huajing Report prepared by Beijing Huajing, an independent economic information research institution. We also produce GBL and THF, which are immediate downstream derivative products of BDO. We ranked fifth in China in terms of total designed BDO production capacity in 2009, according to the Huajing Report.

In view of China’s growing market for biodegradable materials and leveraging on our existing expertise in BDO production, we intend to expand downstream into BDO-based biodegradable PBS and PBS copolymers production and apply approximately 10% of the net proceeds from the Global Offering to construct the first phase of our PBS production facilities. Please refer to the paragraph headed “Our strategies” under this section for further details. PBS and PBS copolymers are relatively new materials in China and our Group has no historical track record in their production. While we are confident of our PBS expansion plan, there is no assurance that we will be able to produce PBS and PBS copolymers on a commercial scale or at all. (Please refer to the section headed “Risk factors” in this prospectus).

BDO, our primary product, is an essential chemical intermediate used in the production of high performance polymers, solvents and fine chemicals, which are widely used in the automotive, electronics, construction and apparel industries. GBL has a wide range of applications, including cosmetics, hair sprays, germicides, tablet binders and as process aids in beverage clarification. THF is mainly used as a precursor to polymers and is often used to produce PTMEG, which in turn is a reactant for making other polymers.

During the Track Record Period, we sold our BDO, GBL and THF products principally to PRC manufacturers of different industries such as chemicals, pharmaceutical and industrial electronics, which are primarily located in the Eastern region of China. We believe this direct sales model, compared to a distributorship sales model, allows us to obtain first-hand market information directly from these customers and helps us to build long-term and close customer relationships. During the Track Record Period, we did not sell our BDO, GBL and THF products to any manufacturer of PBS or PBS copolymers. Additionally, we have neither directly exported our products nor, to our knowledge, have we sold our products to customers who in turn re-sell and export our products without further processing.

We are the first among the current BDO producers in China to employ the DAVY Process, according to the Huajing Report. The DAVY Process, which uses maleic anhydride as the principal raw material, is more advanced and cost efficient than the traditional REPPE Process, which uses acetylene and formaldehyde as the principal raw

material. The DAVY Process allows us to produce high-graded BDO with a higher purity level than the national standard generally adhered by BDO manufacturers adopting the REPPE Process. The DAVY Process also co-produces GBL and THF, two of our major products, and allows us to adjust the mix among our three products to enhance the flexibility in fulfilling the customers' orders.

Our current production facilities are located in Dongying, Shandong province, close to our raw material suppliers and most of our major customers. In particular, our current production facilities are adjacent to Sinopec Shengli Oilfield Branch Petrochemical Factory\* (中國石化勝利油田分公司石油化工總廠) ("**Sinopec Shengli**"), China's second largest oil field complex, which supplies to us raw materials including hydrogen and n-butane through pipelines. Our proximity to and long-term relationship with Sinopec Shengli provide us with a convenient supply of principal raw materials and a cost advantage over many of our foreign and domestic competitors. For each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, our purchases from Sinopec Shengli accounted for approximately 11.3%, 9.9%, 12.7% and 32.3% of our total purchases, respectively. As at the Latest Practicable Date, our Dongying BDO production facility had a designed BDO production capacity of approximately 35,000 tpa, a designed GBL production capacity of approximately 17,000 tpa and a designed THF production capacity of approximately 5,000 tpa.

We derive substantially all of our revenue from sales of BDO, GBL and THF. Our revenue was approximately RMB882.7 million, RMB883.3 million, RMB745.4 million and RMB383.9 million for each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, respectively. Our net profit was approximately RMB146.1 million, RMB133.9 million, RMB172.1 million and RMB96.9 million for each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, respectively.

Our principal business development strategy is to leverage our BDO production capabilities and expand into China's growing biodegradable materials market. Since 2008, we have devoted substantial resources to exploring the market and the commercialization potential of BDO-based biodegradable PBS and PBS copolymer products. PBS and PBS copolymers are fully biodegradable macromolecular polymers that are synthesized from succinic acid/binary acid and BDO through a process of condensation polymerization. Due to the comparatively superior characteristics in mechanical properties, processability and heat resistance over other types of biodegradable polymers, PBS and PBS copolymers can be used in a wide range of applications, such as packaging materials, food containers, mulch film, packaging films, bags, disposable medical devices, hygiene products and textiles. In this connection, we entered into a letter of intent with IPCCAS in July 2009 for the licensing of its patented IPCCAS Direct Polycondensation Process to construct a 20,000 tpa PBS production facility, as well as setting up a joint research laboratory to research into new PBS formulations and potential applications. Subsequently in December 2009, we entered into a formal technology licensing agreement with IPCCAS (which was supplemented by a supplemental licensing agreement dated October 29, 2010), under which we were granted a non-exclusive license (which is one-off in nature with no time limit) to use the relevant PBS resin polymerization technologies in our PBS production facilities and our 500-liter PBS laboratory facility adopting the IPCCAS Direct

Polycondensation Process. In May 2010, we further entered into a technology cooperation agreement with Sichuan University for an initial period of five years to collaborate into areas including (without limitation) PBS downstream product development, production technology support and research staff training. Since then, we have established a PBS research team in Zibo of Shandong province collaborating with IPCCAS and the Polymer Research Institute\* (高分子研究所) and the State Key Laboratory of Polymer Materials Engineering\* (高分子材料工程國家重點實驗室) of Sichuan University. We are close to completing the construction of a 500-liter PBS laboratory facility which would be used for testing formulations for and trial production of various types of PBS and PBS copolymer downstream products. The PBS laboratory facility is scheduled to be completed by end of November 2010 and put into operation by December 2010.

In accordance with our expansion plan, we have already commenced the construction of a new production base, which is situated on a parcel of land with a site area of approximately 229,655 square meters in the New-Hi Tech Industrial Development Zone of Zibo, Shandong province. To this end, construction of two PBS production lines in this new Zibo production base with designed production capacity of 5,000 tpa and 20,000 tpa, being the first phase of our three-phase PBS production capacity expansion plan, is currently under way and is scheduled to be completed by June 2011 and September 2011, respectively. As at the Latest Practicable Date, we had entered into non-legally binding letters of intent, valid up to December 31, 2013, with several Independent Third Party PRC manufacturers of medical supplies, packaging and hygienic disposables for intended PBS and PBS copolymers orders totaling over 17,000 tons per annum.

Depending on the then market response to our PBS and PBS copolymer products from our first phase of PBS production facility, we intend to commence construction of a further 50,000 tpa PBS production facility in or around early 2012. According to our preliminary construction schedule, this 50,000 tpa, second phase PBS production facility shall take about eight months to construct. Depending on the then utilization of our first and second phase of PBS production facilities, we may commence construction of a third phase PBS production facility with a designed production capacity of 50,000 tpa as early as in 2013.

To support our planned expansion into the production of PBS and PBS copolymers which are currently in our product development pipeline, and to serve the growing demand for high-graded BDO and its derivative products in China, we plan to expand our BDO production capacity significantly by constructing a new, 55,000 tpa BDO production facility, to be housed alongside our planned PBS production facilities, in our new Zibo production base. This new BDO production facility, which is under construction and is currently scheduled to be completed by June 2011, will employ the newest, fourth-generation DAVY Process with designed BDO, GBL and THF production capacity of approximately 46,800 tpa, 6,600 tpa and 1,600 tpa, respectively.

In addition to the above core production facilities, our Zibo production base will also house various ancillary facilities such as office buildings, staff canteen, warehouses and a waste water treatment facility.

According to our research and development progress to date, it is estimated that the consumption ratio of BDO in PBS production should be around 0.4-0.5 ton of BDO for each ton of PBS and/or PBS copolymer products. On such basis and for purpose of illustration, if all three phases of our PBS production facilities are operating at full capacity, then based on the currently estimated consumption ratio of BDO to PBS, around half of the aggregate designed production capacity of our two BDO production facilities (inclusive of BDO, GBL and THF) will be utilized for producing internally consumed BDO, while the remaining production capacity will be utilized for producing BDO, GBL and THF for external sales to the market. We believe that our expanded BDO production capacity will help to support the future growth of our PBS and PBS copolymer production and solidify our leading position in China's BDO and derivative products market.

## **OUR COMPETITIVE STRENGTHS**

We attribute our success to date and potential for future growth to the following competitive strengths:

### **The second largest producer of high-purity BDO in China**

We were the second largest BDO producer in China in terms of domestic sales volume in 2009 with a market share of approximately 16.0%, according to the Huajing Report prepared by Beijing Huajing, an independent economic information research institution. As at the Latest Practicable Date, our existing BDO production facility had a designed BDO production capacity of approximately 35,000 tpa, a designed GBL production capacity of approximately 17,000 tpa and a designed THF production capacity of approximately 5,000 tpa. Industrial production of BDO is a complex process, and we believe it is difficult to produce high-purity BDO in large volume with consistent quality. Our BDO has a higher purity level than the national standard. We believe we are one of the largest BDO producers that can attain this purity level in large volume based on the Huajing Report. Our large-scale production also helps us to control costs and secure reliable raw material supplies by allowing us to negotiate and enter into advantageous pricing terms with our suppliers.

The large-scale production of high-purity BDO requires significant technological expertise and know-how, posing high barriers of entry to potential competitors. With the planned expansion of our BDO production capacity in the near term, we hope to continue to take advantage of being a BDO market leader in China.

### **First among current BDO producers in China to employ the DAVY Process**

We are the first among the current BDO producers in China to employ the DAVY Process, according to the Huajing Report. The DAVY Process is considered more advanced and cost efficient than the traditional REPPE Process, which to date is still widely used among China's BDO manufacturers. Other advantages of the DAVY Process over the REPPE Process include: (i) cheaper and more readily available principal feedstock (maleic anhydride); (ii) the BDO produced is capable

of achieving a higher purity level than that generally adhered by BDO manufacturers adopting the REPPE Process; (iii) ability to co-produce GBL and THF with adjustable output ratio among BDO, GBL and THF; (iv) lower initial capital investment in production facilities; and (v) lesser amount of waste by-products, thus lowering the costs of waste disposal and environmental compliance. For a brief description of the various BDO production technologies, see paragraph headed “BDO production technology” under the section headed “Industry overview” in this prospectus.

As part of our expansion plan, we are constructing a new, 55,000 tpa BDO production facility in our Zibo production base adopting the newest, fourth-generation DAVY Process. While we are aware that a few of our competitors have recently migrated to or constructed new BDO production facilities adopting the same, we believe that our accumulated expertise and know-how in employing the DAVY Process for our BDO production gives us a significant first-mover advantage that will allow us to operate at higher utilization rates and achieve higher product yields than our competitors that are new to the DAVY Process.

#### **Strong customer base and reputation**

We have established and maintained long-term and close relationships with our key customers by providing consistent quantity and high quality products to them. Our customer base has been reasonably stable from year to year. Our ten largest customers included seven of the same companies for each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010.

Our customers typically demand a challenging combination of high quality and stable supply of BDO. Our ability to supply our products quickly, with consistent quantity and high quality enhances our market reputation and builds customer loyalty.

#### **Stable and low-cost supply of high quality raw materials and other materials**

Purchases of raw materials account for a significant component of our cost of goods sold. We spent approximately RMB592.0 million, RMB593.5 million, RMB372.3 million and RMB220.1 million on raw materials for each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, respectively, accounting for approximately 85.1%, 85.3%, 76.6% and 88.4% of our cost of goods sold for those periods. Maleic anhydride, hydrogen and methanol are the principal raw materials for the production of BDO using the DAVY Process, while n-butane is the principal feedstock for the production of maleic anhydride. These materials are available from sources in Shandong and nearby provinces close to our production facilities. For instance, three of our six suppliers of maleic anhydride are located in Zibo, Shandong province, while the other three are in Hebei province and Tianjin. In December 2009, we commenced in-house production of n-butane-based maleic anhydride, which lessened our reliance on third party purchases. From January 2010 to May 2010, approximately 31.4% of the maleic anhydride used in our BDO production was produced internally. We purchase



hydrogen and, more recently, n-butane, from Sinopec Shengli, which is located next to our Dongying production facilities and delivers these materials to our production facilities through pipelines. The geographic proximity of our production facilities to our major suppliers lowers transportation costs and reduces delivery time. We believe that our market leader status allows us to secure stable and high-quality raw materials on favorable terms from selected suppliers.

#### **Proven operational efficiency**

We have historically operated at high utilization rates. For each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, the utilization rates for our BDO production facility was 83.3%, 100.5%, 99.8% and 100.9%, respectively.

We are able to achieve high utilization rates in part because, as the first among the current BDO producers in China to adopt the DAVY Process, we possess the most experience operating it, which has been proven to be highly efficient. In addition, we have conducted production process enhancements and installed additional equipment to our BDO production facility to lower our production process bottleneck and minimize production down time for maintenance. SINOPEC Fushun Research Institute of Petroleum and Petrochemicals\* (中國石油化工有限公司撫順石油化工開發研究院) (“FRIPP”) and Institute of Coal Chemistry of the Chinese Academy of Sciences (中國科學院山西煤炭化學研究所) (“ICCCAS”), being China’s leading research institutions in the petrochemical industry, have from time to time collaborated with us and provided technical support and updates on industrial development for us to improve our production process and optimize our operational efficiency. We also collaborated with FRIPP to develop an esterification catalyst for use in our BDO production facility in order to lower our production costs.

#### **Experienced management team and employees**

Our growth is attributable, to a large extent, to our experienced management team and employees. Our executive officers, Mr. Zhang, Mr. Lu Wei, Mr. Zhang Xueqing and Dr. Zhang Aimin, have over 15 years of experience in the chemical industry. Members of our management team, particularly our Chairman, Mr. Zhang, and our executive Director, Mr. Lu Wei, have extensive and in-depth experience in the commercial, technical, managerial and regulatory areas of our business. In preparation of our planned business expansion, we have also employed Dr. Zhang Aimin since November 2009 as our chief technical officer to assist us in implementing our PBS production technology and development of PBS and PBS copolymer products. Dr. Zhang is a professor and doctoral member of the Polymer Research Institute\* (高分子研究所) of the Sichuan University and is also a stationed member of the State Key Laboratory of Polymer Materials Engineering\* (高分子材料工程國家重點實驗室) of Sichuan University. Our management’s experience, along with their proven execution capabilities and managerial skills, has contributed to our focused marketing efforts, superior quality control, efficient production planning and stringent cost controls. In addition, we have a team of employees

skilled in maintaining and operating our production facilities and infrastructure. We will continue to rely on our management team and key employees to successfully implement our business strategies.

## **OUR STRATEGIES**

We aim to further strengthen our leading market position in the BDO industry. Additionally, by leveraging on our expertise in BDO production, we aim to become a leader in China's biodegradable materials market through downstream expansion into BDO-based biodegradable PBS and PBS copolymer products, and aim to become a regional leader in PBS and PBS copolymer production. To achieve these goals, we intend to pursue the following strategies:

### **Downstream expansion into PBS and PBS copolymer production**

According to Freedonia, demand for PBS and PBS copolymers in China is forecasted to experience significant growth, with a CAGR of approximately 56.2% from 5,050 tons to 47,000 tons between 2009 and 2014. In view of China's growing market for biodegradable materials and our existing expertise in BDO production by the DAVY Process, we intend to expand downstream into PBS and PBS copolymers production. We have entered into a technology licensing agreement with IPCCAS in December 2009 (as supplemented by a supplemental agreement dated October 29, 2010), under which we were granted a non-exclusive license to use the relevant PBS resin polymerization technologies in our PBS production facilities and our 500-liter PBS laboratory facility adopting the IPCCAS Direct Polycondensation Process. We are close to completing the construction of a 500-liter PBS laboratory facility which would be used for testing formulations for and trial production of various types of PBS and PBS copolymer downstream products. The PBS laboratory facility is scheduled to be completed by end of November 2010 and put into operation by December 2010. To this end, construction of two PBS production capacity of 5,000 tpa and 20,000 tpa, being the first phase of our three-phase PBS production capacity expansion plan, is currently under way and is scheduled to be completed by June 2011 and September 2011, respectively.

In the longer run, we intend to further expand our PBS production capacity by an aggregate of 100,000 tpa through the construction of two additional PBS production lines, each with a designed production capacity of 50,000 tpa, under two additional phases. We currently intend to commence construction of the first 50,000 tpa PBS production facility in or around early 2012 depending on the then market response to our PBS and PBS copolymer products from our first phase of PBS production facilities. According to our preliminary construction schedule, this 50,000 tpa second-phase PBS production facility shall take about eight months to construct. Depending on the then utilization rates of our first and second phases of PBS production facilities, we may commence construction of a third phase PBS production facility with a designed production capacity of 50,000 tpa as early as 2013. These three phases of PBS production facilities will all be housed alongside our new BDO production facility (to be further elaborated below) in our new Zibo production base.

Our Directors believe that as the gross profit margin of both PBS and PBS copolymers are expected to be higher than those of our existing products (namely BDO, GBL and THF), the change of our sales mix as a result of the commercial production and sales of PBS and PBS copolymers in the near future is expected to enhance our overall gross profit margin. Additionally, as our near-term targeted PBS and PBS copolymer customers are different from our existing customers, the introduction of PBS and PBS copolymers is also expected to broaden our overall customer-base.

Our Directors are confident that given our Group's solid foundation as a BDO manufacturer using the DAVY Process, a competitive advantage in terms of securing the principal raw material for the production of PBS and PBS copolymers; its collaborative relationship with IPCCAS, the patent holder of the IPCCAS Direct Polycondensation Process to be adopted by us; our ability to tap onto the expertise of the Polymer Research Institute\* (高分子研究所) and the State Key Laboratory of Polymer Materials Engineering\* (高分子材料工程國家重點實驗室) of Sichuan University through our chief technical officer, Dr. Zhang Aimin, and our collaborative relationship with Sichuan University, our Group is well posed to become an early mover in China's PBS and PBS copolymers market.

#### **Expand our designed BDO production capacity**

The market for BDO and its derivative products in China has grown significantly in recent years. According to the Huajing Report, the demand for and production of BDO in China in 2005 was approximately 141,000 tons and 56,000 tons, respectively. In 2009, the demand for and production of BDO in China were approximately 252,000 tons and 231,000 tons, implying a CAGR of 15.6% and 42.5%, respectively. We believe the market for BDO and its derivative products in China will continue to grow because of growing industrialization, growing per capita disposable income, increasing spending on pharmaceuticals and consumer products, and increasing awareness of the importance of environmental protection. The increased awareness of environmental protection will, in particular, spur demand for biodegradable plastic materials, which we believe will in turn increase significant demand for PBS and PBS copolymers. As we commence and gradually increase our production of PBS and PBS copolymers, we will require increasing amounts of BDO as raw material.

To support our planned expansion into the production of PBS and PBS copolymers and serve the growing demand for high-graded BDO and BDO derivative products in China, we plan to expand our BDO production capacity significantly by constructing a new, 55,000 tpa BDO production facility, to be housed alongside our planned PBS production facilities, in our new Zibo production base. This new BDO production facility, which is under construction and currently scheduled to be completed by June 2011, will employ the newest, fourth-generation DAVY Process with designed BDO, GBL and THF production capacity of approximately 46,800 tpa, 6,600 tpa and 1,600 tpa, respectively.



We believe that our expanded BDO production capacity would enable us to enjoy greater flexibility in adjusting our production and sales mix to meet market demands, while controlling our costs through internal BDO consumption and external BDO sales. It is our intention that upon commencement of our PBS and PBS copolymers production, we will prioritize the use of our BDO produced by first satisfying our internal production requirement of PBS and PBS copolymers. According to our research and development progress to date, it is estimated that the consumption ratio of BDO in PBS production should be around 0.4-0.5 ton of BDO for each ton of PBS and/or PBS copolymers. On such basis, depending on the then prevailing demand for our PBS and PBS copolymer products, we expect our internal BDO consumption will increase as a percentage of our total BDO production as we expand our PBS production capacity in accordance with our expansion plan. (For purpose of illustration, if all three phases of our PBS production facilities are operating at full capacity, then based on the currently estimated consumption ratio of BDO to PBS, around half of the aggregate designed production capacity of our two BDO production facilities (inclusive of BDO, GBL and THF) will be utilized for producing internally-consumed BDO, while the remaining production capacity will be utilized for producing BDO, GBL and THF for external sales to the market.) We also expect our revenue from PBS and PBS copolymer products will increase both in absolute terms and as a percentage of our total revenue in the future when our PBS expansion plan is successfully implemented.

We believe that our expanded BDO production capacity will help to support the future growth of our PBS and PBS copolymer production and at the same time solidify our leading position in China's BDO and derivative products market.

#### **Collaborations with research institutes to develop formulations of PBS and PBS copolymers**

According to industry researches, PBS can be combined with other resins and biodegradable raw materials to arrive at different formulations with specific characteristics that are desirable for production of different end products. As production and application of PBS and PBS copolymers are still at an early stage of development, our Directors believe that there are substantial potential in developing different formulations of PBS and PBS copolymers tailored for specific requirements for different end uses. Alongside our planned expansion into PBS and PBS copolymer production which was under way as at the Latest Practicable Date, it is our intention to tap onto the research capabilities of reputable research and academic institutes in China through collaborative arrangements to develop different PBS and PBS copolymer formulations to promote wider commercial applications and market acceptance of PBS and PBS copolymers.

In this connection, we have entered into a letter of intent with IPCCAS on July 27, 2009 which set out, among other things, the intention of the parties to collaborate into the research of new PBS formulations and potential applications. Further, in May 2010, we have entered into a technology cooperation agreement with Sichuan University for an initial period of five years commencing on May 10, 2010 to collaborate into areas including (without limitation) PBS downstream product development, production technology support and research staff training.

As at the Latest Practicable Date, we had established a PBS research team in Zibo of Shandong province collaborating with IPCCAS and the Polymer Research Institute\* (高分子研究所) and the State Key Laboratory of Polymer Materials Engineering\* (高分子材料工程國家重點實驗室) of Sichuan University. This PBS research team is led by our chief technical officer, Dr. Zhang Aimin, a professor and doctoral member of the Polymer Research Institute (高分子研究所) and a stationed member of the State Key Laboratory of Polymer Materials Engineering (高分子材料工程國家重點實驗室) of Sichuan University. We are close to completing the construction of a 500-liter PBS laboratory facility which would be used for testing formulations for and trial production of various types of PBS and PBS copolymer downstream products. The PBS laboratory facility is scheduled to be completed by end of November 2010 and put into operation by December 2010.

It is our intention to continue to seek similar collaborations with other reputable research and academic institutes in China specializing in areas of biodegradable materials and polymers to strengthen our PBS and PBS copolymer product development and commercialization capability.

**Further improve our production process and efficiency**

One of our key advantages has been our ability to operate at high utilization rates. Our production capability helps to reduce our operating costs and increase our overall competitiveness. We intend to continue to cooperate with China's leading research institutions in the petrochemical industry, such as FRIPP and CAS, to further streamline various aspects of our production process and improve our production efficiency. We have been using the esterification catalyst developed under the collaboration between FRIPP and us, which, compared with the imported esterification catalyst, is of comparable quality but at a much lower cost and requires much less delivery time. We will continue to explore and consider alternative production inputs and process refinements that may further improve the efficiency of our production process. We also plan to explore and adopt additional energy-saving measures to improve our production efficiency. We believe that these improvements to our production process will help to further reduce our costs and increase our profitability.

**Continue to strengthen our sales and marketing efforts, particularly with regard to PBS and PBS copolymers**

We have established and maintained long-term and close relationships with our key customers by providing consistent quantity and high quality products to them. We plan to continue to strengthen our sales and marketing efforts, and our customer service, thus enhancing our market reputation and customers' loyalty. We encourage our sales and marketing personnel to participate in industry conferences and familiarize themselves with industry trends and ongoing research and development of new materials. Before we launch our new product, we research the product and its potential market thoroughly to ensure that it meets our standards of safety, quality and environmental friendliness. We plan to pay close attention to the progress of our customers' expansion plans and adjust our production accordingly so that we are well-positioned to meet the new demands from our customers.

In terms of the development of customer base for PBS and PBS copolymers currently under our product development pipeline, we have formulated a near-term market strategy to focus mainly on customers who have capabilities to use our PBS and PBS copolymers as raw materials and to produce and market the corresponding downstream PBS and PBS copolymer-based end products. We believe this direct sales model, as compared to a distributorship sales model, allows us to obtain first-hand market information directly from these customers and helps us to build long-term and close customer relationships. As at the Latest Practicable Date, we had entered into non-legally binding letters of intent, valid up to December 31, 2013, with several Independent Third Party manufacturers of medical supplies, packaging and hygienic disposables located in the Shandong province, for intended PBS and PBS copolymers orders totaling over 17,000 tons per annum, with selling prices to be fixed by agreement with reference to the then prevailing market prices. To the best knowledge of our Directors, these PRC manufacturers have identified specific targeted PBS applications, such as pre-filled syringes, blood dispensers, single-use liquid dispensers, urine collectors, drug packaging and degradable sanitary napkins. As at the Latest Practicable Date, we have been advised by IPCCAS that they have successfully developed preliminary formulations for various types of PBS downstream products for certain of our potential PBS customers, and has recommended trial production for the relevant industrial applications, which includes PBS/PLA biodegradable disposable syringes and PBS-based film. Taking into consideration the market analyses provided by Freedonia and the aforesaid PBS formulation progress by IPCCAS under our collaborative arrangements on PBS applications to be adopted by our potential PBS customers, we do not foresee any major obstacles on the commercial and technical feasibility of using PBS for these end products.

As and when our direct sales channel becomes more established in the long-term, we may consider expanding our PBS and PBS copolymer customer base to a wider range to cover reputable distributors with well-established distribution networks and channels in the biodegradable materials market of China.

We also plan to market our products by participating in various biodegradable material-related academic conferences and exhibitions, and visiting relevant industry participants.

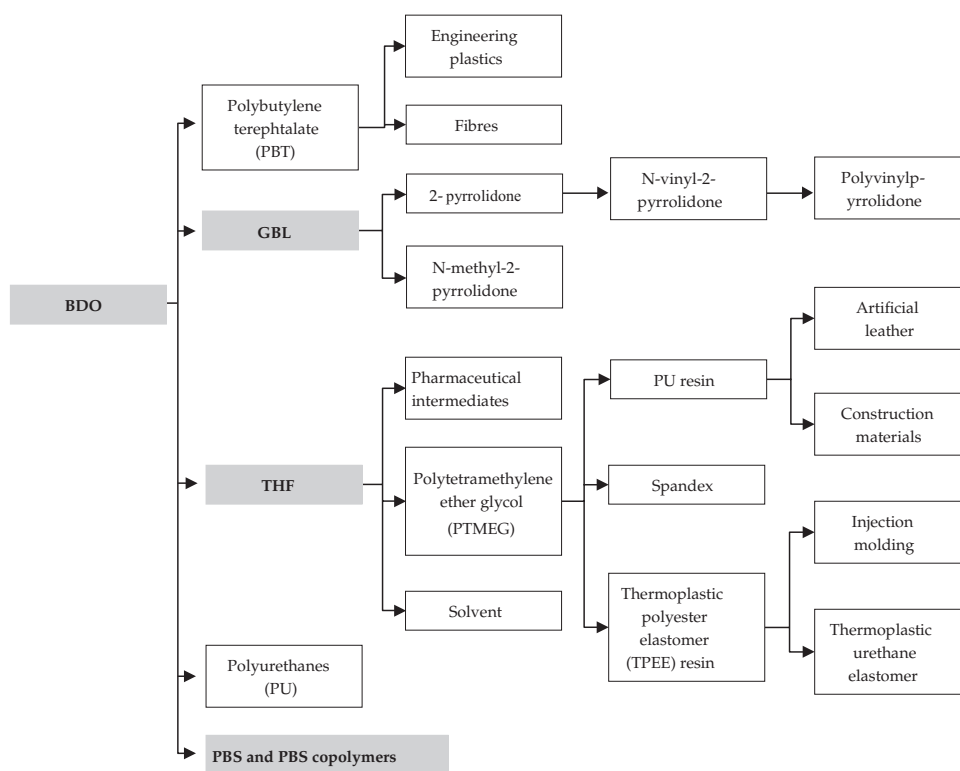
#### **Pursue strategic acquisitions and alliances**

We believe that strategic and selective acquisitions of and alliances with complementary businesses can expand our product offerings, broaden our customer base and enhance our technological expertise. We plan to selectively consider acquisitions that would complement our existing production facilities, improve our operational efficiency or strengthen our research and development capabilities. In particular, we may pursue strategic acquisitions of manufacturers of our raw materials to achieve a more integrated manufacturing process and to meet growing demand for raw materials following our production capacity expansion. As at the Latest Practicable Date, we had not yet identified any potential acquisition targets.

## OUR PRODUCTS

### Current products

We specialize in the production of BDO and its immediate downstream derivative products, GBL and THF. BDO, our primary product, is an essential chemical intermediate used in the production of high performance polymers, solvents and fine chemicals, which are widely used in the automotive, electronics, construction and apparel industries. GBL has a wide range of applications, including cosmetics, hair sprays, germicides, tablet binders and as process aids in beverage clarification. THF is mainly used as a precursor to polymers and is often used to produce PTMEG, which in turn is a reactant for making other polymers. The following chart illustrates the major derivative products of BDO.



### BDO

Our principal product is BDO, or 1,4-butanediol, an important basic organic chemical raw material and a feedstock for fine chemicals with wide industrial applications. BDO is a saturated carbon-4 straight-chain dibasic alcohol, having a molecular formula of  $C_4H_{10}O_2$ . BDO is a colorless, transparent and almost odorless viscous liquid with a freezing point of approximately 20.1°C and a boiling point of approximately 228°C. We produce BDO within a purity level between 99.57% to 99.70%, which is higher than the national standard of 99.5% established by the Organic Branch of National Chemical Standardized Technology Committee (全國化學標準化技術委員會有機分會).

At present, there are four major BDO production methods commonly employed, namely the REPPE Process, the DAVY Process, the butadiene acetoxylation process and the propylene oxide process. While the global BDO industry has been shifting away from the acetylene-based REPPE process to the other three cheaper processes (in terms of costs of principal feedstocks), according to the Huajing Report, over 80% of BDO production capacity in the world is still employing the REPPE Process while most of the newly built BDO production facilities are employing the DAVY Process.

BDO is widely used in the manufacture of solvents such as GBL and THF, our two other major products, which are co-produced with BDO under the DAVY Process. According to the Huajing Report, the immediate downstream product which accounted for the largest consumption of BDO in China is THF. It accounted for approximately 41.2% of total BDO consumption in China in 2009. BDO is also used as a feedstock in the manufacture of polymers such as polybutylene terephthalate (PBT), a plastic that is applied by the auto industry to make under bonnet parts, exterior parts and automotive headlight brackets and by electrical and electronics industries as insulator, and polyurethanes (PU), which is a versatile plastic material and is widely used in making seating foam, insulation foam, sealants, adhesives, spandex fibers and hard plastic parts. In addition, BDO is a principal feedstock in the manufacture of PBS and PBS copolymers, which are fully biodegradable macromolecular polymers synthesized from succinic acid/binary acid and BDO and are currently in our product development pipeline.

For each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, revenue derived from our sales of BDO was approximately RMB489.0 million, RMB529.5 million, RMB414.7 million and RMB209.5 million, respectively, representing approximately 55.4%, 59.9%, 55.6% and 54.6% of our total revenue for each respective period.

#### *GBL*

We also produce GBL, an immediate downstream product of BDO, as a by-product in our BDO production under the DAVY Process. GBL's chemical name is  $\gamma$ -butyrolactone, and its molecular formula is  $C_4H_6O_2$ . GBL is a colorless, transparent and oily liquid with a freezing point of approximately  $-43^{\circ}C$  and a boiling point of approximately  $201^{\circ}C$  to  $206^{\circ}C$ , with a weak odor and soluble in water. We are able to produce GBL with a purity level up to 99.5%.

GBL has a wide range of applications, including cosmetics, hair sprays, germicides, tablet binders and as process aids in beverage clarification. GBL is used for manufacturing N-methyl-2-pyrrolidone, a dipolar aprotic solvent which is used as intermediary for the synthesis of agrochemicals, pharmaceuticals, textile auxiliaries, plasticizers, stabilizers and specialty inks, and by the electronics industry for printed circuit board manufacturing. It is also used in the manufacture of 2-pyrrolidone, an intermediary product in the manufacture of polyvinylpyrrolidone, which in turn is used in the production of tablet binders, hair fixative preparations, adhesives, coating and inks, photoresist, paper, photography, textiles and fibers applications.



For each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, revenue derived from our sales of GBL was approximately RMB240.2 million, RMB244.0 million, RMB221.7 million and RMB112.9 million, respectively, representing approximately 27.2%, 27.6%, 29.7% and 29.4% of our total revenue for each respective period.

#### *THF*

THF is also an immediate downstream product of BDO and represents the most popular use for BDO. THF's chemical name is tetrahydrofuran and its molecular formula is  $C_4H_8O$ . THF is a colorless, water-miscible (i.e. able to mix and form a homogeneous solution with water) organic liquid with low viscosity at standard temperature and pressure. We produce THF as a by-product of our BDO production under the DAVY Process. Our THF has a higher purity level than the national standard of 99.8% established by the Organic Branch of National Chemical Standardized Technology Committee (全國化學標準化技術委員會有機分會) and a freezing point of no lower than  $-108.5^{\circ}C$ .

THF is mainly used as a precursor to polymers and is often used to produce PTMEG, which in turn is a reactant for making other polymers. PTMEG is used in the manufacture of castable and thermoplastic polyurethanes, thermoplastic polyester elastomers and polyurethane fibers (spandex), which are commonly found in a wide range of industrial and commercial end products from wheels, industrial tires, mining screens, industrial belts, cable jacketing, hot-melt coatings hoses, tank and pipe liners, adhesives and sealants to ski boots, transparent films for laminating, medical tubing, fabric and leather coatings and artificial leather. Due to its broad solvency for both polar and non-polar compounds, THF is used as a solvent in many pharmaceutical syntheses. In addition, THF's high volatility and purity facilitate solvent removal and recovery without leaving residuals in the products.

For each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, revenue derived from our sales of THF was approximately RMB153.4 million, RMB109.8 million, RMB108.9 million and RMB61.5 million, respectively, representing approximately 17.4%, 12.5%, 14.7% and 16.0% of our total revenue for each respective period.

#### **Products under development**

##### *PBS and PBS copolymers*

PBS, or polybutylene succinate, is a fully biodegradable macromolecular polymer synthesized from succinic acid and BDO through a process of condensation polymerization. It has a melting point of  $114^{\circ}C$  and is in solid form under room temperature. PBS is a relatively new product among the biodegradable polymers in the global market and is in a development stage. As far as we are aware, Japan, South Korea, Western Europe and the U.S. are known to have scaled commercial production capacity of PBS products.

PBS copolymers are fully biodegradable synthetic aliphatic/aromatic copolyesters synthesized from binary acid and BDO through a process of condensation polymerization. They have a melting point between 100°C and 120°C and are in solid form under room temperature.

Due to the comparatively superior characteristics in mechanical properties, processability and heat resistance, PBS and PBS copolymers can be used in a wide range of applications in various industries. The following table illustrates some of the major applications of PBS and PBS copolymers and their corresponding industries:

<b>Industry</b>	<b>Applications</b>
Packaging	Garbage bag, plastic bag, label bottle (not for water nor alcohol), foamed cushion, barrier sheet, pharmaceutical and cosmetics products packaging
Agricultural	Composite film, seed breeder, mulch films and pesticide carrier
Greenery	Lawn-planting net and vegetation cover
Fishery	Bait bag, cushioning product, net and fish line
Consumer Products	Handbag, pen, card, diaper, magnetic card and hygiene product
Food	Food and beverage packaging, container and disposable tableware
Medical	Medical container and syringe

In addition to the above applications, PBS copolymers can also be used as additive to improve the compatibility of degradable polymers (such as PLA and PHB) with other materials (such as starch), so that the toughness and processability of the mixed degradable materials will be enhanced. And since PBS copolymers can improve the compatibility of degradable polymers and other materials, the greater the demand for these polymers, the greater the demand will be for PBS copolymers.

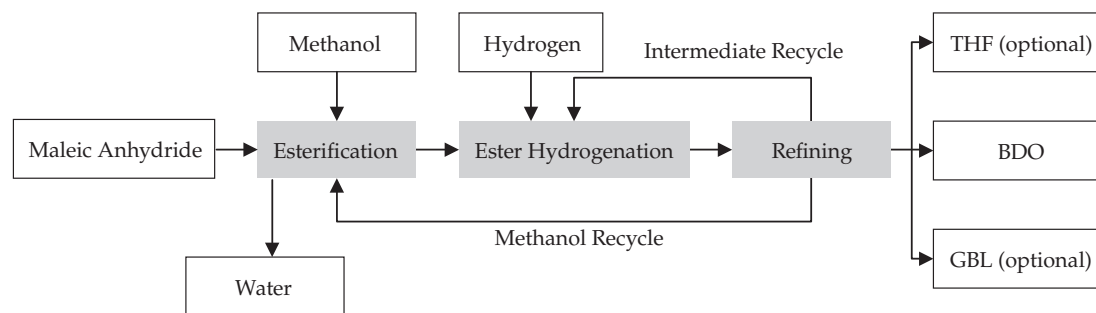
Over the past decade, the Chinese government has promulgated a number of rules and regulations to encourage the use of biodegradable packaging materials, which, along with the general public's increasing awareness of the importance of environmental protection, has contributed to the increasing demand for PBS and PBS copolymers in China. According to Freedonia, total demand for PBS and PBS copolymers in China reached approximately 5,050 tons in 2009.

## OUR PRODUCTION PROCESSES

### BDO – DAVY Process

At present, there are four major BDO production methods commonly employed, namely the REPPE Process, the DAVY Process, the butadiene acetoxylation process and the propylene oxide process. We are the first among the current BDO producers in China to employ the DAVY Process in producing BDO. The DAVY Process is a patented technology developed by DAVY Process Technology Limited, a UK company which develops and licenses advanced process technologies for oil and gas, petrochemicals, commodity chemicals and fine chemicals. It uses maleic anhydride as feedstock, which can be obtained by the oxidation of butane or benzene. The DAVY Process can produce BDO and two of its derivative products, namely GBL and THF, in adjustable ratios by varying the operating conditions and catalyst exposure. Compared to the traditional REPPE Process which is widely used among China's BDO manufacturers, the DAVY Process is considered more advantageous for reasons including: (i) the DAVY Process uses maleic anhydride as the principal raw material, which is cheaper and more readily available compared to acetylene and formaldehyde, the principal raw material used in the traditional REPPE Process; (ii) with our expertise and know-how, the DAVY Process allows us to produce high-graded BDO with a higher purity level than that generally adhered by BDO manufacturers adopting the REPPE Process; (iii) the DAVY Process is able to co-produce GBL and THF and allows us to adjust the ratio among the BDO, GBL and THF to enhance the flexibility in fulfilling the customers' orders, where such option is not available under the REPPE Process; (iv) the DAVY Process requires lower initial capital investment in production facilities than the REPPE Process; and (v) the DAVY Process is more environmentally friendly, producing lesser amount of waste by-products, and thus lowering the costs of waste disposal and environmental compliance.

The DAVY Process involves mainly three steps, namely esterification, ester hydrogenation and refining:



*Source: DAVY Process Technology Limited*

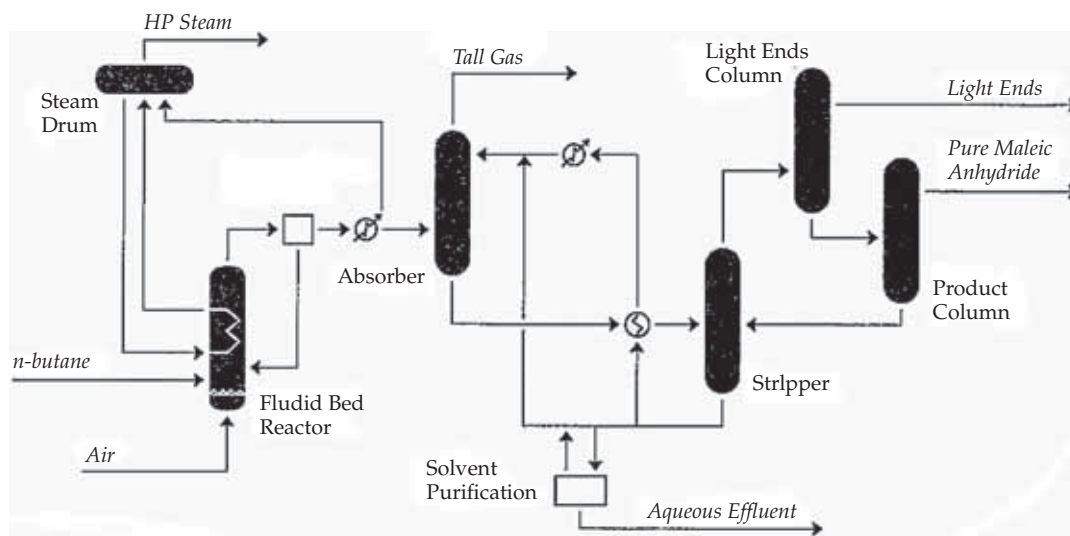
Our existing BDO production facility in Dongying, which was acquired by us from Shandong Shenming, an Independent Third Party, pursuant to an asset transfer agreement dated August 25, 2003, adopts the second-generation DAVY Process. The right to adopt this patented production technology had been granted prior to our acquisition of the production facility in August 2003. The licensing of such right was one-off in nature with no time limit and related principally to constructing the relevant production facility embedding the DAVY Process to produce BDO and its derivative products. DAVY Process Technology Limited confirmed to us that Dongying Shengli has the right to use the DAVY process embedded in our BDO production facility and to carry out technological upgrade and capacity expansion on that production facility when necessary.

In facilitation of the construction of our new 55,000 tpa BDO production facility in our new Zibo production base (which as at the Latest Practicable Date was under construction), we entered into a license agreement on June 14, 2008 with DAVY Process Technology Limited pursuant to which we have been licensed to construct our Zibo BDO production facility and produce BDO and its derivative products employing the fourth-generation DAVY Process, at a consideration determined after arm's length negotiation between the parties. The licensing of such right was one-off in nature with no time limit, and related principally to constructing the relevant production facility embedding the DAVY Process to produce BDO and its derivative products. Compared with the second-generation, the fourth-generation DAVY Process is expected to be more efficient, safer and more environmentally-friendly. It is also expected that the fourth-generation DAVY Process will consume less energy and require smaller amounts of catalysts for producing the same amount of BDO compared with the second-generation DAVY Process. In addition, the fourth-generation DAVY Process is expected to be able to produce BDO with a purity level of 99.8%.

#### **Maleic Anhydride – ALMA Process**

Maleic anhydride is the principal raw material used in BDO production. It can be produced either from benzene or n-butane. Compared to benzene-based maleic anhydride, maleic anhydride produced using n-butane has a higher purity and lower sulfur content. During the Track Record Period and up to the Latest Practicable Date, we purchased benzene-based maleic anhydride from independent suppliers. In December 2009, we commenced in-house production of n-butane based maleic anhydride under the maleic anhydride production facility which we acquired from an Independent Third Party in August 2007. This maleic anhydride production facility is located in Dongying, Shandong province adjacent to our Dongying BDO production facility and employs the ALMA Process for the production of n-butane based maleic anhydride. The ALMA Process is a proprietary process jointly developed by ABB Lummus Crest Inc. (now Lummus Technology under Chicago Bridge and Iron Company NV, a global specialty engineering and construction company) and Alusuisse Italia SpA (a subsidiary of Alusuisse Group AG, a Switzerland company that was acquired by Alcan Inc. (now Rinto Tinto Alcan Inc.) in 2000).

The following flowchart highlights the production process of maleic anhydride under the ALMA Process:



Under the ALMA Process, the n-butane and air are fed separately into a fluid-bed catalytic reactor to produce maleic anhydride. The exothermic heat of reaction is removed by generating high pressure steam. After cyclone separation of the elutriated solids, the reactor effluent is cooled, filtered and fed to the absorber. In the absorber, a proprietary, patented solvent is used to selectively remove maleic anhydride from the cooled reactor effluent. The off gas is exhausted to an incinerator for recovery of its heating value. The bottoms are fed to the stripper where crude maleic anhydride is separated as distillate from re-circulated solvent.

The crude maleic anhydride is fed to the light ends column where a small quantity of by-product light ends is separated as distillate and is sent to the incinerator. The bottoms are fed to the product column where maleic anhydride product is recovered as distillate and the bottoms are recycled back to the stripper.

A small slipstream of the circulating solvent is purified to remove solvent degradation products in order to prevent the build up of impurities in the solvent recycle loop. The absorber offgas is combined with the light ends column distillate and vacuum system exhausts and fed to the incinerator, where unreacted butanes and reaction by-products (carbon monoxide, acetic and acrylic acids) are combusted. The waste heat is recovered as high pressure steam, which is combined with the steam from the reactor and superheated. A portion of this steam can be used to drive the air compressor, with the excess exported or used to generate electric power.

The right to adopt the patented ALMA Process in our maleic anhydride production facility, which was acquired by us from Shandong Jiatai, a then 97.56% owned subsidiary of Shandong Shengming and Independent Third Party, pursuant to an asset transfer agreement dated December 29, 2006, had been granted prior to our acquisition and taking over of the production facility in August 2007. The licensing of such right was one-off in nature with no time limit and related principally to constructing the relevant production

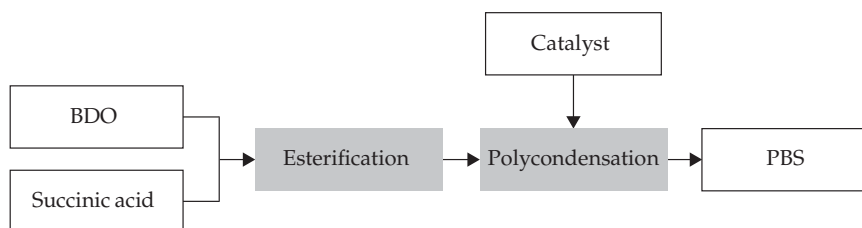


facility embedding the ALMA Process to produce maleic anhydride. ABB Lummus confirmed to us that Dongying Shengli is entitled to use and continue to use the technical information and patent rights relating to the utilization of the ALMA Process embedded in our maleic anhydride production facility.

### Production Process of PBS and PBS Copolymers

To the best of our Directors' knowledge, high molecular weight PBS is generally produced from BDO and succinic acid (丁二酸) in the presence of catalyst through one of the two production methods: the chain extension process (擴鏈法) or the direct polycondensation process (一步法). Our PBS production facilities will adopt the IPCCAS Direct Polycondensation Process we licensed from IPCCAS. IPCCAS is established under CAS and is a conferring authority for Masters and Doctoral degrees in the fields of organic chemistry, inorganic chemistry, physical chemistry, condensed state physics, refrigeration and cryogenic engineering. Its key research areas include optical functional materials and devices, new technologies of cryogenic engineering, new synthesis technologies for green chemistry, and energy materials and new technologies. We initially engaged IPCCAS to investigate into the feasibility of constructing a 20,000 tpa PBS production facility adopting its patented IPCCAS Direct Polycondensation Process in 2008. In July 2009, we entered into a letter of intent with IPCCAS for the licensing of this patented process to construct a 20,000 tpa PBS production facility, as well as setting up a joint research laboratory to research into new PBS formulations and potential applications. Subsequently in December 2009, we entered into a formal technology licensing agreement with IPCCAS (which was supplemented by a supplemental agreement dated October 29, 2010), under which we were granted a non-exclusive license to use the relevant PBS resin polymerization technologies in our PBS production facilities and our 500-liter PBS laboratory facility adopting the IPCCAS Direct Polycondensation Process, at a consideration determined after arm's length negotiation between the parties. The licencing of such right was one-off in nature with no time limit.

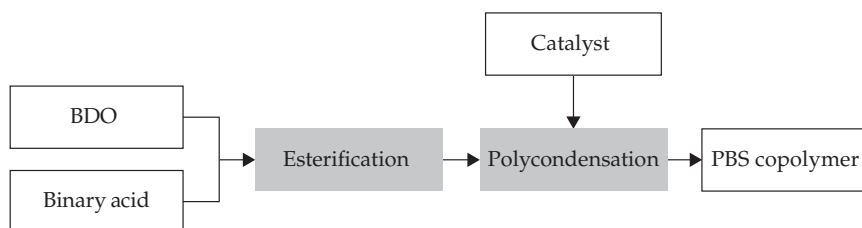
The following chart summarizes the production process of PBS using the IPCCAS Direct Polycondensation Process:



The production process of PBS copolymers intended to be adopted by us is similar to the IPCCAS Direct Polycondensation Process. PBS copolymers are produced directly from the polycondensation of BDO with different kind of binary acid using a high-efficiency catalyst for polymerization.

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The following chart sets out the production process of PBS copolymers intended to be adopted by us:



## PRODUCTION FACILITIES

### Our Existing BDO Facility

Our existing production facility is located in Dongying, Shandong province and adjacent to Sinopec Shengli, China's second largest oil field complex, which supplies to us raw materials including hydrogen and n-butane. Our existing BDO facility is situated on a parcel of land with a site area of 47,856.50 square meters, which we leased from Shengli Petroleum Administration Land Management Division (勝利石油管理局土地管理處) for a term from December 10, 2009 to December 10, 2024 for an annual rental payment of RMB150,748.

Our existing BDO production facility adopts the second-generation DAVY Process. The DAVY Process allows us to produce BDO, GBL and THF in varying ratios by varying the operating conditions and catalyst exposure. The following table sets forth our designed production capacity<sup>(1)</sup> of BDO, GBL and THF for the periods indicated, together with the respective utilization rate:

	Year ended December 31,						Five months ended	
	2007		2008		2009		May 31, 2010	
	<i>Designed</i>		<i>Designed</i>		<i>Designed</i>		<i>Designed</i>	
	<i>production</i>	<i>Utilization</i>	<i>production</i>	<i>Utilization</i>	<i>production</i>	<i>Utilization</i>	<i>production</i>	<i>Utilization</i>
	<i>capacity</i>	<i>rate</i>	<i>capacity</i>	<i>rate</i>	<i>capacity</i>	<i>rate</i>	<i>capacity</i> <sup>(3)</sup>	<i>rate</i>
	<i>(tons)</i>	<i>(%)</i>	<i>(tons)</i>	<i>(%)</i>	<i>(tons)</i>	<i>(%)</i>	<i>(tons)</i>	<i>(%)</i>
BDO	35,000	83.3	35,000	100.5 <sup>(2)</sup>	35,000	99.8	14,479	100.9%
GBL	17,000	72.3	17,000	87.7	17,000	92.6	7,033	100.3%
THF	5,000	132.1 <sup>(2)</sup>	5,000	108.9 <sup>(2)</sup>	5,000	134.0 <sup>(2)</sup>	2,068	167.3%

Notes:

- (1) calculated on the basis that our production facility is operating for 300 days per year.
- (2) the utilization rate of our production facility was over 100% mainly because (i) we utilized our production facility more than 300 days per year and (ii) we varied the operating condition in order to adjust the mix among BDO, GBL and THF; in order to meet customer orders.
- (3) calculated on a pro-rata basis making reference to the annual designed production capacity.

### **Our Maleic Anhydride Production Facility**

Our maleic anhydride production facility is located in Dongying, Shandong province. It is situated on a parcel of land adjacent to our BDO production facility with a site area of 89,730.87 square meters which we acquired in 2003 together with our BDO production facility.

Our maleic anhydride production facility, which has an initial designed production capacity of approximately 15,000 tpa, was put back into operation in December 2009 to produce n-butane based maleic anhydride for consumption in our BDO production. Since taking over the maleic anhydride production facility in August 2007 and up to September 2009, we commissioned a number of process enhancements and equipment upgrades, including replacements and additions of imported equipment, to improve production safety and enhance output efficiency of the production facility. As a result, from January to May 2010, our maleic anhydride production facility had manufactured a total of approximately 9,133 tons of maleic anhydride and achieved an average utilization rate of about 146.1% of its initial design production capacity.

### **Proposed Zibo Expansion**

Our new production base is situated on a parcel of land in the New-Hi Tech Industrial Development Zone of Zibo, Shandong Province, with a site area of approximately 229,655 square meters to house our new BDO and PBS production facilities. We acquired this parcel of land from Land and Resources Bureau on July 2, 2010 for a total consideration of approximately RMB92.0 million.

As at the Latest Practicable Date, construction of two PBS production lines with designed production capacity of 5,000 tpa and 20,000 tpa, being the first phase of our three-phase PBS production capacity expansion plan, is currently under way and is scheduled to be completed by June 2011 and September 2011, respectively. Depending on the then market response to our PBS and PBS copolymer products from our first phase of PBS production facility, we intend to commence construction of a further 50,000 tpa PBS production facility in or around early 2012. According to our preliminary construction schedule, this 50,000 tpa, second phase PBS production facility shall take about eight months to construct. Depending on the then utilization of our first and second phase of PBS production facilities, we may commence construction of a third phase PBS production facility with a designed production capacity of 50,000 tpa as early as in 2013. On the other hand, construction of our new 55,000 tpa BDO production facility with a designed BDO, GBL and THF production capacity of 46,800 tpa, 6,600 tpa and 1,700 tpa, respectively has commenced and is currently scheduled to be completed by June 2011. In addition to the above core production facilities, our Zibo production base will also house various ancillary facilities such as office buildings, staff canteen, warehouses and a waste water treatment facility.

On the basis of the information available to us so far (including contracts, agreements and contractor estimates so far provided) and based on due assessments by our senior management, it is currently estimated that total capital expenditure for completion of our Zibo production base (including construction of three phases of the PBS

## BUSINESS

production facilities and the new BDO production facility and inclusive of technology licensing fees, land use rights and other ancillary construction work) shall amount to approximately RMB1.42 billion (equivalent to approximately HK\$1.66 billion), of which approximately RMB274 million (equivalent to approximately HK\$321 million) have been incurred as at October 31, 2010 funded by internally generated funds, bank borrowings and funds from pre-IPO investments injected as registered capital. The following table summarizes the development plan and capital expenditure schedule in connection with our Zibo production base:

	Designed Production Capacity (tpa)	(Expected) commencement time	(Expected) completion time	(Estimated) Capital Expenditure (RMB million)	Payments made as at October 31, 2010 (RMB million)	Outstanding Capital Expenditure (RMB million)
Land site acquisition	N/A	Completed	Completed	93	93	0
Ancillary site work and facilities	N/A	August 2010	-	37	0	37
BDO production facilities (inclusive of any license fee)	55,000	September 2010	June 2011	560	113	447
1st phase PBS production facilities (inclusive of any license fee)	25,000	September 2010	September 2011	130	68	62
				-----	-----	-----
Subtotal:				820	274	546
2nd phase PBS production facilities (inclusive of any license fee)	50,000	Early 2012	By end of 2012	300	0	300
3rd phase PBS production facilities (inclusive of any license fee)	50,000	2013 earliest	Depending on time of commencement	300	0	300
				-----	-----	-----
Subtotal:				600	0	600
Total:				1,420	274	1,146

We plan to apply approximately HK\$635 million (equivalent to approximately RMB543 million) of net proceeds from the Global Offering to finance the outstanding capital expenditure required to complete construction of our new BDO production facility and the first phase of our PBS production facilities. As for the remaining capital expenditure requirements of RMB600 million (equivalent to approximately HK\$702 million relating to the construction of our second and third phase of PBS production facilities, it is our current intention to finance it by internal funds, bank borrowings, surplus net proceeds from the Global Offering (if any) and, if necessary, by other form of debt financing and/or equity fund raising (so far as permitted under the Listing Rules).

The project design, project size, parameters, construction schedule, budget and other factors relating to our Zibo expansion plan may differ from the descriptions contained in this prospectus. See paragraph headed “Risk factors – Risks relating to our business – Construction of our Zibo production base is subject to various risks and uncertainties” in this prospectus.

## **RAW MATERIALS, UTILITIES AND SUPPLIERS**

### **Raw materials**

Maleic anhydride, methanol and hydrogen are the principal raw materials used in our production of BDO and its derivative products. We also use n-butane as raw material for the production of maleic anhydride, which we commenced producing in-house in December 2009 to support part of our BDO production needs. Each of these raw materials is available from sources in the Shandong province, where our production facilities are located, or in nearby provinces. The geographic proximity of our production facilities to our major suppliers lowers transportation costs and reduces delivery time.

Raw materials represent a significant component of our cost of sales. Our cost of raw materials amounted to approximately RMB592.0 million, RMB593.5 million, RMB372.3 million and RMB220.1 million for each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010 accounting for approximately 85.1%, 85.3%, 76.6% and 88.4%, respectively, of our total cost of sales.

#### *Maleic anhydride*

The primary raw material for the production of BDO using the DAVY Process is maleic anhydride. During the three years ended December 31, 2007, 2008 and 2009, the maleic anhydride we required for our operations were readily available from third party suppliers at prevailing market price and principally all of the maleic anhydride used in our BDO production were purchased from third party suppliers. Since we commenced in-house production of maleic anhydride in December 2009, we successfully lessened our reliance on third party purchases. From January 2010 to May 2010, approximately 31.4% of the maleic anhydride used in our BDO production was produced internally. During the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, our cost of maleic anhydride amounted to approximately RMB531.7 million, RMB534.1 million, RMB323.8 million and RMB193.5 million, representing approximately 89.8%, 90.0%, 87.0% and 87.9% of our total cost of raw materials, respectively. During the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, our average purchase price per ton of maleic anhydride was about RMB9,367, RMB8,292, RMB4,811 and RMB6,759, respectively. As the international oil prices have increased recently, the cost of maleic anhydride is expected to increase accordingly.



### *Methanol*

Methanol is used as a raw material for BDO production. As a basic petrochemical material, methanol is readily available in the Shandong province. During the Track Record Period, we purchased all of our methanol supply from third party suppliers, and our average purchase price per ton of methanol was approximately RMB2,517, RMB2,874, RMB1,900 and RMB2,138, for each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, respectively.

### *Hydrogen*

Hydrogen is an essential raw material for BDO production. During the Track Record Period, our hydrogen was principally supplied by Sinopec Shengli. Sinopec Shengli is located adjacent to our Dongying production facility and delivers hydrogen to us via a pipeline, which represents a significant advantage to us as hydrogen is highly flammable, difficult to transport by road and costly to store in large quantities. Our average purchase price per ton of hydrogen was approximately RMB15,000, RMB15,000, RMB14,000 and RMB15,000, for each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, respectively.

As a supply backup, we also have our own hydrogen production facility in our Dongying production base, which uses methanol to produce hydrogen.

### *N-butane*

N-butane is used as raw material for our in-house production of maleic anhydride. We purchase n-butane also from Sinopec Shengli, which delivers n-butane to our production facility plant through pipelines. From January to May 2010, our average purchase price of n-butane was approximately RMB4,444 per ton.

## **Other materials, and utilities used in the production**

### *Catalysts*

Catalysts are required for all of our principal production processes, namely the DAVY Process for BDO, GBL and THF, the ALMA Process for maleic anhydride and the IPCCAS Direct Polycondensation Process for PBS and PBS copolymers.

We primarily use two kinds of catalysts in our DAVY production process, an esterification catalyst and a hydrogenation catalyst, both of which are purchased from third parties. For each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, our average purchase price of esterification catalysts per cubic meter was approximately RMB129,000, RMB135,000, RMB135,000 and RMB135,000, respectively, while our average purchase price of hydrogenation catalyst per ton was approximately RMB274,000, RMB281,000, RMB281,000 and 281,000 respectively.

We also use a specific catalyst purchased from third parties for our production of maleic anhydride, which we commenced in December 2009. We purchased 3.8 tons of specific catalyst in December 2009 and our average purchase price of this specific catalyst was approximately RMB427,000 per ton. We had not purchased any additional catalyst during the five months ended May 31, 2010.

Upon commencement of our PBS and PBS copolymer production, we intend to purchase from IPCCAS a special catalyst developed by them for use in the pre-polycondensation process under the IPCCAS Direct Polycondensation Process.

#### *Steam*

Steam is a necessary input for BDO production. We use steam to pre-heat reactors in order to facilitate the necessary chemical reactions required to produce our products. During the Track Record Period prior to commencement of our in-house maleic anhydride production in December 2009, all of our steam was supplied by Sinopec Shengli via a pipeline, with an average purchase price of approximately RMB225.25, RMB225.25 and RMB225.25 per ton, respectively. Since commencement of our maleic anhydride production, the steam produced as by-product from the production process of maleic anhydride is more than able to satisfy our internal steam demand for BDO production and we sell the excess steam produced back to Sinopec Shengli.

#### *Electricity*

During the Track Record Period, our electricity is principally supplied by an electricity supplier in the Shandong province. During the Track Record Period, we have not experienced any material suspension of production at our facilities due to power shortage, and planned shutdowns are undertaken only in accordance with our annual maintenance schedule.

### **Suppliers**

Our suppliers are mostly located in the Shandong province. We typically enter into or renew supply contracts based upon an annual review of quality, pricing terms and our projected demand for the coming year. We generally enter into framework purchase agreement with Sinopec Shengli for a period of one to two years. We generally enter into framework purchase agreement with our other suppliers annually whereby the estimated quantity and quality of raw materials that we will purchase and other general terms are stipulated while the time of delivery and prices are determined on a monthly basis. These annual framework purchase agreements are entered into mainly for purpose of better securing a reliable and timely supply of large quantities of raw materials that meet our specifications. We are generally granted credit terms of up to a maximum of 90 days from our suppliers. Since 2008, we made prepayments for purchase of some of our maleic anhydride, to secure favourable price from our maleic anhydride suppliers.

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Our five largest suppliers during the Track Record Period were mostly maleic anhydride suppliers. For each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, purchases from our five largest suppliers accounted for approximately 86.4%, 84.5%, 73.0% and 82.5% of our total amount of purchases, and the largest supplier accounted for 23.4%, 20.5%, 19.9% and 32.3% of our total amount of purchases, respectively. None of our Directors, their respective associates, or to the knowledge of our Directors, shareholders who will own more than 5% of our issued share capital immediately following the Global Offering had any interests in any of our five largest suppliers during the Track Record Period.

### SALES AND MARKETING

#### Our customers

We sell our products principally to PRC manufacturers of different industries such as chemicals, pharmaceutical and industrial electronics, which are primarily located in the Eastern region of China. The following table sets out our breakdown of revenue by geographic location during the Track Record Period:

	Year ended December 31,						Five months ended	
	2007		2008		2009		May 31, 2010	
	Revenue (RMB'000)	Percentage (%)	Revenue (RMB'000)	Percentage (%)	Revenue (RMB'000)	Percentage (%)	Revenue (RMB'000)	Percentage (%)
Eastern Region <sup>(1)</sup>	703,365	79.7	717,409	81.2	615,195	82.5	312,403	81.4
Central Region <sup>(2)</sup>	89,649	10.1	74,563	8.4	44,751	6.0	28,669	7.5
Northern Region <sup>(3)</sup>	81,107	9.2	82,983	9.4	68,516	9.2	36,258	9.4
Southern Region <sup>(4)</sup>	8,150	0.9	8,343	1.0	11,275	1.5	3,647	0.9
North-eastern Region <sup>(5)</sup>	398	0.1	–	–	5,626	0.8	2,924	0.8
<b>Total</b>	<b>882,669</b>	<b>100.0</b>	<b>883,298</b>	<b>100.0</b>	<b>745,363</b>	<b>100.0</b>	<b>383,901</b>	<b>100.0</b>

*Note:*

- (1) Eastern region includes Shanghai, Jiangsu, Zhejiang, Anhui, Shandong and Jiangxi.
- (2) Central region includes Hubei, Hunan and Henan.
- (3) Northern region includes Beijing, Tianjin, Hebei and Shaanxi.
- (4) Southern region includes Fujian, Hubei, Guangdong and Hainan.
- (5) North-eastern region includes Liaoning, Jilin and Heilongjiang.

We have established and maintained long-term and close relationships with our key customers by providing consistent quantity and high quality products to them. Our customer base has been reasonably stable from year to year. We generally grant 15-30 days credit period to our long-term customers. Our ten largest customers included seven of the same companies for each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010. Sales to our five largest customers accounted for approximately 37.8%, 34.1%, 21.5% and 26.1% of our revenue while sales to our largest customer accounted for approximately 9.5%, 8.7%, 5.6% and 7.4% of our revenue,

respectively, during each of the three years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010. None of our Directors, their respective associates, or to the knowledge of our Directors, shareholders who will own more than 5% of our issued share capital immediately following the Global Offering had any interests in any of our five largest customers during the Track Record Period. We make provisions on impairment of trade receivables based on assessment of their recoverability through reviewing the aging of our receivables and settlement history of our customers. We have not made any provision for trade receivables during the Track Record Period.

We did not sell any BDO or its derivatives to any manufacturer of PBS or PBS copolymers for the Track Record Period. Additionally, during the Track Record Period, we have neither directly exported our products nor, to our knowledge, have we sold our products to customers who in turn re-sell and export our products without further processing. We believe domestic demand will be sufficient to absorb the increases to our production capacity resulting from our planned Zibo expansion based on the forecasted demand for BDO stated in the Huajing Report. However, we may eventually consider moving into the export market as our designed production capacity expands and depending on the gap between prevailing domestic and international BDO prices.

We believe that our success in developing our PBS business depends on our research, marketing and production capabilities. With the support of our PBS research team, our management team and our marketing director have been working together on PBS market researching, forecasting market demands, and sourcing and liaising with potential PBS customers. As PBS and PBS copolymers are relatively new materials, we have adopted a customer-oriented approach at this initial stage by taking the initiatives to test formulations for and carry out trial production of various types of PBS and PBS copolymers for our potential PBS customers' downstream applications. We have been working closely with our potential PBS customers to ensure that our PBS and PBS copolymers can satisfy their production needs.

In terms of the development of customer base for PBS and PBS copolymers currently under our product development pipeline, we have formulated a near-term market strategy to focus mainly on customers who are capable of producing and marketing the corresponding downstream PBS and PBS copolymer-based end products with our PBS and PBS copolymers. As these near-term targeted customers are different from customers of our existing BDO products, the introduction of PBS and PBS copolymers is also expected to broaden our overall customer-base. Moreover, we believe this direct sales model, as compared to a distributorship sales model, allows us to obtain first-hand market information directly from these customers and helps us to build long-term and close customer relationships. As at the Latest Practicable Date, we had entered into non-legally binding letters of intent, valid up to December 31, 2013, with several Independent Third Party PRC manufacturers of medical supplies, packaging and hygienic disposables for intended PBS and PBS copolymers orders totaling over 17,000 tons per annum.

## BUSINESS

### Sales and marketing

The table below sets forth, for the periods indicated, our sales revenue and the corresponding sales volume of our products.

	Year ended December 31,												Five months ended			
	2007				2008				2009				May 31, 2010			
	Revenue		Sales Volume		Revenue		Sales Volume		Revenue		Sales Volume		Revenue		Sales Volume	
	RMB'000	%	tons	%	RMB'000	%	tons	%	RMB'000	%	tons	%	RMB'000	%	tons	%
BDO	489,036	55.4	29,263	60.6	529,475	59.9	35,099	63.3	414,741	55.6	34,952	60.8	209,486	54.6	14,561	58.2
GBL	240,209	27.2	12,470	25.8	243,986	27.6	14,905	26.9	221,696	29.7	15,780	27.5	112,875	29.4	7,016	28.1
THF	153,424	17.4	6,581	13.6	109,837	12.5	5,431	9.8	108,926	14.7	6,716	11.7	61,540	16.0	3,435	13.7
Total	882,669	100.0	48,314	100.0	883,298	100.0	55,435	100.0	745,363	100.0	57,448	100.0	383,901	100.0	25,012	100.0

While timing varies based on order specifications, our orders have an approximate lead time of one to two weeks.

We enter into framework supply agreements with our regular customers setting forth product specifications, total quantity and other general terms and conditions whereas the prices of which are determined on a monthly basis. Such agreements usually have a term of one year, with orders being placed and filled pursuant to customers' periodic instructions based upon the terms in the annual framework supply agreement.

Our sales contracts typically contain provisions that require us to deliver BDO and derivative products with specific characteristics. During the Track Record Period, we have not received any material complaints from our customers regarding the quality of our products and none of our orders were rejected or resulted in returns. We generally require our customers to make payment upon delivery of products, except that for those long-term customers who place orders of substantial amounts and who have a good payment record, we normally accept deferred payment on a case-by-case basis. It is our policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis.

As at the Latest Practicable Date, our sales department consisted of 6 personnel based in a sales center in Jinan, Shandong province. Their principal responsibilities include customer relationship management, order consultation and sales coordination and control. We also promote sales through participation in trade shows, and industry conferences.



## BUSINESS

### Pricing

The following is the average selling price (net of value-added tax) of each of our products for the Track Record Period:

	Year ended December 31,			Five months ended
	2007	2008	2009	May 31, 2010
	(RMB/ton)			
BDO	16,712	15,085	11,866	14,387
GBL	19,263	16,369	14,049	16,088
THF	23,313	20,224	16,219	17,916

The selling prices of our BDO and its derivative products are primarily determined by prevailing domestic and international market prices, which, in turn, are determined by demand and supply in the domestic and international market, the prices set by our competitors and our ability to identify new markets for our products. In determining prices for individual orders, we also take into account customer specifications, lead times, transport costs and quantities ordered. Our Group's average selling prices of BDO, and its derivative products GBL and THF were in a decreasing trend from second quarter of 2007 to early 2009 for a number of reasons, including (i) the global economic downturn; (ii) the excessive price pressure resulting from the dumping behavior of BDO manufacturers in Saudi Arabia and Taiwan; (iii) the significant decrease in the price of BDO in China in 2008, from the highest at RMB23,000 per ton to the lowest at RMB9,200 per ton; and (iv) the significant decrease in our average purchase price of maleic anhydride, the primary raw material for the production of BDO, which created room for reduced BDO prices. However, since April 2009, the price of BDO in China had started to rebound as a result of the expected affirmative anti-dumping investigation results and global economic recovery. In December 2009, most of the domestic BDO manufacturers priced their BDO products at or over RMB13,500 per ton, representing an increase of 46.7% from its trough. The average market price of BDO has continued to increase in 2010 and reached RMB13,248 per ton in June 2010.

We believe that high-volume production capabilities and the superior quality and high purity of our products manufactured by the DAVY Process differentiate us from many of our domestic competitors and provide a significant competitive advantage, allowing us to sell our products at a premium. We believe that our customers prefer to purchase BDO and BDO derivative products from large-scale producers to ensure consistent quantity, high quality, stable supplies and low logistical and administrative expenses.

## COMPETITION

### BDO

Since BDO is an important basic organic chemical raw material and a feedstock for fine chemicals, its market demand is influenced by the overall development of China's economy and the chemical industry. Leveraged on the rapid development of China's chemical manufacturing industry, domestically produced BDO cannot fully satisfy China's demand despite the significant growth in BDO production in the past few years, and China remains a net importer of BDO during 2005 to 2009.

Since establishment, our BDO and derivative products have been sold domestically. As far as we are aware, there are currently nine major domestic BDO manufacturers in China with a total designed BDO production capacity of 371,000 tons in 2009. A summary of them is as follows:

<b>Company</b>	<b>Designed BDO Production Capacity in 2009 (tons)</b>	<b>Technology Employed</b>	<b>Market Share in 2009 (sales volume of BDO in the PRC market) (note 2)</b>
Shanxi Sanwei Group Co., Ltd.* (山西三維集團股份有限公司)	75,000	REPPE Process	34.2%
Xinjiang MarkorChem Co., Ltd.* (新疆美克化工有限責任公司)	60,000	REPPE Process	15.2%
Nanjing Bluestar New Chemical Materials Co., Ltd.* (南京藍星 化工新材料有限公司)	55,000	DAVY Process	9.5%
Dairen Chemical Corp.* (大連化 學工業股份有限公司)	36,000	Propylene Oxide Process	N/A
<i>Dongying Shengli A&amp;C Chemical Co., Ltd.* (東營勝利 中亞化工有限公司), a subsidiary of our Group</i>	<i>35,000</i>	<i>DAVY Process</i>	<i>16.0%</i>
Fujian Meizhou Lvjian Industry Co., Ltd.* (福建湄洲氯城工業有 限公司)	30,000 (note 1)	REPPE Process	N/A

## BUSINESS

Company	Designed BDO Production Capacity in 2009 (tons)	Technology Employed	Market Share in 2009 (sales volume of BDO in the PRC market) (note 2)
Shanxi Bidi Ouhua Chemical Co., Ltd.* (陝西比迪歐化工有限公司)	30,000 (note 1)	REPPE Process	3.5%
Sichuan Tianhua Co., Ltd.* (四川 天華股份有限公司)	25,000	REPPE Process	4.8%
Yunnan Yunwei Group Co., Ltd.* (雲南雲維集團有限公司)	25,000 (note 1)	REPPE Process	N/A

*Source: the Huajing Report*

*Note:*

- 1 Facilities were in construction or commenced trial production during the year of 2009.
- 2 Only the market share of the six largest BDO manufacturers in China in terms of sales volume is available in the Huajing report.

Our sales volume is affected by the market demand for our BDO and BDO derivative products and the production capacity of our competitors. We compete on the basis of reliable and timely production, customer service, product quality and consistency, price and our ability to fill high-volume orders.

We generally are able to market our BDO products at prices higher than the prevailing market prices in the PRC. The DAVY Process we employ for our BDO production is considered more advanced and cost efficient than the traditional REPPE Process, which to date is still widely used among China's BDO manufacturers. We believe that with our accumulated expertise and know-how in employing the DAVY Process early on for our BDO production, we are able to operate our BDO production facilities at high efficiency and produce BDO at a higher purity level than the PRC national standard. This in turn gives us the competitive advantage over our competitors and enables us to price our BDO products at a premium to the prevailing market prices. Our ability to price our BDO products at a premium to the prevailing market prices coupled with the cost efficiency of our production process enables us to achieve a higher gross profit margin than some of our competitors.

In addition to domestic BDO manufacturers, we also face significant competition from BDO producers located outside China who export their products for sale in China. In recent years, some producers from Saudi Arabia and Taiwan were dumping BDO in China and led to the decline in BDO average sales price. In response to complaints from BDO producers in China, on December 24, 2009, MOFCOM considered that BDO producers from Saudi Arabia and Taiwan had been dumping BDO in the China market which

significantly damaged the domestic BDO industry. As a result, MOFCOM imposed an anti-dumping duty at a rate of 4.5% to 13.6% on BDO imported from Saudi Arabia and Taiwan into China for a period of five years from December 25, 2009.

## **PBS**

PBS and PBS copolymers are relatively new products among the biodegradable polymers in the global market and the PBS and PBS copolymer segment in China is currently at an initial stage of development. Currently, the PRC government emphasizes the importance of environmental protection and promotes the use of biodegradable plastic materials, which we believe creates a favorable policy environment for the growth of the PBS and PBS copolymer market.

Until recently, China has been entirely reliant on foreign supplies of PBS and PBS copolymers, primarily purchased from suppliers in Japan and South Korea. According to Freedonia, total demand for PBS and PBS copolymers reached approximately 5,050 tons in China in 2009. To the best of our knowledge, we have so far identified two PBS manufacturers in China. A pharmaceutical and health care products manufacturer in Zhejiang province employs the IPCCAS Direct Polycondensation Process to produce PBS and had an annual PBS production capacity of 3,000 tons which is expected to increase to 20,000 tons in 2011. The PBS produced by this manufacturer is mainly used for onward production of its products. Another one, a succinic acid manufacturer in Anhui province, employs the chain extension process collaborated with Tsinghua University to produce PBS and had an annual production capacity of 10,000 tons which came on line in October 2009. To the best of our knowledge, we have not identified any manufacturer of PBS copolymers in China to date.

The prices of PBS and PBS copolymers in China may be determined or influenced by various factors, such as availability of other biodegradable polymers, PRC government policy on biodegradable materials, global and domestic PBS and PBS copolymer supply and demand, development of downstream BDO derivative products and applications, the prices set by our competitors and our ability to identify and develop markets for our PBS and PBS copolymer products.

As and when our PBS and PBS copolymers are launched to the market, we expect to compete with domestic PBS producers (either producing PBS using the same technology granted to us by IPCCAS or other technology developed by other research institutions in China), and overseas PBS and PBS copolymer producers, particularly in Japan and the United States, who may have a longer operating history, more experience and better marketing resources in respect of PBS and PBS copolymers than we do. We intend to produce PBS and PBS copolymers, which are biodegradable according to the international degradability standards, in particular ASTM D6400 and EN13432. Please refer to the paragraph headed “Degradability standards and certification” in the section headed “Industry Overview” in the prospectus for details of the said standards.

See section headed “Industry overview” in this prospectus for more information.

## RESEARCH AND DEVELOPMENT

We remain focused on enhancing the efficiency of our production technology, improving our product quality and conducting research on how to further vertically integrate our production chain. Over the years, our technical personnels have successfully developed and recommended various solutions to improve our BDO production process. SINOPEC Fushun Research Institute of Petroleum and Petrochemicals\* (中國石油化工有限公司撫順石油化工開發研究院) (“**FRIPP**”) and Institute of Coal Chemistry of the Chinese Academy of Sciences (中國科學院山西煤炭化學研究所) (“**ICCCAS**”), being China’s leading research institutions in the petrochemical industry, have from time to time collaborated with us and provided technical support and updates on industrial development for us to improve our production process and optimize our operational efficiency. For example, we entered into an agreement with FRIPP in November 2004 to develop an esterification catalyst for use in our BDO production facility in order to lower our production costs. Our primary responsibilities under the agreement with FRIPP include performing various tests on the quality, shelf life and other metrics of the esterification catalyst and providing feedback to FRIPP to aid their development efforts. Under the agreement, FRIPP owns the intellectual property rights of the esterification catalyst, which our Group has priority to purchase at a discounted price. Recently in January 2010, we also entered into a technology advancement design contract with ICCCAS, pursuant to which ICCCAS would provide design plans for upgrading our maleic anhydride production facility in Dongying to increase its production capacity to 20,000 tpa with purity level of 99.5% and above, and oversee the upgrade process, and our Group is primarily responsible for the financial cost of such technological advancement and upgrade.

In connection with our planned expansion into the development and production of PBS and PBS copolymers, we initially entered into a letter of intent with IPCCAS on July 27, 2009 which set out, among other things, the intention of the parties to collaborate on the research of new PBS formulations and potential applications. Subsequently in December 2009, we entered into a formal technology licensing agreement with IPCCAS (which supplemented by a supplemental agreement dated October 29, 2010), under which we were granted a non-exclusive license to use the relevant PBS resin polymerization technologies in our PBS production facilities and a 500-liter PBS laboratory facility adopting the IPCCAS Direct Polycondensation Process. As at the Latest Practicable Date, we have been advised by IPCCAS that they have successfully developed preliminary formulations for various types of PBS downstream products for certain of our potential PBS customers who are PRC manufacturers of medical supplies, packaging and hygienic disposables, and has recommended trial production for the relevant industrial applications, which includes PBS/PLA biodegradable disposable syringes and PBS-based film.

We also entered into a technology cooperation agreement with Sichuan University for an initial period of five years commencing on May 10, 2010, pursuant to which both the Polymer Research Institute (高分子研究所) and the State Key Laboratory of Polymer Materials Engineering (高分子材料工程國家重點實驗室) of Sichuan University will join efforts with us in developing various PBS and PBS copolymer derivative formulations for commercial applications. Dr. Zhang Aimin, our chief technical officer, is a professor and doctoral member of the Polymer Research Institute\* (高分子研究所) and a stationed member of the State Key Laboratory of Polymer Materials Engineering\* (高分子材料工程國家重點實驗室) of Sichuan University. Under the technology cooperation agreement, Sichuan University shall work with us to develop three to five PBS and PBS copolymer formulations with potential commercial applications each year, and shall assist us in resolving any production related technical issues. Sichuan University shall also provide us with information on updated production technologies, PBS and PBS copolymer market outlooks and analyses as well as new scientific developments in the polymer field, and shall provide technical training (with a standard equivalent to its unit course passing standard) to a minimum of two of our staff per year. Our primary responsibilities under the technology cooperation agreement with Sichuan University include (1) providing financial support to Sichuan University's research and development efforts; (2) assisting in the production development process through providing trial production facilities and applying for the relevant approvals; (3) providing all necessary assistance to Sichuan University's staff on their visits to our premises, including accommodation; and (4) providing latest market information and user feedback on the prototype products developed by Sichuan University. Under this technology cooperation agreement, any intellectual property rights developed pursuant to the collaborations under this technology cooperation agreement shall be registered jointly under both parties while we shall be entitled to the exclusive right of use.

For the purpose of the above collaborations with various research institutes, we have not entered into any profit-sharing arrangement in respect thereof.

As at the Latest Practicable Date, we had 14 technical personnels with expertise in chemical or mechanical engineering to engage in research and development activities for our BDO production and related process technology refinements. On the other hand, in preparation of our planned expansion into the downstream PBS and PBS copolymers production, we have recently established a PBS research team of 5 members in Zibo collaborating with IPCCAS and the Polymer Research Institute\* (高分子研究所) and the State Key Laboratory of Polymer Materials Engineering\* (高分子材料工程國家重點實驗室) of Sichuan University. Led by Dr. Zhang Aimin, members of this research team all possess graduate or post-graduate education in the area of materials engineering, high polymers materials and chemistry and have received on-site training provided by the Polymer Research Institute\* (高分子研究所) and the State Key Laboratory of Polymer Materials Engineering\* (高分子材料工程國家重點實驗室) of Sichuan University as well as IPCCAS. This research team shall be responsible for researching into different formulations of PBS and PBS copolymers for new end-product applications, as well as technology enhancements and/or refinements on our PBS production process. To facilitate our PBS research activities, we are close to completing the construction of a 500-liter PBS laboratory facility which would be used for testing formulations for and trial production of various types of PBS and PBS copolymer downstream products. The PBS laboratory facility is scheduled to be completed by end of November 2010 and put into operation by December 2010.



## BUSINESS

We believe that our on-going research and development efforts are critical to the maintenance of our long-term competitiveness, customer loyalty and our ability to attract new customers and develop new markets. We plan to continue dedicating resources to research and development activities aiming to lower the cost of raw materials, streamline manufacturing processes, increase production capacities, and develop high value-added chemicals and advanced materials.

### QUALITY CONTROL

We have established a strict quality control system and a set of quality control standards for our existing BDO production. We have obtained ISO 9001:2008 certification for our quality control management system, evidencing our quality control system being able to meet international standards of quality assurance.

We have established our own analytical laboratory to perform quality assurance testing. Inspection and quality control is carried out by our staff during the production process, including (a) inspecting raw materials before acceptance; (b) examining product-in-process to ensure that product quality is satisfactory and consistent; and (c) conducting properties tests on finished products to determine consistency and quality. As at the Latest Practicable Date, we have not received any material complaints from our customers regarding the quality of our products.

Our quality control personnel are also responsible for ensuring that the quality of our product meets national standard where required. Our senior management team is actively involved in liaising with our quality control personnel to ensure that we adjust the quality level of our products to meet specific customer requirements. As at the Latest Practicable Date, we had 9 quality control employees.

### INTELLECTUAL PROPERTY

As at the Latest Practicable Date, we have registered two trademarks in China and one in Hong Kong. Our Dongying BDO production facility employs the patented second-generation DAVY Process developed by DAVY Process Technology Limited, which has given us consent to continue our use of the proprietary technology. Our Dongying maleic anhydride production facility employs the patented ALMA Process jointly developed by ABB Lummus Crest Inc. and Alusuisse Italia SpA, which have also given us consent to continue our use of the proprietary technology. For our new production facilities in Zibo, we have licensed the fourth-generation DAVY Process technologies from DAVY Process Technology Limited for our new BDO production facility, and have licensed from IPCCAS the IPCCAS Direct Polycondensation Process for our new PBS production facilities. See paragraphs headed “BDO – DAVY Process”, “Maleic anhydride – ALMA Process” and “Production process of PBS and PBS copolymers” under this section headed “Business” in this prospectus.

We entered into an agreement with FRIPP in November 2004 to develop an esterification catalyst for use in our BDO production facility in order to lower our production costs. Under the agreement, FRIPP owns the intellectual property rights of the esterification agent, which we have priority to purchase at a discounted price. In May

2010, we entered into a technology cooperation agreement with Sichuan University for an initial period of five years commencing on May 10, 2010, pursuant to which both the Polymer Research Institute (高分子研究所) and the State Key Laboratory of Polymer Materials Engineering (高分子材料工程國家重點實驗室) of Sichuan University will join efforts with us in developing various PBS and PBS copolymer derivative formulations for commercial applications. Under this technology cooperation agreement, any intellectual property rights developed pursuant to the collaborations under this technology cooperation agreement shall be registered jointly under both parties while we shall be entitled to the exclusive right of use.

We believe the bulk of our production expertise is in the form of process technology, manufacturing expertise and technical know-how derived from industry experience, research and development, and operating history. To protect these proprietary technologies, we rely primarily on contractual arrangements with key employees, such as our management and technical personnel. We typically enter into a standard confidentiality and non-competition agreement or include non-disclosure clauses in employment contracts with our key management and technical personnel who have access to proprietary know-how.

#### **INSURANCE COVERAGE**

We maintain insurance policies for fixed assets (including our BDO, GBL, THF and maleic anhydride production equipment) in our Dongying production facilities. We also maintain insurance policies for vehicle damages or losses, traffic accidents, and third-party liabilities for traffic accidents.

We plan to purchase insurance to cover the fixed assets to be constructed in Zibo, Shandong province. See paragraph headed “Risks relating to our business – We may incur losses resulting from operating hazards, product liability claims or business interruptions and our insurance coverage may not be sufficient to cover the risks related to our business” under the section headed “Risk factors” in this prospectus. Our Directors consider that the Group’s insurance coverage is adequate and in line with the industry norm.

We have not submitted any major claims to our insurers during the Track Record Period.

#### **PROPERTY**

Jones Lang LaSalle Sallmanns Limited, an independent valuation company, has valued our real estate property interests at approximately RMB208,948,000 as at August 31, 2010. The letter, summary of values, valuation basis and the valuation certification from Jones Lang LaSalle Sallmanns Limited in connection with its valuation are set out in Appendix IV of this prospectus.

Our PRC legal advisers have confirmed that our Group has valid title certificates for all properties owned by us.

## BUSINESS

Some of our leased properties in the PRC may be subject to legal irregularities. We have not completed the lease registration for the following leased properties in the PRC:

- office units located in close proximity with our new Zibo production base as our current PRC main administration offices;
- office units located in Jinan of Shandong province as our Group's sales representative office; and
- building located in Zibo of Shandong province currently housing our 500-liter PBS laboratory facility

referred to as properties no. 4, 5, 6 and 7 under "Property interests rented and occupied by our Group in the PRC" in our property valuation report in Appendix IV to this prospectus.

The above office units are non-production related and can be readily relocated. As to our 500-liter PBS laboratory facility, it is primarily for trial and testing purposes. We intend to relocate the said facility to our new production base in Zibo City once construction of the production base is completed. Our PRC legal advisers has advised that non-registration of leases of the above properties will not render the lease agreements invalid or affect the legality of the lease agreements under the Contract Law of the PRC (《中華人民共和國合同法》).

## ENVIRONMENTAL PROTECTION

We are subject to a variety of governmental laws and regulations on environmental protection. The major environmental regulations applicable to us are set out in the paragraph headed "Environmental regulations" under the section headed "Regulatory overview" in this prospectus. We have implemented various measures to ensure that we comply with the applicable PRC environmental protection laws and regulations. We have installed monitoring systems and various equipment in our production facilities to process and monitor the discharge of solid waste to minimize the impact on the environment. Our environmental protection department, led by Mr. Lu Wei, our executive Director and general manager of Dongying Shengli, maintains regular contact and communication with the relevant environmental protection bureau for the purpose of keeping abreast of any further development and changes in environmental laws and regulations.

Dongying Shengli has engaged a third party waste water and gas treatment company since January 2004 to process our waste water and gas generated from our Dongying operations. To ensure that the waste water and gas processed by such third-party waste water and gas treatment company complies with the relevant PRC laws and regulations, we have inspected its Pollutant Discharge Permit (《排污許可證》) and its business licence, and maintained close contact with its management. Our PRC legal advisers have advised us that if this third-party waste water and gas treatment company breaches any of the applicable rules, regulations and laws of the PRC in processing and discharge of the waste water and gas from our Group which results in damage to third parties, we may be held jointly and severally liable for civil liabilities towards such third

parties, but not for administrative liabilities towards government agencies if our Group is in compliance with the applicable rules regulations and the laws of the PRC. We completed construction of our own waste water treatment facility in our Dongying Production facility in September 2007 to process some of the waste water generated from our operations. This self-owned facility was put into trial run from December 2007 until October 2008, then tested by the Environment Monitoring Station of Dongying\* (東營市環保監察站) on October 16, 2008, and subsequently examined and accepted by the Environmental Protection Bureau of Dongying (東營市環境保護局) on March 4, 2010. With such self-owned waste water treatment facility, we ceased to process our waste water through the waste water and gas company since 2008 and we currently use solely our own waste water treatment facility to process waste water generated from our Dongying operations. We monitor the performance of our own waste water processing and discharge through random checks on the waste water discharged to ensure that such operations are in compliance with the relevant environmental laws and regulations in the PRC. In respect of our new production base in Zibo, the Environmental Protection Bureau of Zibo (淄博市環境保護局) has approved and allowed another waste water company to process waste water generated from our operation.

Pursuant to the confirmation letters issued by the Environmental Protection Bureau of Dongying (東營市環境保護局) and the Environmental Protection Bureau of Zibo (淄博市環境保護局) on August 5, 2010, each of Dongying Shengli and Full Win New Material has been in compliance with all relevant PRC environmental laws and regulations. Our Directors have confirmed that, during the Track Record Period and up to the Latest Practicable Date, (i) we had complied with applicable PRC laws and regulations on environmental protection in all material respects; (ii) we had completed environmental impact studies and obtained all the required environmental permits and approvals for our production facilities; and (iii) no environmental pollution incident was discovered and no administrative penalties was made against or imposed on us. Our PRC legal advisers have confirmed that our Group has complied with all relevant PRC environmental laws and regulations in all material respects during the Track Record Period, and has obtained the required environmental permits and approvals for its operations.

According to the Yellow River Delta Economic Zone and Efficient Eco-Development Plan (黃河三角洲高效生態經濟區發展規劃) promulgated by the PRC State Council on November 23, 2009, certain regions in the PRC are segregated as the Yellow River Delta National Nature Reserve Zone (黃河三角洲自然保護區) in which the discharge of waste water and gas is strictly prohibited. Our Directors confirm that the Group's production facility in Dongying and is not located in or near from the Yellow River Delta National Nature Reserve Zone, and that the Group has never been subject to any complaint or investigation in this regard in relation to its operation in Dongying. Our PRC legal advisers have confirmed that the measures in relation to the nature reserve zone under the Yellow River Delta Economic Zone and Efficient Eco-Development Plan are not applicable to the Group.

We spent approximately RMB204,000, RMB294,000, RMB285,000 and RMB134,000 in respect of regulatory compliance with applicable environment protection requirements in the PRC for the financial years ended December 31, 2007, 2008 and 2009 and the five months ended May 31, 2010, respectively. We expect such expenditure going forward will

increase when our new production facilities commence production. We currently do not have any specific expenditure plan in this regard. However, we will devote operating and financial resources to such compliance whenever we are required by PRC laws and regulations to do so in the future.

## **SAFETY CONTROL**

### **Our chemical products and materials**

Our business operations involve the use and production of chemicals that are potentially dangerous, including maleic anhydride, methanol, hydrogen, n-butane, BDO, GBL and THF. Mishandling of these chemicals could result in damage to, or destruction of, properties or production facilities, personal injury, environmental damage, business interruption and possible compliance and legal liability.

Maleic anhydride, the primary feedstock in the production of BDO using the DAVY Process, is toxic and flammable. The dust and steam from maleic anhydride causes irritation and inhalation of such can cause pharyngitis, laryngitis and bronchitis, accompanied by abdominal pain. Direct contact with eyes and skin can cause significant burns. Maleic anhydride is classified as dangerous chemical in China according to the Catalogue of Dangerous Chemicals (GB12268-2005) (《危險貨物品名表》(GB12268-2005) (the “Catalogue”)).

Methanol, another raw material in BDO production, is highly poisonous and may result in blindness, metabolic acidosis, or damage to the central nervous system and liver if ingested or inhaled. Methanol is classified as dangerous chemical in China according to the Catalogue.

Hydrogen is an essential raw material for our BDO production. It is a flammable, colorless, odorless, compressed gas packaged in cylinders at high pressure. It poses an immediate fire and explosive hazard when concentrations exceed 4%. It is much lighter than air and burns with an invisible flame. Hydrogen is not classified as dangerous chemical in China according to the Catalogue.

N-butane is used as raw material for the production of maleic anhydride. It is a colorless gas with no odor and is in liquid form when under pressure. Exposure to n-butane can occur through eye and skin contact and inhalation. Contact with the liquefied form of n-butane causes frostbite of the eyes or skin and exposure to very high concentration of n-butane can affect the central nervous system, causing narcosis and asphyxiation. N-butane is classified as dangerous chemical in China according to the Catalogue.

BDO is toxic and flammable, and it causes slight skin, eye and respiratory tract irritation. Oral intake of more than 25mg can cause central nervous system disturbances including decreased alertness, dizziness and respiratory depression. Currently, BDO is not classified as a dangerous chemical in China according to the Catalogue.

GBL is a strong mucous membrane irritant, as well as a mild skin irritant. GBL can penetrate the epidermis and cause rashes or eczema and it also has a slight narcotic effect. GBL overdose can cause severe sickness, coma and death. Currently, GBL is not classified as dangerous chemical in China according to the Catalogue.

THF can penetrate the skin and cause rapid dehydration. THF readily dissolves latex and is typically handled with nitrile or neoprene rubber gloves. THF is highly flammable and tends to form highly-explosive peroxides when exposed to air. THF is currently classified as dangerous chemical in China according to the Catalogue.

In China, manufacturers engaged in production of certain dangerous chemicals are required to have a Safety Production Permit. Based on a confirmation letter issued by Dongying City Safe Production Administration (東營市安全生產監督管理局) dated July 27, 2009, our maleic anhydride production complies with the relevant national safe production laws and regulations. We are not required to obtain the Safety Production Permit under PRC laws and regulations for our BDO and GBL production or for our use of methanol in our BDO production. We did not obtain the relevant Safety Production Permit for THF when we commenced production of THF in January 2007. We were not required to possess a Safety Production Permit to engage in the trial production from January to June 2007, as supported by the fact that the Safety Production Administration of Dongying (東營市安全生產監督管理局) issued a confirmation letter dated August 13, 2010 confirming that, Dongying Shengli was allowed a trial production period of six months before obtaining the Safety Production Permit and the Safety Production Administration of Dongying (東營市安全生產監督管理局) would not impose any administrative penalties and fines upon Dongying Shengli during the trial production period. On June 7, 2007, we obtained our Safety Production Permit for THF, which was effective until June 6, 2010. On June 7, 2010, we renewed our Safety Production Permit for THF, which is effective until June 6, 2013. We have not in the past experienced any suspension in production of THF due to lack of any requisite license. The Safe Production Administration of Dongying (東營市安全生產監督管理局) issued a confirmation letter dated October 26, 2009 confirming that, after taking into account of the trial production application filed prior to the trial production of THF, it would not impose any fine or other administrative penalties on us for any historical failure to obtain the Safety Production Permit. Further, the Safety Production Administration of Dongying (東營市安全生產監督管理局) issued a confirmation letter dated August 5, 2010 confirming that Dongying Shanghi complies with the relevant national safety production laws and regulations, had not experienced any material accidents relating to safety production and was not subject to any fines, rectification or other penalties.

In respect of our new production base in Zibo, its construction was approved by the Safety Production Administration of Zibo (淄博市安全生產監督管理局). The Safety Production Administration of Zibo (淄博市安全生產監督管理局) issued a confirmation letter dated August 5, 2010 confirming that Full Win New Material complies with the relevant national safety production laws and regulations, had not experience any material accidents relating to safety production and was not subject to any fines, rectification or other penalties.



## **Occupational health and safety**

We are subject to the PRC laws and regulations regarding occupational health and safety. In order to ensure compliance of relevant standards under the applicable laws, we have appointed a full-time employee for the administration and monitoring of workplace safety, set up safety warning signs at the production or operational sites with substantial risk of danger or on the relevant facilities or equipment, and provide our employees with occupational safety and health education and training to enhance their awareness of safety issues. Apart from fully complying with the applicable laws, such as the “Implementation Measures for the Safety Production Permit for the Manufacturers of Dangerous Chemicals” (危險化學品生產企業安全生產許可證實施辦法) and the “Regulations on the Safety Production Permit” (安全生產許可證條例), details of which are set out in paragraph headed “Requirements on safe production” under the section headed “Regulatory overview” in this prospectus, we voluntarily adopt measures to follow the “Guidelines of Implementing the Management System of Occupational Health and Safety in Chemical Enterprises” (化工企業職業安全健康管理體系實施指南) issued by the State Administration of Work Safety. More particularly, we have (i) established an internal management mechanism with a package of policies and principles; (ii) appointed a full-time person for the administration and monitor of work safety, (iii) effect work-related injury insurance; (iv) implemented measures to prevent occupational disease, equipped our employees with requisite appliances and set up safety warning marks at the production or business operation sites that have substantial dangerous elements or on the relevant facilities or equipment; (v) formulated an emergency plan and installed our premises with rescue facilities; and (vi) provided training to our employees on accident prevention and emergency management.

Our staff are required to attend 24 to 120 hours of training before commencement of duty, depending on their level of seniority and job nature. Our training includes a three-level safety training program (factory, production unit, and small group,) skill training, and outside training. Our training covers national laws and regulations as well as standards on production safety, corporate safety production management, labour hygiene knowledge, industrial accident insurance laws, procedures on reporting occupational injury and illnesses. We also provide medical check-ups to plant employees from time to time. At individual facilities, safety measures and regular safety inspection points are imposed at all stages in the production process to minimize the possibility of work-related accidents and injuries.

We regard occupational health and safety as one of our important social responsibilities. We have maintained a good production safety track record. In accordance with government regulations, we classify our injury records into categories ranging from light injuries to fatalities. By definition, a “light injury” case is recorded when there is any incident that causes the employee to be away from work for less than 105 days. There have been no injuries in any category since the commencement of our operations.

We have complied with the relevant PRC laws and regulations on occupational health and safety in all material respects and have not experienced any material accidents or injuries during our production process during the Track Record Period.

<b>BUSINESS</b>
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## EMPLOYEES

As at the Latest Practicable Date, we had 210 employees (including personnel provided by third-party employment agency as set out below).

The following table shows a breakdown of our employees (including personnel seconded from Tianyu Petrochemical as set out below) by department and location as at the Latest Practicable Date:

### 1. Hong Kong headquarter

Department	Number of employees
Management and administration	4
Finance and accounting	3
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Sub-total	7
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### 2. Dongying and Jinan

Department	Number of employees (seconded from Tianyu Petrochemical)
Management and administration	39(2)
Production	
BDO production	32(12)
Maleic anhydride production	11(3)
Energy generation	35(2)
	<hr/>
	82
Quality control	9(3)
Maintenance	22(5)
Production Safety	2(1)
Production process technology	8(3)
Sales and marketing	6(1)
Finance and accounting	9(1)
	<hr/>
Sub-total	173(33)
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3. Zibo

Department	Number of employees
Management and administration	20
Production process technology	7
Finance and accounting	3
Sub-total	30

Dongying Shengli has, since April 2005, entered into a secondment arrangement agreement with Shengli Oilfield Tianyu Petrochemical Engineering Co., Ltd.\* (勝利油田天宇石化工程有限公司) (“**Tianyu Petrochemical**”) (which is renewed from time to time), a subsidiary of China Petroleum & Chemical Corporation Shengli Oilfield Branch\* (中國石油化工有限公司勝利油田分公司) (“**Shengli Oilfield**”) and an Independent Third Party, for secondment of certain employees to Dongying Shengli. The arrangement was mutually agreed between Shengli Oilfield and our Group primarily because during the relevant time, Shengli Oilfield was under corporate restructuring which involved, among other things, streamlining its staffing, and while our Group had agreed to take on a number of staff from Shengli Oilfield for our operations, the employees in concern did not agree to terminate their permanent employment relationships as state-employees with Shengli Oilfield. Under the then effective secondment arrangement agreement, Tianyu Petrochemical would enter into employment contracts with the relevant secondment employees, who would then be sent to work at our production facilities. Our PRC legal adviser has confirmed that the above secondment arrangement is in compliance with the applicable PRC labour laws and regulations. As confirmed by our PRC legal advisers, pursuant to the relevant PRC laws, Tianyu Petrochemical, as the employer of these employees, is under the obligation to pay social insurance and housing fund for these employees. According to the secondment agreement, we are under the contractual obligation to reimburse Tianyu Petrochemical such social insurance and housing fund paid. We have fully performed the said obligation and there has not been any disputes arisen as a result of the reimbursement arrangement since the secondment arrangement was in place and up to the Latest Practicable Date. As at the Latest Practicable Date, a total of 33 employees were under such secondment arrangement.

From time to time, we also employ temporary employees to support our production. We plan to hire additional employees for our new BDO and PBS production facilities as we expand.

We believe that we offer our employees competitive compensation packages and various training programs, and as a result we have generally been able to attract and retain qualified personnel.

We believe we maintain a good working relationship with our employees and have not experienced any material labor disputes or any difficulties in recruiting staff for our operations.

### **Welfare contributions**

Pursuant to the relevant PRC laws and regulations, we are required to pay for a portion of our employees' pension insurance, medical insurance, unemployment insurance, birth insurance, work-related injury insurance (together, "**social insurance**") and housing fund contributions. We received confirmation letters dated August 4, 2010 and August 5, 2010 from the relevant authorities confirming that each of our subsidiaries has complied with the relevant labor protection laws and regulations, and is not subject to any late payment or fine or penalties since its establishment. Due to inconsistent implementation and interpretation of the PRC laws and regulations by the relevant local authorities, during the Track Record Period, we have not fully paid, or have not been required by the relevant local authorities to fully pay, the social insurance payments for our employees, including certain temporary employees and employees under probation of Dongying Shengli and Full Win New Material who either (i) have retired prior to being employed by us; (ii) are registered as rural residents or (iii) are new joiners. As at the Latest Practicable Date, there were 22 employees of Dongying Shengli and 11 employees of Full Win New Material who fall under this category.

Also, during the Track Record Period, the social insurance and housing fund contributions of certain employees of Dongying Shengli whose permanent residence are registered in Jinan or Zibo have been arranged to be effected under social benefit accounts of Full Win New Material (our Zibo subsidiary), Shandong Quanxin Aluminum Co., Ltd.\* (山東泉信不銹鋼有限公司) (a related party company in which Mr. Zhang has an effective interest of approximately 20%) and another Independent Third Party company in Jinan. This arrangement was put in place primarily because some of our employees who are residents of Jinan and Zibo are unwilling to register their social benefit accounts in Dongying. Our PRC legal advisers have advised us that such arrangements does not fully comply with relevant PRC laws. To ensure strict compliance with the relevant PRC social insurance and housing fund laws and regulations, we have entered into labour contracts with such employees and we now pay for their social insurance and housing funds directly under our own social insurance and housing fund accounts.

Moreover, during the Track Record Period, the social insurance and housing fund contributions of certain of the employees of Dongying Shengli were made by themselves and reimbursed by us. As at the Latest Practicable Date, we have rectified this practice by effecting such funds directly under our own social insurance and housing fund accounts.

As advised by our PRC legal advisers, if the above arrangements is subsequently overruled by the relevant authorities, according to applicable PRC social insurance and housing fund laws, the responsible persons of our subsidiaries may be liable to a fine up to RMB10,000 and we, as employer who fails to report and pay social insurance contributions, may be ordered to rectify the problem and pay the contributions by a stipulated deadline. As at the Latest Practicable Date, we did not receive any order to rectify the problem or notice on payment of social insurance or housing fund contribution from the government authorities, and we undertake to pay the contributions by the stipulated deadline in case we are ordered to do so. Mr. Zhang, our Controlling Shareholder, has agreed to indemnify our Group, subject to the terms and condition of the Deed of Indemnity, in respect of any liabilities that may arise as a result of any non-compliance of social insurance and housing fund laws and regulations. Our PRC legal advisers have confirmed that as we have not received any notices from or have not been ordered by the relevant government authorities to pay any outstanding social insurance and housing fund contribution up to the Latest Practicable Date, the daily late fee payment is not applicable to our Group and our Group is not subject to any other penalties or fines as a result of the above irregularities of the Group's contribution to the social insurance and housing fund.

In view of the opinion of the Company's PRC legal advisers and given Mr. Zhang has agreed to indemnify our Group in respect of any liabilities that may arise as a result of any non-compliance of social insurance and housing fund laws and regulations, we consider that it is not necessary to make, and accordingly had not made any provision for social insurance contributions during the Track Record Period.

In case we are requested by the relevant government authorities in the PRC to pay the amounts of social insurance and housing fund contributions deemed outstanding, the maximum total amount of fund contributions payable by our Group up to May 31, 2010 is estimated to amount to approximately RMB3.5 million calculated by deducting the total amount of social insurance and housing fund contributed by us of approximately RMB4.9 million from the total maximum amount of social insurance and housing fund payable by us of approximately RMB8.4 million up to May 31, 2010.

## **LEGAL COMPLIANCE**

Our Company's PRC legal advisers have confirmed that our Group had obtained all the necessary approvals, licenses and permits from appropriate regulatory authorities in all material respects for our current business operations in the PRC.