

## BUSINESS

### OVERVIEW

Based in Shaanxi Province of the PRC, the Group is principally engaged in the production and sale of cotton yarn and grey fabric in the PRC. With production facilities located at Jing Yang County (涇陽縣) and Dali County (大荔縣) in Shaanxi Province, the Group presently has installed approximately 156,300 spindles for cotton yarn production and approximately 1,039 units of shuttle loom for grey fabrics production.

Currently the Group offers 11 types of cotton yarns and 19 types of grey fabrics to its customers. The Group's products have different applications in textile and garment products such as beddings and clothings. The existing customer group includes fabric weaving mills, dyeing factories, textile and garment manufacturers and the customer base of the Group has spread across 12 provinces and municipalities in the southern and eastern regions of the PRC including major garment and textile production bases such as Jiangsu, Zhejiang, Fujian, Guangdong and Shaanxi provinces.

Set out below is a summary of the key financial highlight of the Group during the Track Record Period:

	Year ended 31 December			CAGR
	2008	2009	2010	2008–2010
	RMB'000	RMB'000	RMB'000	%
Revenue	458,904	554,340	709,948	24.4
Gross profit	114,294	152,907	156,020	16.8
Profit for the year	75,960	98,857	97,417	13.3

As illustrated in the above table, the Group achieved a CAGR growth of approximately 24.4% in revenue for each of the three financial years ended 31 December 2010. The Directors consider that the growth is attributed to the Group's competitive strengths and its ability to capture the customers' demand by expanding its scale of operations through acquisition of certain production facilities from insolvent state-owned enterprises and construction of new production plant.

In order to capture the market demand and enjoy the benefit derived from economies of scale, with the management's extensive experience in the textile industry, the Group has acquired production facilities and factory premises of insolvent state-owned enterprises from local governments in the PRC in open tenders, which are enhanced to meet the Group's production needs. Since the commencement of insolvent in 2001, the Group has successfully acquired and enhanced production facilities of three bankrupt stated-owned cotton textile factories. The Directors consider that this expansion approach allows the acquired production facilities to start operation within a shorter time frame when compared to building a new production plant.

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To maintain the competitiveness of the Group, the Directors have put significant emphasis on product introduction and production technology development. A new production plant in Jing Yang County, Yongle Production Plant, commenced trial run in January 2010, and was in commercial-scale operation in March 2010. Yongle Production Plant is equipped with automated facilities and is capable of producing a variety of combed cotton yarn products to cater for different needs of the customers. For the year ended 31 December 2010, Yongle Production Plant generated revenue by sale of combed cotton yarn products of approximately RMB70.84 million, representing approximately 10.0% of the Group's revenue for the year.

With quality lint cotton supply from Xinjiang, the Group is able to deliver its products in good quality and at competitive pricing and develop itself as one of the key cotton textile product suppliers in the north-west region of the PRC.

### COMPETITIVE STRENGTHS

The Directors consider that the success of the Group and its potential for future growth are attributed to the following strengths:

#### **Quality lint cotton supply network**

A stable supply of lint cotton is of primary importance to the Group's business. According to the National Bureau of Statistics of China, Xinjiang is the largest cotton farming region in the PRC. Due to favourable climate conditions in the region, Xinjiang produces higher quality cotton in terms of colour and fibre length compared with the eastern region of the PRC, and is the only long-staple cotton production base in the PRC.

As the Group's operations are located in the north-west region of the PRC, the Group has established a good supplier network in Xinjiang to ensure its lint cotton supply. The Directors consider that Xinjiang's lint cotton not only provides quality assurance to the Group's products but also the availability of long staple cotton enables the Group to develop higher count combed cotton yarn products so as to enhance the Group's product offering spectrum and profitability.

During the Track Record Period, the lint cotton purchase from suppliers in Xinjiang accounted for approximately 70.7%, 65.7% and 61.0% of the total cotton purchases respectively. The Group has maintained stable trading relationships with a number of its major lint cotton suppliers. Currently, the Group has 17 lint cotton suppliers and 9 of whom have trading history of more than 5 years with the Group.

#### **Emphasis on production technology development**

In view of the ever changing development in the textile industry, the Directors recognize the importance of keeping up with production technology development.

To further enhance the Group's production capacity and product mix, it has invested in the construction of a new spinning plant equipped with automated facilities in Yongle Town. In January 2010, the Yongle Production Plant commenced trial run and is capable of producing a variety of higher count combed cotton yarn products.

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Currently, with quality long staple cotton supply from Xinjiang, the Group has set out development plan for manufacturing certain higher count cotton yarn products such as 80 counts and 120 counts combed cotton yarn in order to broaden its product offering spectrum. The Directors believe that the Group's competitiveness and profitability will be significantly enhanced if these products can be successfully launched to the market. For further details, please refer to the paragraph headed "Product Introduction" in this section.

### **Experienced management team**

The Group's management team is made up of personnel with extensive operational experience in the PRC cotton textile industry. Mr. Chen, the managing director of the Company, has more than 10 years of experience and has played an important role in the formulation of the Group's business strategy and overall supervision of daily operations. The details of their working experience are set out in the section headed "Directors, Senior Management and Employees" in this prospectus.

### **High product quality**

Currently the Group offers 11 types of cotton yarns and 19 types of grey fabrics to its customers. For cotton yarn products, the Group derived over 90% of its sales from fine-count cotton yarn products (i.e. yarn count between 29 and 58) and high count cotton yarn products (i.e. yarn count of 60 or above) during the Track Record Period. Due to their versatility, the Group's fine-count cotton yarn products can be further processed into different pure cotton and blended fabrics that are commonly used in the manufacture of different quality cotton textile products.

In addition, the Group's grey fabric products have different applications in apparels and home textile products such as bedding products and clothing fabrics.

The Directors believe that the Group's products are well received by its customers and it did not experience any return of goods during the Track Record Period.

### **Stable relationships with customers**

The target customers of the Group are mainly fabric weaving mills, dyeing factories, procurement agents, and textile and garment manufacturers. All of them are domestic customers.

The Group has maintained stable business relationships with its customers. Currently, the Group has 93 customers and 61 of whom have more than 3 years of trading history with the Group.

The Directors believe that these trading relationships are built up on, inter alia, its ability to deliver quality products and intensive customer relationship management, and the Group values these relationships as an invaluable assets for its sustainable business development.

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## PRODUCTS

The Group is principally engaged in the production and sale of cotton yarn and grey fabric and sells all its cotton yarn and grey fabric products under the “Jing He” (涇河牌) brand. Cotton yarns and grey fabrics are the basic materials manufactured in the upstream of the textile production chain and can be further used in production of garment and textile products for end use in daily life. As such, the Directors consider that the Group’s products, in particular cotton yarns, are relatively more adaptable to changes in textile and apparel production trend. Set out below are analyses of the Group’s major product categories in terms of sales amount and sales volume during the Track Record Period:

### (i) Analysis of sales amounts

	Year ended 31 December					
	2008		2009		2010	
	RMB'000	%	RMB'000	%	RMB'000	%
Cotton yarn	166,678	36.3	181,392	32.7	501,323	70.6
Grey fabric	292,226	63.7	372,948	67.3	208,625	29.4
<b>Total</b>	<b>458,904</b>	<b>100.0</b>	<b>554,340</b>	<b>100.0</b>	<b>709,948</b>	<b>100.0</b>

### (ii) Analysis of sales volume

	Year ended 31 December		
	2008	2009	2010
Cotton yarn (in tonnes)	9,046	9,465	19,474
Grey fabric (in kilometres)	65,611	93,621	56,788

### (iii) Analysis of selling price

	For the year ended 31 December		
	2008	2009	2010
Cotton yarn (RMB/tonnes)	18,425	19,165	25,743
Grey fabric (RMB/kilometres)	4.5	4.0	3.7

*Note:* Average selling prices represent the turnover for the year divided by the total sales volume for the year.

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### (iv) Product range

#### *Cotton yarn*

Set out below are analysis of revenue by major cotton yarn categories offered by the Group during the Track Record Period:

Product category	Count No.	For the year ended 31 December					
		2008		2009		2010	
		RMB'000	%	RMB'000	%	RMB'000	%
A. Carded yarns							
Medium-count yarns	19 to 28	12,362	7.4	16,582	9.1	34,807	6.9
Fine-count yarns	29 to 58	146,706	88.0	145,583	80.3	291,072	58.0
High-count yarns	60 or above	7,610	4.6	19,227	10.6	104,608	21.0
Subtotal		166,678	100.0	181,392	100.0	430,487	85.9
B. Combed yarns							
Fine-count yarns	29 to 58	—	—	—	—	68,947	13.8
High-count yarns	60 or above	—	—	—	—	1,889	0.3
Sub-total		—	—	—	—	70,836	14.1
Total		166,678	100.0	181,392	100.0	501,323	100.0

*Remark:* The fineness of different classes of cotton yarn is expressed in count number (British Standard).

The Group has been producing cotton yarn products since its commencement of business in 2001. With increasing demand in quality and variety, the Group has expanded its product range to meet different production needs of its customers. All the Group's cotton yarn products are pure cotton yarn products and can be generally classified into carded yarns and combed yarns. In general, the selling prices of cotton yarns increases with their fineness (in terms of count number) and combed yarns have a higher selling prices than carded yarns as combed yarns are more even, compact and smoother. For further details of cotton yarn production, please refer to the paragraph headed "Production Process". Currently, the Group offers 11 types of cotton yarns ranging from 21 counts to 60 counts. The Group's fine-count cotton yarn (i.e. yarn count between 29 and 58) products can be processed into different pure cotton and blended fabrics for various textile applications and it accounted for over 70% of cotton yarn sales during the Track Record Period.

The Group mainly manufactured carded cotton yarns in the past. To enhance product mix and profit margin, the Group's Yongle Production Plant began to produce combed cotton yarn products in March 2010 since its commencement of commercial operations. Currently, the Group offers 4 combed cotton yarn models to its customers, including 32 count, 40 count, 50 count and 60 count combed pure cotton yarns. The management intends to introduce more combed cotton yarn models to the market in the future. For further details of introduction of new products, please refer to paragraph headed "Product Introduction" in this section. As part of the production strategy, the Group uses own cotton yarns for grey fabric production.

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The Group's 40 count carded cotton yarn (C40s) model was awarded as Shaanxi Famous Product by the People's Government of Shaanxi Province in January 2009. For details of other achievement regarding its products and operations, please refer to the paragraph headed "Awards and Recognition" in this section.

### *Grey fabrics*

Set out below are analysis of revenue by major grey fabric categories offered by the Group during the Track Record Period:

<u>Product category</u>	<u>Tex No.</u>	<u>For the year ended 31 December</u>					
		<u>2008</u>		<u>2009</u>		<u>2010</u>	
		<u>RMB'000</u>	<u>%</u>	<u>RMB'000</u>	<u>%</u>	<u>RMB'000</u>	<u>%</u>
Medium-count fabrics	21 to 30	30,155	10.3	31,569	8.5	1,657	0.8
Fine-count fabrics	11 to 20	<u>262,071</u>	<u>89.7</u>	<u>341,379</u>	<u>91.5</u>	<u>206,968</u>	<u>99.2</u>
Total		<u>292,226</u>	<u>100.0</u>	<u>372,948</u>	<u>100.0</u>	<u>208,625</u>	<u>100.0</u>

- Remark:*
- (1) Coarse-count fabric 31 tex or above (18 count or below)
  - (2) Medium-count fabric 21 to 30 tex (19 count to 28 count)
  - (3) Fine-count fabric 11 to 20 tex (29 count to 55 count)
  - (4) The fineness of different classes of grey fabric is expressed in tex no. (International Standard) and the equivalent count number (British Standard) is included in brackets above.

The Group began to sell grey fabric products in 2006 through outsourcing of weaving work to independent third parties. The outsourcing arrangements for grey fabric production were terminated since the acquisition of production facilities of 13th Weaving Mill and Guang Hua Weaving Mill for the Group's use in 2008. With subcontracting arrangements and acquisition of said production facilities, the sales of grey fabric products accounted for a significant proportion of the Group's total revenue during the Track Record Period.

Currently, the Group mainly produces pure cotton grey fabrics and offers 19 types of grey fabric models to its customers. The Group's grey fabric products are classified in terms of count number (i.e. the average of count number of weft yarns and warp yarns in each fabric model) and the fine count fabrics accounted for approximately 90% of the grey fabric sales. The selling prices of grey fabrics are a function of the fineness (count number) of cotton yarns used, density and size of the cloth. In general, given the same count number of cotton yarn used, the higher the density and size of the cloth, the higher the selling prices. Its grey fabrics have different applications in apparels and home textile products such as bedding products and clothing fabrics.

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## SALES AND MARKETING

### Market profile

All of the Group's products are sold in the PRC and the geographical coverage spreads across 12 provinces and municipalities in the southern and eastern regions of the PRC, including major garment and textile production bases such as Jiangsu, Zhejiang, Fujian, Guangdong and Shaanxi Provinces. Set out below is a geographical analysis of the Group's turnover by provinces during the Track Record Period:

Province	Year ended 31 December					
	2008		2009		2010	
	RMB'000	%	RMB'000	%	RMB'000	%
Zhejiang	142,082	31.0	175,576	31.7	145,172	20.5
Shaanxi	142,423	31.1	151,109	27.3	100,417	14.1
Jiangsu	93,184	20.3	122,592	22.1	226,249	31.9
Fujian	29,356	6.4	36,486	6.6	84,802	11.9
Hebei	19,188	4.2	26,347	4.7	16,491	2.3
Sichuan	12,128	2.6	22,098	4.0	42,920	6.0
Chongqing	10,702	2.3	12,985	2.3	31,607	4.5
Guangdong	9,841	2.1	7,147	1.3	43,699	6.2
Other provinces	—	—	—	—	18,591	2.6
<b>Total</b>	<b>458,904</b>	<b>100.0</b>	<b>554,340</b>	<b>100.0</b>	<b>709,948</b>	<b>100.0</b>

### Customers

The target customers of the Group mainly include fabric weaving mills, dyeing factories, procurement agents, textile and garment manufacturers. Currently, all of them are domestic customers.

Set out below is a table showing the relative significance of the Group's major customer categories during the Track Record Period:

Major customer group	For the year ended 31 December					
	2008		2009		2010	
	RMB'000	%	RMB'000	%	RMB'000	%
Textile and garment manufacturers	254,898	55.5	303,659	54.8	309,541	43.6
Fabric weaving mills	102,644	22.4	124,436	22.4	252,965	35.6
Dyeing factories	80,990	17.7	102,285	18.5	90,088	12.7
Procurement agents	20,372	4.4	23,960	4.3	57,354	8.1
<b>Total</b>	<b>458,904</b>	<b>100.0</b>	<b>554,340</b>	<b>100.0</b>	<b>709,948</b>	<b>100.0</b>

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During the Track Record Period, sales to the top five customers in aggregate accounted for approximately 23.9%, 24.2% and 18.8% of the total turnover of the Group respectively. Sales to the largest customer accounted for approximately 5.5%, 5.1% and 5.1% of the total turnover of the Group for the Track Record Period respectively.

The Group maintains stable business relationships with its major customers and most of these customers, including the top five customers for the Track Record Period have more than 3 years of trading history with the Group. The Group primarily focuses on serving medium to large-sized customers with long trading history as the Directors believe that these customers usually have better credit profile and such strategy reduces the Group's effort in sales administration work.

The Directors have confirmed that as at the Latest Practicable Date, none of the Directors or their respective associates or, so far as the Directors are aware, any Shareholders who own 5% or more of the issued Shares immediately following the completion of Share Offer and the Capitalisation Issue (taking no account of any Shares which may be taken up under the Share Offer) has any interests in any of the top five customers of the Group during the Track Record Period.

During the Track Record Period and up to the Latest Practicable Date, the Group had not experienced any material adverse impact on its operations as a result of cancellation, reduction or deferral of customer orders.

### **Sales and marketing activities**

The sales and marketing activities of the Group are conducted by its centralized sales and marketing department. As at the Latest Practicable Date, this department had approximately 18 personnel and is organized into 5 marketing teams based on geographical segmentation.

Each of the sales and marketing team is responsible for customer affairs liaison, including order enquiries and handling, after sales marketing services and customer feedback, in the designated region. The Group enters into letters of intent with some of its major customers to set out the indicative level of their purchases over a short period of time, such as 3 month period. The letters of intent only give these customers a higher priority for order placement and are not legally binding on either party. Upon receipt of sales enquiries, the responsible personnel will take the initiative to coordinate with the production department to determine the production schedule and will confirm the sales orders with customers if ordered quantity and delivery schedule can be fulfilled. Since the pricing of the Group's products varies from time to time, the actual selling price will be agreed with customers in 2–6 days before the delivery of goods. In general, the Group adopts a cost plus pricing policy, details of which are set out in paragraph headed in "Pricing and credit policy" below.

The Group's sales and marketing strategy is formulated by the managing Director with assistance from personnel of the sales and marketing department and production department. In order to facilitate the planning process, the sales and marketing department collects latest market and product information through different means. The sales team occasionally visits major PRC textile wholesale markets to keep abreast of the latest developments on product trends and market conditions. For development of new customers or launch of new products, the sales team will arrange product samples for target customers' trial run in order to receive their comments on the Group's products.



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The Group also seeks customers' feedback from time to time in respect of the quality of its existing products and expectation on new products through frequent visits with its customers and other communication means such as email and telephone.

### **Pricing and credit policy**

The pricing of the Group's products is determined by the price-setting committee, which comprises management from different departments, including sales, purchase, production and finance, with reference to various factors including the prevailing prices of similar cotton yarn and fabric products, raw material costs, production overheads, market conditions and delivery schedules. The Group generally adopts a cost-plus pricing policy after taking into account of all these factors. The Directors believe that this pricing strategy provides the Group with flexibility to respond to the changing market conditions, in particular price fluctuations caused by the demand and supply situation of lint cotton from time to time. The Directors have confirmed that the Group was able to pass on the increase in material costs in procurement and production to its customers during the Track Record Period.

As all of the Group's products are sold in the PRC domestic market, all sales are dominated in Renminbi. The Group generally offers a standard credit term of not more than 90 days to its customers. The Group's finance department reviews the status of outstanding amounts due from its customers on a monthly basis. In the event any receivable is long overdue, the finance personnel will coordinate with the sales and marketing personnel to follow up with settlements. No further credit sales will be made to the relevant customer until the amount due is settled.

During the Track Record Period, the accounts receivable turnover rates (i.e. the average of beginning and closing accounts receivable balances of the year over the turnover in the relevant year) were approximately 46.2 days, 49.6 days and 55.9 days respectively.

The Group's policy regarding bad debt is to provide adequate provision for irrecoverable amounts specifically identified. During the Track Record Period, the Group had not experienced any material bad debt problems.

### **Logistics**

Delivery of the Group's products is outsourced to local logistic service providers. The sales personnel of the Group confirms the specifications and quantity of shipment with the logistic company upon completion of loading and checks with its customers for receipt.

During the Track Record Period and up to the Latest Practicable Date, the Group did not experience any material adverse impact on its operations as a result of failure to meet delivery schedules of its customers.

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## PRODUCTION

### Production facilities

Currently, the Group operates four cotton spinning/weaving plants, two of which are located at Jing Yang County (涇陽縣) and the other two at Dali County (大荔縣), and one central cotton warehouse. These plants are equipped with various spinning and/or weaving facilities ranging from blowing machines to shuttle looms. Some of the facilities, especially those installed in Yongle Production Plant, are imported from overseas and are automated production equipment.

Details of the Group's production facilities as at 31 December 2010 are summarized as follows:

	Year of completion of construction/acquisition	Location	Main products	Gross floor area (sq.m.)	Production facilities	
					Yarn (Spindles)	Grey fabric (Shuttles)
<b>A. Spinning/Weaving plants</b>						
Jing Yang Production Plant	2001	Jing Yang County	Carded cotton yarn	43,403.70	32,400	—
Dali Production Plant	2008	Dali County	Carded cotton yarn and grey fabric	43,675.11	42,500	890
Guang Hua Production Plant	2008	Dali County	Carded cotton yarn and grey fabric	37,839.04	48,700	1,410
Yongle Production Plant	2009	Jing Yang County	Combed cotton yarn	18,121.00	32,700	—
Total				143,038.85	156,300	2,300
<b>B. Cotton warehouse</b>						
Yongle warehouse	2009	Jing Yang County	Storage of lint cotton	10,586.00	N/A	N/A

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Due to the enforcement of the 2011 version of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄(2011年本)) with effect from 1 June 2011, approximately 1,261 units of the Group's loom for grey fabric production were classified as "eliminated category" machinery under the said catalog and were required to suspend from production with immediate effect.

As at the Latest Practicable Date, upon the elimination of the said weaving machinery, details of the Group's production facilities are summarized as follows:

	Year of completion of construction/ acquisition	Location	Main products	Gross floor area (sq.m.)	Production facilities	
					Yarn (Spindles)	Grey fabric (Shuttles)
<b>A. Spinning/Weaving plants</b>						
Jing Yang Production Plant	2001	Jing Yang County	Carded cotton yarn	43,403.70	32,400	—
Dali Production Plant	2008	Dali County	Carded cotton yarn and grey fabric	43,675.11	42,500	169
Guang Hua Production Plant	2008	Dali County	Carded cotton yarn and grey fabric	37,839.04	48,700	870
Yongle Production Plant	2009	Jing Yang County	Combed cotton yarn	18,121.00	32,700	—
Total				<u>143,038.85</u>	<u>156,300</u>	<u>1,039</u>
<b>B. Cotton warehouse</b>						
Yongle warehouse	2009	Jing Yang County	Storage of lint cotton	10,586.00	N/A	N/A

The table below illustrates the change in the annual production capacity of the Group in 2011 and 2012 after the elimination of the said weaving machinery and the implementation of expansion production capacity in accordance with the future plan:

	Actual annual production capacity					Estimated annual production capacity		
	As at 1 January 2011		Elimination with effect from 1 June 2011	After 1 June 2011		Phase II expansion of Yongle Production Plant (last quarter of 2012)	After last quarter of 2012	
	Yarn (Spindles)	Grey fabric (Shuttles)	Grey fabric (Shuttles)	Yarn (Spindles)	Grey fabric (Shuttles)	Yarn (Spindles)	Yarn (Spindles)	Grey fabric (Shuttles)
Jing Yang Production Plant	32,400	—	—	32,400	—	—	32,400	—
Dali Production Plant	42,500	890	721	42,500	169	—	42,500	169
Guang Hua Production Plant	48,700	1,410	540	48,700	870	—	48,700	870
Yongle Production Plant	<u>32,700</u>	<u>—</u>	<u>—</u>	<u>32,700</u>	<u>—</u>	<u>32,700</u>	<u>65,400</u>	<u>—</u>
	<u>156,300</u>	<u>2,300</u>	<u>1,261</u>	<u>156,300</u>	<u>1,039</u>	<u>32,700</u>	<u>189,000</u>	<u>1,039</u>

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For further details of the effect of the elimination of the said weaving machinery on the Group's operations, please refer to the sub-paragraph headed "the 2005 and 2011 versions of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄(2005年本及2011年本))" of this paragraph.

Currently, the Group intends to focus on expansion of cotton yarn production facilities. The Group has no plan for replacement of the eliminated grey fabric production facilities by using the net proceeds from the New Issue. For details of the Group's expansion plan on cotton yarn production facilities, please refer to the section headed "Future Plans and Use of Proceeds".

The following map sets forth the approximate geographical locations of the Group's production facilities:



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## Production volume and utilization rates

Set out below is a summary of the Group's annual production capacity, actual production volume and utilisation rate during the Track Record Period:

	Year ended 31 December		
	2008	2009	2010
<b>A. Production facilities</b>			
— Yarn (spindles)	120,800	120,800	156,300
— Fabric (looms)	2,590	2,590	2,300
<b>B. Designed annual production capacity (Note 1)</b>			
— Yarn (tonnes)	10,089	19,775	25,484
— Fabric (kilometers)	41,990	142,150	126,670
<b>C. Actual production volume</b>			
1. Self production			
— Yarn (tonnes)	7,335	18,170	23,184
— Fabric (kilometres)	16,770	93,436	56,610
2. Subcontracting			
— Yarn (tonnes)	10,056	3,967	3,711
— Fabric (kilometres)	47,075	—	—
3. Total actual production (Note 2)			
— Yarn (tonnes)	17,391	22,137	26,895
— Fabric (kilometres)	63,845	93,436	56,610
<b>D. Converted production volume (Note 3)</b>			
Self production			
— Yarn (tonnes)	7,329	18,162	23,715
— Fabric (kilometers)	16,539	84,047	45,575
<b>E. Utilisation rate (Note 4)</b>			
— Yarn	72.64%	91.84%	93.06%
— Fabric	39.39%	59.13%	35.98%

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*Notes:*

1. The annual production capacity is determined on the following assumptions:
  - (i) For cotton yarn products, all spinning facilities are assumed to produce 32 count yarn only. Since 32 count yarn is one of the major models in the Group's cotton yarn product range, it is chosen as the basis for comparison in order to simplify the conversion of yarns with different count number into one standardized yarn model as mentioned in note 4 below.
  - (ii) For grey fabric products, all weaving facilities are assumed to produce grey fabric model C 19.5/19.5 236/228 170 cm only. Since C 19.5/19.5 236/228 170 cm is one of the major models in the Group's grey fabric product range, it is chosen as the basis for comparison in order to simplify the conversion of different grey fabric model into one standardized grey fabric model as mentioned in note 4 below.
  - (iii) All spinning and weaving facilities are operated on 3-shift basis with 23.5 hours a day and 355 days per year after taking into account of maintenance schedule. This is the actual operating schedule adopted by the Group during the Track Record Period. The Group has scheduled maintenance work for production facilities on rotational basis throughout the year and thus no allowance for maintenance work is made for the above operating schedule.
  - (iv) The operators are well trained and familiar with the production process.
2. During the Track Record Period, approximately 8,569 tonnes, 12,770 tonnes and 7,086 tonnes of actual cotton yarns produced were used for the Group's production of grey fabrics.
3. The converted production volume for cotton yarns is calculated from actual production volume of different models of cotton yarn multiplying by a standard industry factor to give a 32 count yarn weight equivalent for comparison and illustrative purpose. Since different yarn models have different level of cotton consumption, the conversion of different yarn models into 32 count yarn model is to standardize all the production output to produce a more meaningful comparison.

The converted production volume for grey fabrics is calculated from actual production volume of different models of grey fabrics multiplying by a standard industry factor to give a C 19.5/19.5 236/229 170 cm fabric length equivalent for comparison and illustrative purpose. Since different grey fabric models have different level of cotton yarn consumption, the conversion of different grey fabric models into C 19.5/19.5 236/229 170 cm model is to standardize all the production output to produce a more meaningful comparison.
4. Utilisation rate is determined by dividing converted production volume at the Group's facilities (self production volume) by the annual production capacity on the assumption set out in note 1 above. For cotton yarn spinning, the utilisation rate is only calculated with reference to the production capacity of spindles installed in all spinning machines as no intermediate products such as slivers and rovings are produced for sale. For the year ended 31 December 2008, new facilities in Dali Production Plant and Guang Hua Production Plant were acquired in June and October of 2008 respectively. Thus the annual production capacity for these two plants is calculated with reference to the post acquisition period and utilization rate is determined with post acquisition production volume.
5. The subcontracting arrangements for grey fabric production were terminated in July and November 2008 following the acquisition of production facilities in Dali Production Plant and Guang Hua Production Plant as mentioned in note 4 above. The actual subcontracting volume for grey fabrics of 47,075 kilometres represented the production by subcontractors before the acquisition of such production facilities.

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As illustrated in the calculation, except for the year ended 31 December 2008, the utilization rates of cotton yarn production capacity of the Group were over 90%. The lower utilization rate in 2008 was due to lower production output during the handover period after the acquisition of production facilities.

Since the Group uses its own cotton yarns for production of grey fabrics, the Directors will determine the grey fabric production strategy after taking into account (i) the gross margin spread between cotton yarns and grey fabrics; (ii) the level of cotton yarn output as determined by respective production facilities; and (iii) the Group's capability to fulfill the customers' product quality requirements.

The Group's utilization rate of fabric production facilities was generally low during the Track Record Period. It increased from approximately 39.39% in 2008 to 59.13% in 2009 and then declined to 35.98% in 2010. Due to lower utilisation during the handover period after the acquisition of the production facilities in Dali Production Plant and Guang Hua Production Plant in 2008, the utilization rate for fabric production was relatively lower in 2008. As there was an increase in demand of the grey fabric of the Group in 2009, the management deliberately relocated more of the Group's production resources to grey fabrics to maximize the return for 2009. Since the last quarter of 2009, due to the decrease in demand for the Group's current grey fabric product offering and the decision of the management to have a higher proportion of cotton yarn output for sale and a lower proportion for production of grey fabrics, the utilization rate of grey fabrics was the lowest in 2010.

During the Track Record Period, the Group had not experienced any interruptions or material equipment breakdown in its production facilities which resulted in any significant impact on the Group's results of operations and financial position.

### **2005 and 2011 versions of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄(2005年及2011年本))**

Pursuant to the Tentative Regulation to Promote the Adjustment in the Structure of Industries (促進產業結構調整暫行規定) issued on 2 December 2005, "eliminated" category refers to the production technique, equipment and product: (i) not fulfilling the relevant rules and regulations of the PRC; (ii) causing significant wastage and pollution to the environment; or (iii) not complying with safety production requirements. Under the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄) (2005 version), production facilities classified as "eliminated category" in cotton textile industry (Group I(12)) include the following models of spinning machines:

- (1) Models manufactured before the establishment of the PRC;
- (2) All series 1 models;
- (3) A512 and A513 models manufactured in or prior to 1979;
- (4) B581 and B582 models for fine count yarn production; and
- (5) BC581 and BC582 models for coarse count yarn production.

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On 6 February 2010, the State Council issued the Notice of Expediting the Elimination of Backward Production Capacity (關於進一步加強淘汰落後產能工作的通知) setting out a concrete timeframe for elimination of production facilities classified as “eliminated category” in the 2005 version of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄) for various manufacturing industries including steel, non-ferrous metals, light and textile industries.

In order to ascertain the legality for continuous use of these machines in the production process, the Group has obtained two letters from Jing Yang County Bureau of Development and Reform dated 5 May 2010 and Dali County Bureau of Economic Development dated 14 July 2010 respectively confirming that all production facilities then owned by the Group had complied with the technical standards as set out in the year 2005 version of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄) and were not subject to suspension from production pursuant to the then government policies.

On 27 March 2011, the NDRC issued Order No. 9 in respect of promulgation of the 2011 version of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄(2011年本)) to replace the 2005 version, with effect from 1 June 2011.

The 2011 version of the Guiding Catalog for Adjustment in the Structure of Industries expands the scope of “eliminated category” Group I (13) for cotton textile industry as follows:

1. All “1” series cotton spinning facilities including blowing, carding, drawing, roving and spinning equipment; Series 1332 cone-winding machines; Series 1511 weaving machine; all “1” series warping and sizing equipment;
2. Spinning machine models A512 and A513;
3. Spinning machine models B581 and B582 models for fine count yarn production and models BC581 and BC582 models for coarse count yarn production.

The Directors have conducted a review of the Group’s production facilities and noted that approximately 1,261 units of loom for grey fabric production were classified as Series 1511 weaving machines as specified in item 1 above, of which approximately 721 units and 540 units were located in Dali Production Plant and Guang Hua Production Plant respectively and have been suspended from production immediately upon the 2011 version of the Guiding Catalog for Adjustment in the Structure of Industries came into effect on 1 June 2011. These weaving machines subject to elimination represented approximately 81.0% and 38.3% of the number of looms in Dali Production Plant and Guang Hua Production Plant respectively.

As at 31 May 2011, the net book value of these 1,261 units of looms amounted to approximately RMB207,000 and had been fully written off upon the new catalog came into effect.

The Directors estimate that the Group’s grey fabric production capacity will be reduced to approximately 45.2% of current level or approximately 57,216.8 kilometers in term of grey fabric model C 19.5/19.5 236/228 170 cm upon suspension of the above eliminated weaving machines.



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Apart from the above, the Group has obtained confirmation letters from Jing Yang County Bureau of Development and Reform that it does not have any other spinning and weaving equipment that falls within the scope of “eliminated category”. For further details of these confirmation letters, please refer to paragraph headed “Environmental Issue Compliance” in this section.

Due to the competition from high density grey fabric products from other manufacturers, the demand for the Group’s grey fabric products has decreased since the fourth quarter of 2009 and the Directors expect that the demand for the Group’s grey fabric products in the foreseeable future will be maintained at similar level as in the fourth quarter of 2010.

Based the Group’s record, the Group produced grey fabric products amounting to approximately 45,575 kilometers in term of grey fabric model C 19.5/19.5 236/228 170 cm in 2010.

As a result of the change in marketing strategy to focus on the sales of cotton yarn products instead of grey fabric products, the utilization rate for grey fabric in 2010 was 35.98%. Assuming the Group maintains the same production level in 2011, the utilization rate after elimination of 1,261 units of loom mentioned above is estimated to be approximately 79.7%. Hence, the Directors consider the above weaving facilities falling within the eliminated category were under-utilized and the reduced production capacity will be sufficient for current production requirement.

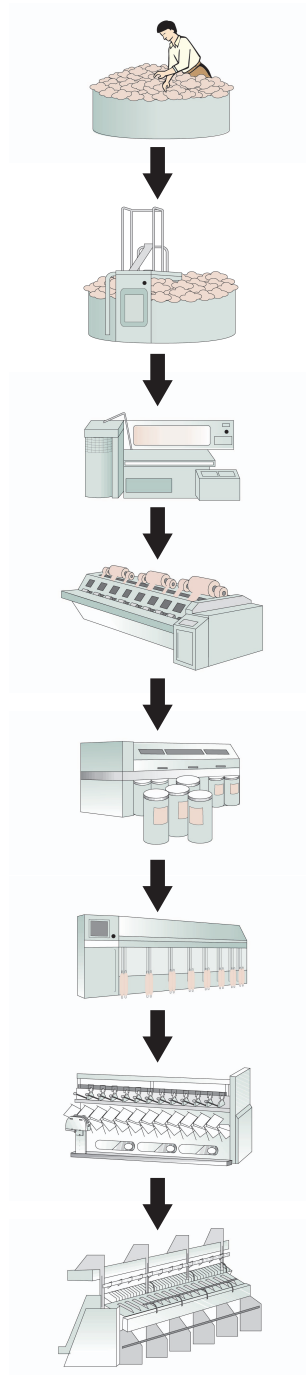
Given that (1) the reduced grey fabric production capacity is capable of maintaining the production level as in 2010 in view of the decline in demand for the Group’s grey fabric products since the last quarter of 2009; and (2) the Group will primarily focus on expansion of cotton yarn production facilities, the Directors confirm that the Group has no plan for replacement of the eliminated grey fabric machineries and do not foresee their elimination will have any material impact on the Group’s business operations and financial performance in near future.

## Production process

### 1. Cotton yarn spinning

Spinning is a sequence of processes that convert raw cotton fibres from bale into yarn suitable for use in various end products.

The following diagrams illustrate the major production procedures adopted by the Group for spinning of cotton yarn:



#### *Mixing*

Bales of different grades are selected to mix with each other to achieve desired properties such as colour and length for production of yarn with specific end use.

#### *Blowing*

Compacted layers of baled cotton are loosened and converted into small, light fluffy tufts for the removal of dirt and large foreign matter. The tufts are then arranged into thin cotton sheet for carding.

#### *Carding*

Carding performs second level (for combed cotton yarn) and final level (for carded cotton yarn) of cleaning function. The process further turns tufts of fibres into a high degree of separation or openness for removal of trash and other foreign objects and collects the clean and loosen fibres into a rope-like form called “sliver” for use in subsequent process.

#### *Combing (For combed cotton yarn only)*

Combing provides more extensive cleaning and its purpose is to remove short fibres, neps and trash from carded sliver so that the resulting (combed) sliver is more clean, lustrous and uniform in length.

#### *Drawing*

Drawing straightens and increases the parallelism of fibres by combining several sliver into one drawn sliver. Indeed, drawing also produces the sliver that is more uniform in weight per unit of length and helps to achieve greater blending capabilities.

#### *Roving*

Roving reduces the weight of the sliver to a suitable size for spinning into yarn by elongation. Twist is inserted into the fibre to maintain the integrity of draft strands (strand of cotton) to increase the parallelism of fibre for spinning.

#### *Spinning*

Spinning inserts twist and drafts the roving into yarn with desired yarn size or count number.

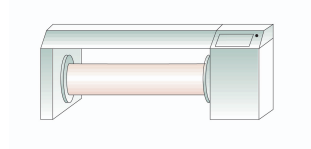
#### *Cone-winding*

Cone-winding removes impurities and defects and packs the yarns into a correct package (bobbins) for further process and transportation.

## 2. Cotton fabric (grey fabric) weaving

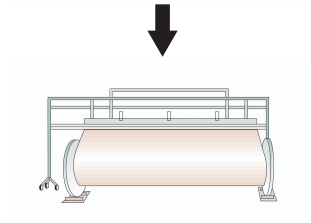
Weaving is a process in which two sets of cotton yarns are interlaced with each other to form fabric (grey fabric). One set of yarn is called warp which runs in lengthwise manner from the back to the front of the loom. The other set called weft are the filling runs into the warp in crosswise manner.

The following diagrams illustrate the major production procedures adopted by the Group for weaving of cotton fabric (grey fabric):



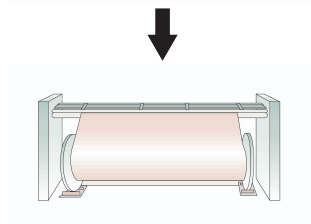
### *Warping*

Hundreds of yarns (warp) are rolled onto the warp bar (beam) of a beaming machine in a parallel manner from racks of bobbins for the preparation of sizing process.



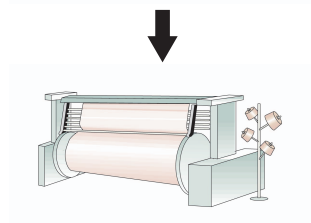
### *Sizing*

The warp is strengthened with coating called “size” with the help of slasher machine to improve weavability by reducing breakage of yarns during the weaving process.



### *Drawing-in*

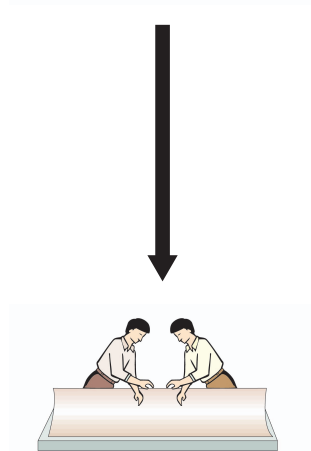
Each of the warp end is drawn separately through the opening (eye) of the heddles and dents of the reed for preparation of the weaving process.



### *Weaving*

Two sets of yarn, warp and weft, are interlaced perpendicular to each other to form the fabric in a loom with the following actions:

- (i) Shedding: Alternate warp yarns are raised to form a shed so that a carrier device (shuttle) can pass through the yarns.
- (ii) Picking: The weft yarn is inserted into the shed by the shuttle from one side of loom to the other.
- (iii) Beating up: The reed pushes (or beats) each weft yarn against the fell of the grey fabric to result in a firm and compact fabric construction.
- (iv) Taking up and letting off: The grey fabric is rolled onto (taken up) the cloth bar (beam) and the warp yarns are released from (let off) the warp beam.



### *Inspection and packaging*

The grey fabric is inspected, then mended and packed into finished products in accordance with customers' specification.

## **PROCUREMENT**

### **Purchase of lint cotton**

The principal raw material used for spinning of cotton yarn is lint cotton and the Group uses its own cotton yarn for weaving of cotton fabric. During the Track Record Period, the lint cotton cost accounted for approximately 60.3%, 65.1% and 75.3% of the total cost of production respectively.

The Group purchases all lint cotton in the PRC domestic market, mainly from Xinjiang, the largest cotton farming area in the PRC, and from Shaanxi Province.

Due to favourable climate condition in the region, Xinjiang produces higher quality lint cotton in terms of colour and fibre length compared to eastern region such as Shandong. The Directors consider the Group's use of Xinjiang's lint cotton as the principal raw material provides quality assurance in its output, which enhances the product competitiveness in the marketplace. In addition, Xinjiang is the only plantation area that grows long-staple cotton in the PRC and thus procurement from Xinjiang also facilitates the Group in development of higher count cotton yarn products. For further details of new product development, please refer to paragraph headed "Product Introduction" in this section below.

### **Suppliers**

The Group has established stable procurement relationships with its major lint cotton suppliers. Currently, the Group has approximately 17 suppliers and some of the major suppliers have trading history with the Group for over 5 years. In selecting lint cotton suppliers, the Group takes into account of, *inter alia*, (i) their scale of operations; (ii) stability of supply; (iii) price; and (iv) product quality.

During the Track Record Period, the average unit purchase costs per ton of lint cotton were approximately RMB10,773, RMB10,936 and RMB14,501 respectively. The Group did not use financial instrument to hedge the movements in cotton price movement in its daily operations as it did not have such expertise and it was able to pass on the cost to its customers. Instead, the Group controls lint cotton costs and its supply by entering into medium term supply contracts with its suppliers.

In order to enjoy more favourable purchase prices and ensure consistency in quality of supply, the Group generally makes bulk purchases from a number of major suppliers. The Group generally enters into a number of supply contracts with some of the major suppliers to set out the intended purchase quantity over a short period of time of 3 to 6 months. The prices of lint cotton will be negotiated and determined, primarily based on the quantity of supply and deposit arrangements, with reference to the then market prices. In general, an initial deposit equal to approximately the estimated sales amount for each delivery will be placed with these suppliers before delivery to ensure the Group's priority of supply and favourable price treatment. If the quality of actual delivery varies from the quality inspected at the point of entering into an individual contract, the final settlement price will be adjusted accordingly after the delivery and quality reinspection of lint cotton. The Directors have confirmed that the price adjustments were generally within 5% of the original contract prices during the Track Record Period and there was no material adverse impact on the operations of the Group. Occasionally, based on management experience, the Group will purchase more lint cotton than normal production requirements in anticipation of upward trend in lint cotton prices in order to achieve better control of production cost.

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In addition, the Group adopts cost plus pricing policy for its products and thus the Group is generally able to transfer the impact of increase in cotton prices to its customers in its daily operations. For details of the Group's pricing policy, please refer to the sub-paragraph headed "Pricing and credit policy" under the paragraph headed "Sales and marketing" above.

During the Track Record Period, the purchase from the top five suppliers in aggregate accounted for approximately 66.9%, 70.5% and 61.0% of the total cost of lint cotton purchase of the Group respectively. Purchase from the largest supplier accounted for approximately 21.2%, 18.7% and 16.7% of the total cost of purchase of the Group respectively for the same period.

During the Track Record Period and up to the Latest Practicable Date, the Group had not experienced any shortage or disruption of cotton supply. Given the availability from domestic and overseas sources, the Directors do not foresee significant difficulty in securing stable supply of good quality lint cotton. Two of the Group's production sites, Jing Yang Production Plant and Yongle Production Plant, are strategically located adjacent to the national cotton reserve bank in Shaanxi Province, which provides the Group with convenient access to valuable information about quality and quantity of state supply to facilitate the Group in making procurement decision for state's lint cotton.

Most of the Group's cotton purchase is granted with credit period of 90 days.

None of the Directors and their respective associates or, so far as the Directors are aware, any Shareholders, who own 5% or more of the issued Shares immediately following completion of the Share Offer and the Capitalisation Issue (taking no account of any Shares which may be taken up under the Share Offer) had any interests in any of the top five suppliers during the Track Record Period.

### **Supply from Weinan City Linwei District Chun Guang Cotton Company Limited**

Weinan City Linwei District Chun Guang Cotton Company Limited\* (渭南市臨渭區春光棉業有限公司) ("Chun Guang"), one of the Group's suppliers of lint cotton during the Track Record Period, has been controlled by Mr. Zhang Zemin (張澤民), an employee of the Group, since 18 June 2009. The Group ceased to purchase from Chun Guang in September 2010. The processing of lint cotton in Chun Guang mainly included seed cotton cleansing, feeding, ginning and packaging. The processes were mainly handled by machinery with the monitoring of staff. Due to its small scale operation and obsolescence of its equipment subject to elimination under current state policy mentioned below, Chun Guang ceased to process and supply any lint cotton to the Group in September 2010.

In order to ensure consistency in lint cotton quality, it is the Group's procurement practice to maintain several key suppliers in both Shaanxi Province and Xinjiang. The Group had sourced lint cotton produced in Shaanxi Province from Chun Guang since December 2005 until September 2010. During the Track Record Period, Chun Guang was a supplier and procurement agent of the Group for lint cotton in Shaanxi Province. It had about 37 staff, namely 6 permanent staff and up to approximately 31 workers during the cotton harvesting season, with annual supply ability of approximately 3,600 tonnes of lint cotton, approximately 75% of which was supplied to the Group and the remaining portion was provided to 4, 4 and 3 customers respectively during the Track Record Period. Chun Guang was equipped with 14 units/sets of machinery (including cotton seed cleansing and ginning machinery) for its production process. The sales volume of Chun Guang was approximately 3,255 tonnes, 3,588 tonnes and 3,459 tonnes during the Track Record Period. With its local network of lint cotton processing firms, Chun Guang was also able to source additional lint cotton from other suppliers beyond its production

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capacity to fulfil the Group's purchase orders. In consideration of the quality and the quantity of Chun Guang's supply that was able to meet the Group's production needs, it had become the largest supplier of the Group in Shaanxi Province over time.

The distinguishing feature of Chun Guang was that it acted both as procurement agent and supplier to the Group because a portion of its supply was processed by itself and the remaining was sourced from other suppliers. As a general procurement practice adopted for all lint cotton suppliers, the Group only imposed the quality and quantity requirements in accordance with lint cotton supply contracts with Chun Guang. As such, the obligations of Chun Guang as procurement agent and suppliers were the same from the Group's perspective as it was only concerned about the quality and quantity of supply from Chun Guang as a whole.

The Group made prepayments to Chun Guang for its supply, which prepayments were used by Chun Guang to source cotton from local farmers and other suppliers. The prepayment arrangement with Chun Guang was the same as that adopted by the Group with other key lint cotton suppliers. The prepayment is a form of initial deposit placed with these suppliers to ensure the Group's priority of supply and favourable price treatment. The lint cotton sold by Chun Guang to the Group was on normal commercial terms and at a comparable price level with other suppliers.

Chun Guang was the Group's third/fourth largest supplier during the Track Record Period, with total purchases amounting to approximately RMB25,906,000, RMB32,620,000 and RMB38,913,000 respectively, representing approximately 13%, 13% and 9% of the Group's total purchase respectively. In order to avoid any conflict of interest of Mr. Zhang Zemin that may occur in his capacity as the Group's employee on the one part and as owner of Chun Guang being a supplier of the Group on the other part, as an internal control measure, all purchases with Chun Guang were handled by the Group's purchase department and approved by Mr. Chen.

Mr. Zhang Zemin has been an employee in the administration department of the Group responsible for public relation affairs since 2002 and has become the assistant to Mr. Chen (the managing director of the Company) since 2008 responsible for the Group's public relation affairs. He is not involved in procurement or other management role of the Group. He acquired 85% equity interest in Chun Guang from three independent third parties on 18 June 2009 at a consideration of approximately RMB4.25 million as his own investment decision. The consideration was determined based on the original investment cost of the three independent third parties. Due to the pessimistic view on the future prospect of the industry at that time, the consideration was based on the original investment cost, instead of the net asset value of Chun Guang. Mr. Zhang confirmed that he arranged his financing for the acquisition with his personal savings and borrowings from his personal network independent of the Group, the Controlling Shareholders, the Directors, senior management of the Group and their associates. Chun Guang was managed by its own management team independent of the Group. The consideration of approximately RMB4.25 million was settled by Mr. Zhang in full in September 2009 and the amount raised from Mr. Zhang's personal network for settlement of consideration was settled by Mr. Zhang before the end of 2010. The beneficial owner of the balance of 15% equity interest in Chun Guang, who is an individual person, is an independent third party to the Group, its directors, senior management, Mr. Zhang and its associates.

Pursuant to the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄) (2005 version), the raw cotton processing equipment installed in Chun Chuang production site has been classified as "eliminated" category and is required to suspend from use. "Eliminated" category refers to the production technique, equipment and product: (i) not fulfilling the relevant rules and

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regulations of the PRC; (ii) causing significant wastage and pollution to the environment; or (iii) lacking of safety production requirements in accordance to the Tentative Regulation to Promote the Adjustment in the Structure of Industries (促進產業結構調整暫行規定) issued on 2 December 2005.

Pursuant to the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄) (2005 version), the cotton processing equipment classified as “eliminated” category includes:

- (1) Roller type cotton gin machine with roller length below 1,000 millimetre;
- (2) Saw tooth Cotton Gin Machine with number of saw below 80; and
- (3) Lint cotton packaging machine with pressure below 200 tonnes.

Chun Guang’s lint cotton packaging machines falls within the definition of (3) above. The Directors have confirmed that the quality of the lint cotton sourced from Chun Guang was able to meet the production needs and quality requirement of the Group. Mr. Zhang further confirms that the raw cotton processing equipment were of high energy consumption.

As advised by Mr. Zhang, although the Guiding Catalog for Adjustment in the Structure of Industries (2005 version) (產業結構調整指導目錄(2005年本)) was released in 2005, he was not aware of the Guiding Catalog for Adjustment in the Structure of Industries and its implication on Chun Guang when he made his investment decision. On 6 February 2010, the State Council issued the Notice of Expediting the Elimination of Backward Production Capacity (關於進一步加強淘汰落後產能工作的通知) setting out a concrete timeframe for elimination of production facilities classified as “eliminated category” in the Guiding Catalog for Adjustment in the Structure of Industries (2005 version) (產業結構調整指導目錄(2005年本)) for various manufacturing industries including steel, non-ferrous metals, light and textile industries. The time frame applicable for textile industry for elimination of backward production capacity is by the end of 2011. Due to strict enforcement of the said policy, Chun Guang ceased to process and supply any lint cotton to the Group in September 2010. Other major lint cotton suppliers of the Group have confirmed that no production equipment installed in their production facilities has been classified as “eliminated” category and required suspension of production. After the termination of purchase from Chun Guang, the Group was able to source lint cotton from other suppliers to maintain its production. Hence, the Directors do not foresee any significant interruption in lint cotton supply under the said state policy.

The Directors have confirmed that since the termination of procurement relationship with Chun Guang, the Group has not engaged any other procurement agent in Shaanxi Province as it has already identified another independent lint cotton supplier, Dali Yue Da Cotton Company Limited\* (大荔裕達棉業有限公司) (“Yue Da”), in the Weinan region to replace Chun Guang to secure its lint cotton supply in Shaanxi Province. None of the Group, its directors, senior management or their respective associates had any relationship with Yue Da throughout the Track Record Period.

Yue Da is a domestic cotton processing company located at Dali County, Weinan Region, the PRC with an annual production capacity of approximately 8,000 tonnes of lint cotton. The Group began its procurement of lint cotton from Yue Da in July 2010. For the year ended 31 December 2010, the total quantity of lint cotton purchased from Yue Da amounted to approximately 1,685 tonnes, representing approximately 21.06% of Yue Da’s annual production capacity. From the Group’s current list of lint cotton suppliers, including Yue Da, there are 3 suppliers located in Shaanxi Province with total annual capacity of approximately 16,000 tonnes in 2010. The 3 suppliers in Shaanxi Province supplied lint

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cotton to the Group during the Track Record Period. In view of the supply capability of other suppliers, the Directors consider that they are capable of making up the shortfall resulting from the termination of procurement relationship with Chun Guang and there is no significant impact on the Group's lint cotton supply since the termination of such relationship.

In the event that any of its suppliers is unable to supply lint cotton to the Group in future, the Group can first mitigate the interruption of supply by increasing purchase from other major suppliers to make up the shortfall. In addition, as there are a number of lint cotton suppliers in both Shaanxi Province and Xinjiang, the Directors do not foresee any significant difficulty in identifying new suppliers for replacement.

As the Group does not own raw cotton processing equipment for the processing of lint cotton, the relevant provision of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄) that affected Chun Guang does not have any impact on the Group.

Save as disclosed above, none of the Group, its Directors, its senior management and their respective associates has any relationship with Chun Guang throughout the Track Record Period.

### **Outsourcing arrangements**

In order to capture the market demand beyond the Group's then production capacity and expand the product scope, the Group entered into outsourcing arrangements with four local spinning mills, including 13th Weaving Mill and Guang Hua Weaving Mill, for production of cotton yarn and grey fabric during the Track Record Period. During such period, the outsourcing expenses accounted for approximately 27.8%, 3.0% and 2.4% of the total production cost of the Group respectively.

In June and October 2008, the production facilities of 13th Weaving Mill and Guang Hua Weaving Mill were acquired by the Group, and their respective outsourcing contracts were terminated upon completion of the acquisitions. For details of the said acquisitions, please refer to the section headed "History and Corporate Structure" in this prospectus. The other two outsourcing mills, save that Mr. Wang Cong Ying (汪聰穎), a director and the chairman of one of these outsourcing mills, was also a director of Jing Yang Golden Shield until March 2003, are independent third parties. The outsourcing contract with Mr. Wang's mill expired on 31 December 2010 and that with the other outsourcing mill will expire on 31 July 2011 respectively. Mr. Wang is not an employee of the Group. The existing outsourcing mill mainly provides cotton yarn spinning service to the Group. The Directors confirm that the key production processes of the subcontractors and the Group are similar and the Group also produces similar products as the subcontractors. The Group enters into outsourcing arrangements as its cotton yarn spinning facilities have been operating at near full capacity, and the Directors consider that outsourcing arrangements can provide additional capacity to fulfill extra orders. In addition, the outsourcing arrangement can provide some flexibility in production scheduling so that the Group's cost structure can be enhanced by concentrating on relatively high cost products and outsourcing low cost products.

The term of the existing outsourcing contract is for one year and the scope of work is the provision of spinning service for certain models of fine count carded cotton yarn at agreed price with the supply of lint cotton by the Group. The outsourcing contract can be terminated by either party by serving one month's notice.



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Given the enlarged production capacity subsequent to completion of the said acquisitions in 2008 and the commencement of trial run of Yongle Production Plant in January 2010, the Directors consider the Group's reliance on outsourcing arrangements will be greatly reduced.

### **Consumption of electricity and steam**

Stable electricity supply is essential for the Group's production. The Group also needs steady supply of steam to maintain optimum temperature and humidity for fabric weaving operation.

Electricity for the Group's production is supplied by the local power supply authority and steam is generated by boilers installed in the Group's production sites with coal purchased from independent third parties and underground water.

During the Track Record Period, the electricity charges accounted for approximately 5.5%, 17.8% and 9.4% of the total cost of production respectively and fuel costs accounted for approximately 0.2%, 0.8% and 0.3% of the total cost of production respectively.

During the Track Record Period and up to the Latest Practicable Date, the Group had not experienced any major disruption in supply of electricity and steam.

### **INVENTORY CONTROL**

The Group operates a two-tier warehouse system. At the first tier, the Group has a main lint cotton warehouse in Jing Yang County for centralized procurement and storage management capable of storing about 2,000 tonnes of lint cotton for 30 days' use. At the spinning mill level, each of the production plants has its own warehouses for temporary storage of lint cotton for scheduled production for 5 to 10 days and finished goods ready for delivery.

Stringent internal control procedures are adopted by the Group in the main lint cotton warehouse and production plant level to monitor stock conditions and discrepancy arising from physical movement of stock. These procedures include, inter alia, restricted access to designated personnel, updated records of all incoming and outgoing items and stock count procedures. According to the Group's internal control policy, stock count procedures are performed by finance staff and warehouse supervisor every month. Stock count results are reconciled with warehouse records and reviewed by the senior management.

The Group has adopted a lean production approach for its operations; most of the work-in-progress and finished goods are made in accordance with customers' orders with only a minimum level of work-in-progress and finished goods maintained. During the Track Record Period, the Group achieved an inventory turnover rate (i.e. the average inventory balance for the year end over the cost of sales in the relevant year) of approximately 34.8 days, 23.4 days and 14.4 days respectively.

During the Track Record Period, the Group's inventory comprises raw materials, work-in-progress and finished goods. As at 31 December 2008, 2009 and 2010, the Group's inventory balance represented approximately 10.1%, 4.4% and 5.2% of its total assets respectively and the inventory items mainly comprised of raw materials (mainly lint cotton bales) and finished goods (mainly cotton yarn and cotton fabric ready for delivery). As at 31 December 2008, 2009 and 2010, raw materials represented approximately 74.3%, 66.0% and 50.6% of the Group's inventory balance respectively and finished goods represented approximately 16.6%, 17.7% and 46.8% of its Group's inventory balance respectively.

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The Group had not made any provision for obsolete stock during the Track Record Period.

### QUALITY CONTROL

The Directors recognize that product quality is a key determinant of the Group's success in the marketplace. The Group has adopted both domestic and international standards as quality benchmark in its yarn and fabric production process. These applicable standards include GB/T398-2008, a PRC standard for quality of cotton yarn products, and the Uster Standards, a commonly used benchmarks for trading of textile product at assured levels of quality across the global markets. Currently, the Group's cotton yarn products are in compliance with the GB/T398-2008 and the Group is working towards attaining a even higher quality level as specified in the Uster Standards. Currently, the Group's products are not yet in compliance with the Uster Standards. The Directors expect approximately 6 months is required for the Group to adopt Uster Standards benchmarking.

In addition, in the past few years, the Group received a number of domestic and international certifications in respect of its production process and products, including ISO 9001:2008 and ISO 10012:2003. For further details of these certifications, please refer to the paragraph headed "Awards and Accreditation" in this section below.

In order to achieve the desired product quality to meet its customers' expectations, the Group has a quality control team of approximately 54 staff responsible for carrying out regular inspections on different stages of the production process. The following are key quality control measures implemented by the Group:

#### Procurement

Sample testing on lint cotton quality and supplier visits are conducted before confirmation of purchase commitment in order to ensure that the quality of supply meets the Group's production needs. Inspection work on lint cotton quantity and sample testing is carried out before receipt of goods in the warehouse.

#### Production

Technicians are responsible for supervision and monitoring of proper operation by workers and examination of the quality of work-in-progress and finished goods throughout the production process. More comprehensive testing on different product parameters are conducted in the testing laboratory in each of the production facilities and test results are recorded in the daily inspection reports to ensure that product quality complies with the production requirements.

#### Inventory management

Access to warehouse is restricted to warehouse staff only. Sufficient space is maintained between different batches of lint cotton to prevent fire and all lint cotton is placed on wooden pallet to prevent flooding of water.

### **Machinery and equipment management**

Workers are responsible for the proper functioning of machinery in different work procedures. Inspection and maintenance of machine condition are performed by engineers and technicians in accordance with the Group's maintenance and repair plan.

### **Sales and marketing**

Sales and marketing personnel are responsible for handling customers' feedbacks and after sales services.

### **Staff training and payroll system**

Operational training in respect of work safety and proper work procedures is provided to new staff. In addition, the payroll of workers is linked to their performance with respect to quality and quantity of their output as assessed by the technician and quality control staff.

## **PRODUCT INTRODUCTION**

New product introduction project is usually coordinated by the Group's quality control centre and supported by management from sales, purchase and production departments. These new products are mainly market available cotton textile product models which have not been previously commercially produced by the Group. The introduction of these new products will deploy the Group's existing production facilities and commercially available production technology and facilities. As at 31 December 2010, the quality control centre had 54 staff and is responsible for daily operational quality control aspects as well as coordination and management of new product development projects. During the course of new product introduction project, the quality control centre will conduct technical study on product quality requirements, coordinate with production department for trial run and perform sample testing with reference to applicable quality standards such as GB/T 398-2008 standard.

The Group's research and development expenses were approximately RMB0.35 million, RMB0.64 million and RMB0.90 million respectively during the Track Record Period and mainly incurred as staff costs for the quality control centre and salary of engineers of Yongle Production Plant involved in workflow design for new product production.

New product introduction project begins with information gathering from market investigation and feedback from customers. Engineers from production department will then study technical requirements to design the workflow and adjust the production parameters for new product production and the purchase department will procure the required grades of lint cotton for trial production run. During the trial production period, the quality control centre will conduct sample testing in the Group's laboratory to ensure that the quality of new products comply with the designed specifications and/or required standards. The sample products will then be sent to customers' factories for trial run. Upon receipt of customers' acceptance of product quality, the Group will place the new products in its product portfolio for future customer order.

The Group has set out a development plan for other higher count combed yarn models such as 80 counts and 120 counts and other cotton blended yarn products such as cotton/polyester yarns, cotton/rayon yarns and cotton/acrylic yarns. The Directors have confirmed that the Group intends to produce these high count yarn models in accordance with the GB/T398-2008 standard, a PRC standard for quality of cotton yarn products adopted by the Group for its current cotton yarn products and commonly

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adopted by other PRC manufacturers for cotton yarn products. The Group plans to further upgrade, modify and expand its production facilities so as to facilitate the product development program in the future. Please refer to the section headed “Future Plans and Use of Proceeds” in this prospectus for details.

### COMPETITION

The Directors consider that textile industry is highly competitive and competitions come in two dimensions. As a natural fibre producer, the Group faces competition from synthetic fibre producers such as polyester in terms of applications and prices. As a domestic cotton fibre producer, the Group faces direct competition from other local players. Nevertheless, the Directors believe that keeping abreast of the latest technology and product innovation will maintain the Group’s competitiveness in the marketplace.

Textile industry is recognized as one of the “pillar industries” in the PRC. According to the statistics published in 2009/10 China Textile Industry Development Report, the number of enterprises in cotton and chemical fibres textile sector in the PRC exceeds 11,000 units. Since the Group’s primary market and operations is in China, the management has made an enquiry to the Statistical Centre of China Textile Industry Association (中國紡織工業協會統計中心), the PRC official industry authority for collection of industry statistics and its publication, as to whether there is any official publication regarding analysis or comparison in terms of product variety, product quality, reliability of supply and prices among industry players in both PRC and overseas and noted that no such publication has been released by them.

In order to facilitate a comparison against its competitors in the dimensions mentioned above, the Group has collected a sample of publicly available information, mainly from competitors’ company websites and their disclosure materials from PRC stock exchanges and the Stock Exchange (if listed), from the PRC top 20 cotton textile companies ranked by Statistical Centre of China Textile Industry Association and other PRC listed cotton textile companies and the results are as follows:

#### Product variety

The Group currently offers 11 models of cotton yarns and 19 models of grey fabrics. From the information collected, the number of product models for cotton yarn products offered by these competitors ranges from 41 to 5,500 whereas the number of product models for grey fabric products offered by these competitors ranges from 39 to 1,000. The Directors consider that the apparent great difference in number of model offering between the Group and competitors is attributed to two factors.

First, each of the companies adopted different criteria for their model classification and thus some companies may have a finer definition for each model at their discretion. For example, a company may further classify a particular count cotton yarn, e.g. 30 count, with different grades of lint cotton used into different sub-models resulting in more choices in their product lists. On the contrary, the Group adopts a relatively simple classification and its products are only classified in terms of count number.

The second reason for the difference is that some of these competitors are actually able to offer more product choices in terms of count number and product properties such as finer yarns with count number up to 330 count, chemical fibre blended yarns and fabrics with different weaving pattern. Currently, the Group only offers pure cotton yarns with count range between 21 and 60 and pure cotton grey fabrics. While wider product choice is obviously a competitive advantage, the Directors also

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believe that there are also successful companies who compete only with niche market focus. Therefore, the competitive positioning is unique to individual case. The Directors consider that it is more important for the Group to maintain consistency in product quality and increase in number of product offering in accordance with cost efficiency.

### **Product quality**

The Directors consider that product quality standards adopted for benchmarking is based on the respective market needs. For those who target export markets, various standards are commonly adopted including Uster Statistics for yarn products, US four point system and Japanese ten points for fabric products. Since the Group's market is in the PRC, the Group benchmarks its products to GB/T 398-2008 and GB/T406-2008, applicable PRC standards for cotton yarns and grey fabrics. The Directors consider that the adoption of those PRC standards is sufficient to maintain the Group's product competitiveness in the domestic market. The Group will continue to monitor the customers' needs and adopt more stringent quality control procedures.

### **Reliability of supply**

The reliability of supply includes both qualitative and quantitative aspects. On qualitative side, it can be referred to as product quality accomplishment as mentioned in the paragraph above. On quantitative side, it can be referred to as supply ability in terms of sales volume and/or production capacity. Currently, the Group has production capacity of approximately 19,113 tonnes of cotton yarns (in term of 32 count cotton yarns) and approximately 95,000 kilometres of grey fabrics (in term of C19.5/19.5 236/228 170 cm grey fabrics). From the information collected, the scale of operations of these competitors ranges in terms of production capacity or annual sales volume from 12,000 tones to 720,000 tones for cotton yarns and from 70,000 kilometers to 1,307,000 kilometers for grey fabrics. Since the Group's scale of operations falls into the lower end of these ranges, the Directors consider the Group has room to upscale its operation to enhance its competitiveness.

### **Prices**

The product price is a function of a number of factors including nature of product, product quality, raw material price and contract volume, etc. Direct price comparison between the Group and its competitors is complicated and difficult due to two reasons. First, different companies have different product spectrum and groupings or classifications and most of them do not release detailed price information in public domain. In addition, there is no official price index or benchmark for standard cotton yarn and grey fabric products in the PRC.

As the Group's products are common textile products available in the market, the management will collect price information on similar products produced by other mills through their personal contacts for reference in the price determination exercise. Based on limited price information disclosed in the 2010 annual report of one of the cotton yarn competitors, the average percentage price difference in medium count yarn class and fine count yarn class in 2010 was approximately 11.5% and 1% respectively. Hence, the Directors believe that the Group prices similar products at a comparable level to its competitors in the PRC.

## **ENVIRONMENTAL ISSUE COMPLIANCE**

The Directors believe that the operations of the Group do not generate any pollutants which may cause any significant adverse impact on the environment. Since lint cotton is the major material used and no dyeing work is involved in the Group's production process, only minimum level of waste is generated and no sewage treatment is considered necessary.

According to confirmation letters issued by Dali County Environmental Protection Bureau dated 16 April 2010 and 10 June 2011, during the past three years, Dali Production Plant and Guang Hua Production Plant had complied with and had not violated the requirements of national and local environmental protection laws, regulations and policies.

According to confirmation letters issued by Jing Yang County Environmental Protection Bureau dated 19 April 2010 and 9 June 2011, during the past three years, Jing Yang Production Plant had complied with and had not violated the requirements of national and local environmental protection laws, regulations and policies.

According to a confirmation letter by Jing Yang County Environmental Protection Bureau dated 20 September 2010 and the confirmation letter dated 9 June 2011 mentioned above, Yongle Production Plant had complied with and had not violated the requirements of national and local environmental protection laws, regulations and policies, since its commencement of operation.

Pursuant to Environmental Protection Law of the PRC (中華人民共和國環境保護法), promulgated by the Standing Committee of the National People's Congress of the PRC on 26 December 1989, the departments of environmental protection administration of the local people's governments at or above the county level are competent authorities to conduct unified supervision and management of the environmental protection work within areas under their jurisdiction. In view of this, the Company's PRC legal advisers have confirmed that all the said environmental authorities are competent authorities to issue the confirmation letters in respect of the Group's environmental issue compliance.

The said confirmation letters confirm all the Group's production plants have complied with the national and local environmental protection laws, regulations and policies during the Track Record Period.

Pursuant to the current PRC regulations and policies, certain machinery and equipment used in the textile industry are required to be suspended from production due to high power consumption and low operational efficiency. Despite being enhanced, certain machinery of the Group acquired from the state-owned enterprises have been in use for some years. In order to ascertain the legality for continuous use of these machines in the production process, the Group has obtained two letters from Jing Yang County Bureau of Development and Reform dated 5 May 2010 and Dali County Bureau of Economic Development dated 14 July 2010 respectively confirming that all production facilities then owned by the Group had complied with the technical standards as set out in the year 2005 version of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄(2005年本)) and were not subject to suspension from production pursuant to the then government policies.

On 27 March 2011, the NDRC issued Order No. 9 in respect of promulgation of the 2011 version of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄(2011年本)) to replace the 2005 version with effect from 1 June 2011. In view of this, the Directors have conducted a review of the Group's production facilities and noted that approximately 1,261 units of loom for grey

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fabric production were classified as “eliminated” category and have been suspended from production immediately upon the 2011 version of the Guiding Catalog for Adjustment in the Structure of Industries came into effect on 1 June 2011.

Upon the elimination of these production facilities, the Group has obtained two letters from Jing Yang County Bureau of Development and Reform dated 31 May 2011 and Dali County Bureau of Economic Development dated 30 May 2011 confirming that (i) the 1,261 units mentioned above had been suspended from use; and (ii) all production facilities currently owned by the Group have complied with the technical standards as set out in the year 2011 version of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄) and are not subject to the scope of “eliminated category”. For further details of these “eliminated” grey fabric production facilities, please refer to the sub-paragraph headed “the 2005 and 2011 versions of the Guiding Catalog for Adjustment in the Structure of Industries (產業結構調整指導目錄(2005年本及2011年本))” of the paragraph headed “Production” in this section.

In view of the above, the Directors believe that the Group’s operations have complied with the applicable environmental laws and regulations.

### **INTELLECTUAL PROPERTY RIGHTS**

The Group’s intellectual property rights mainly consist of the trademarks detailed in the sub-paragraph headed “Intellectual Property” of the paragraph headed “Further Information about the Business” in Appendix VI to this prospectus.

The Directors are not aware of any material infringement of the Group’s intellectual property rights during the Track Record Period and the period up to the Latest Practicable Date. The Directors believe that the Group has taken all reasonable measures to prevent any infringement of its intellectual property rights and to avoid any losses as a result of infringement of the intellectual property rights by third parties including the use of the Company’s logos. As at the Latest Practicable Date, the Directors were not aware of any pending or threatened claims against any member of the Group relating to infringement of any intellectual property rights owned by third parties.

### **INSURANCE**

The Group has maintained insurance policies covering risks in respect of its fixed assets and inventory.

In addition, the Group also made sufficient social insurance contribution for all of its employee since its application for outstanding contribution in previous years in May 2010. For details of social insurance contribution, please refer to paragraph headed “Social Insurances and Housing Fund” in the section headed “Directors, Senior Management and Employees”.

The Group is not required to maintain product liability insurance under the prevailing PRC laws. As such, the Group does not maintain insurance to cover itself against product liability for its products. The Directors have confirmed that the Group had not experienced any material third party liability claims in relation to its products and accidents arising from the Group’s operations during the Track Record Period and up to the Latest Practicable Date.

## **PROPERTIES**

### **Owned properties**

The Group was granted with the land use rights of 5 parcels of land with a total site area of approximately 141,213.20 sq.m., on which 25 buildings and various ancillary structures are constructed for production, storage, administration and dormitory purposes. The total gross floor area of these buildings is approximately 71,739.13 sq.m. In Jing Yang Production Plant, 15 buildings with a total gross floor area of approximately 15,978.14 sq.m., representing approximately 36.8% of the total gross floor area in the plant, are used for dormitory, workshop, warehouse, office and ancillary purposes without building ownership certificates. These buildings are part of the production and ancillary facilities acquired from the State-owned Assets Supervision and Administration Bureau of Jing Yang County in 2001 and have been in use since their completion between 1970s and 1990s. Pursuant to the confirmation dated 26 October 2010, the Housing and Urban-Rural Development Bureau of Jing Yang County (涇陽縣住房和城鄉建設局) confirmed that all 15 buildings are legally erected and occupied in good condition. No order of removal has been imposed.

The said 15 buildings are mainly simple single-storey properties or structures. Three buildings with a total gross floor area of approximately 11,012.25 sq.m., representing approximately 69% of the total gross floor area of the 15 buildings and previously used as workshops are idle. The remaining properties and structures are used for ancillary purposes including security guard post, power supply room, turbine room and store room and are not pertaining to the Group's operations. Given the low usage of these properties and structures, the Group plans to demolish these properties and hence the Directors do not consider to obtain the building ownership certificates for these properties. The demolition plan will commence in August 2011 and is expected to complete by the end of 2011. The Directors consider that the defective properties, either individually or taken as a whole, are not crucial to the Group's operations and there are no material safety concerns in relation to the defective properties, given the low usage of these properties and structures and annual inspection of their conditions carried out by the management. As at the Latest Practicable Date, these defective properties have not been demolished and a deed of indemnity dated 27 June 2011 was executed by the Controlling Shareholders in favour of the Group to jointly and severally indemnify the Group, among other things, for all costs, losses of profits and businesses, penalties and fines and expenses which may be suffered by the Group as a result of or in connection with the 15 buildings in the Jing Yang Production Plant being used for workshop, office, warehouse, dormitory and ancillary purposes without building ownership certificates. If the security guard post, power supply room and turbine room are required to be rebuilt at Jing Yang Production Plant after the demolition, the Directors estimate the costs and time for the reconstruction would be approximately RMB0.59 million and 2 months respectively.

Pursuant to the Tort Liability Law of the PRC (中華人民共和國侵權責任法), which became effective on 1 July 2010, where any building, structure or facility or any thing laid thereon or suspended therefrom falls off or falls down, causing any harm to another person, if the owner cannot prove that he is not at fault, he shall assume the tort liability. Since most of the properties are idle, the Company's PRC legal advisers have confirmed that it is too remote to estimate the potential liability.

Pursuant to the Supreme People's Court Interpretation on Some Issues concerning the Application of Law for the Trial of Cases on Compensation for Personal Injury (最高人民法院關於審理人身損害賠償案件適用法律若干問題的解釋) (法釋[2003]20號) issued on 1 May 2004, if a fatal accident occurs in these properties, the Group may be liable for the victim's medical expenses, funeral expense, casualty compensation, victim's dependent compensation and funeral related out of pocket expenses. According



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to the interpretation, funeral expenses should be calculated with reference to six months of average local monthly salary; casualty compensation should be calculated with reference to twenty years of local urban or rural level of annual disposable income; and victim's dependent compensation and funeral related out of pocket expenses will be estimated on individual case basis.

According to the statistics published by Xian Yang City for the 1st half of 2010 (2010年上半年咸陽城鎮居民家庭人均收入構成情況表), the average local salary and disposable income for the first six month period in 2010 in Xian Yang City were approximately RMB6,002 and RMB8,156 respectively. Based on the above figures, the Company's PRC legal advisers estimate the compensation for a fatal accident case to be approximately RMB326,240 plus victim's medical expenses, dependent compensation and other out of pocket expenses.

Pursuant to the Notice on Institutional Reform Program of People's Government of Shaanxi Province (Ting Zi (2008) No. 23) (中共中央辦公廳國務院辦公廳關於印發《陝西省人民政府機構改革方案》的通知 (廳字(2008)23號)) issued by the Chinese Communist Party Central Committee General Office and The State Council General Office, the Provincial Housing and Urban-Rural Development Department ("Housing and Urban-Rural Development Department") is responsible for the management of housing and urban-rural development affairs in Shaanxi Province. As a delegate at county level, the Housing and Urban-Rural Development Bureau of Jing Yang County is responsible for the supervision and registration of properties within their jurisdiction. Hence, the Company's PRC legal advisers have confirmed that the Housing and Urban-Rural Development Bureau of Jing Yang County is the competent authority to issue the said confirmation to affirm the conditions of these properties and there is no legal impediment to obtain the building ownership certificates, if needed.

Save as disclosed above, the Group has obtained all the state-owned land use rights certificates and building ownership certificates for the said lands and buildings.

### **Lease properties**

The Group has entered into a lease agreement in respect of two factory premises, Dali Production Plant and Guang Hua Production Plant, with Shaanxi Golden Shield, a company controlled by the managing director of the Company, Mr. Chen, and a non-executive Director, Mr. Lin. Pursuant to the lease agreement dated 20 June 2010, the Group leases the properties located at Dali Production Plant and Guang Hua Production Plant with a gross floor area of approximately 43,675.11 sq.m. and 37,839.04 sq.m. respectively for a term of 20 years commencing from 5 August 2009 at nil consideration. Upon the expiration of this lease term, the Group has the right to extend the lease on the same terms until the expiration of the building ownership certificates in respect of these premises. The extension of the lease can be made by the Group serving on Shaanxi Golden Shield a renewal notice specifying the duration of extension three months prior to the expiration of the existing lease. The Group also has the first right of refusal to acquire the premises at the then depreciated value based on the acquisition cost paid by Shaanxi Golden Shield. If Shaanxi Golden Shield intends to sell the factory premises, it must first notify the Group to consider the offer. If the Group rejects the offer and Shaanxi Golden Shield wishes to sell to a third party purchaser, Shaanxi Golden Shield should obtain the Group's consent before disposing of the properties to third parties. Pursuant to the Contract Law of the PRC which became effective on 1 October 1999 and the lease agreement between the Group and Shaanxi Golden Shield, the Company's PRC legal advisers have confirmed that the first right of refusal is enforceable.

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Since the consideration for the lease is nil, the applicable percentage ratios under the Listing Rules on an annual basis will be nil and accordingly the lease constitutes an exempt continuing connected transaction for the Company under the Listing Rules upon Listing exempt from the compliance with the reporting, announcement and independent shareholders' approval requirements under Chapter 14A of the Listing Rules.

If the two factory premises were leased to the Group by Shaanxi Golden Shield on an arm's length basis, the Directors estimated that the monthly rental would have been approximately RMB122,500 and RMB182,500 for Dali Production Plant and Guang Hua Production Plant respectively. Hence, the additional rental expenses incurred by the Group would have been approximately RMB1,100,000, RMB3,660,000 and RMB3,660,000 respectively for the Track Record Period.

In the event that the lease were terminated, the Group might need to relocate its machinery and equipment in Dali Production Plant and Guang Hua Production Plant. The Directors estimate that the relocation cost would be approximately RMB4.93 million.

The Company has rented a property of about 629 square feet at Unit 1003, 10th Floor, No. 69 Jervois Street, Hong Kong from an independent third party for use as its Hong Kong head office.

The texts of a letter, a summary of valuation and valuation certificates prepared by Vigers Appraisal & Consulting Limited. are set out in Appendix III to this prospectus.

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## AWARDS AND RECOGNITION

The Group has received the following awards and accreditation in respect of its products and operation:

Accreditation/Award	Area of accreditation	Issuing organisation	Date of grant	Validity period/ date
GB/T 15496-2003 GB/T 15497-2003 GB/T 15498-2003	Good Standardizing Practice	Shaanxi Provincial Quality & Technical Supervision Bureau (陝西省質量技術監督局)	11 May 2011	11 May 2011 to 10 May 2014
ISO10012:2003 Standard GB/T 19022-2003	Product quality, production, energy conservation, environmental monitoring	China CMS (中啟計量體系認證中心)	4 September 2008	4 September 2008 to 3 September 2012
ISO 9001:2008 Standard/GB/T 19001:2008	Cotton yarn and fabric design and production	CQM Certification (方圓標志認證集團有限公司)	14 February 2011	13 February 2014
Role Model Enterprise	Product quality	China Product Quality Association (中國品牌質量信譽協會)	2008	2008 to 2009
Shaanxi Famous Product	Cotton yarn model C40s	People's Government of Shaanxi Province (陝西省人民政府)	22 January 2009	October 2008 to October 2011
Grade AAA Quality Manufacturing Enterprise	Product quality	China Product Quality Association (中國產品質量協會)	2009	2009–2011
Shaanxi Famous Trademark	Trademark 	Shaanxi Province Administration for Industry & Commerce	24 November 2010	24 November 2010 to 23 November 2013