
OUR RELATIONSHIP WITH CONTROLLING SHAREHOLDERS

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Immediately after completion of the Global Offering, Excel Orient which is beneficially owned by Mr. LIU Dong will effectively hold 69.20% of the total issued share capital of our Company (assuming the Over-allotment Options are not exercised).

Apart from the equity interest in our Company and members of our Group, as at the Latest Practicable Date, Mr. LIU Dong and his spouse, Ms. WANG Lingli, held interests in certain companies with equity interest of less than 5% or being dormant, and in the following companies:

Name of companies	Place of establishment	Principal business	Percentage of interest held by Mr. LIU Dong, Ms. WANG Lingli and their associates	Managerial position held by Mr. LIU Dong and Ms. WANG Lingli
Yinshan Chemical Fiber	China	Production activities ceased in 2005. Previous principal business includes manufacture and sale of chemical fabrics and staple fiber which were mainly used as raw materials for toy manufacturing	Mr. LIU Dong: 98% (Note 1)	Nil
Tianrui Investment	China	Investment holding of 100% equity interest in Tianhao	Mr. LIU Dong: 100% (Note 2)	Nil
Tianhao	China	Dyeing and finishing of textile products	Tianrui Investment: 75%	Nil

Note 1: Mr. LIU Dong (through himself and his trustees) held 98% equity interest in Yinshan Chemical Fiber. For details, please refer to the paragraph headed “Yinshilai Textile” in the section headed “History, Reorganization and Group Structure” in this prospectus.

Note 2: Mr. LIU Dong (through his trustees, Ms. WANG Lingli (his spouse) and Ms. SHAN Min (the mother of Ms. WANG Lingli)) held 100% equity interest in Tianrui Investment. For details, please refer to the paragraph headed “Huiyin Textile” in the section headed “History, Reorganization and Group Structure” in this prospectus.

As confirmed by our Directors, Yinshan Chemical Fiber ceased production activities in 2005 because its business was not profitable due to shrinking market and difficulties in the sourcing of raw materials. Prior to cessation of production activities, the products of Yinshan Chemical Fiber were mainly used as raw materials for toy manufacturing and could not be used as raw materials for textile manufacturing. The major customers of Yinshan Chemical Fiber were toy and clothing manufacturers in Shandong Province and our Group and Yinshan Chemical Fiber had no common customers. Mr. LIU Dong advised that he intends to use Yinshan Chemical Fiber as an investment vehicle in businesses which are not related to the textile industry.

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Mr. LIU Dong advised that Tianhao is currently the only investment of Tianrui Investment. Tianhao is engaged in the business of dyeing and finishing of fabric products, which is not the business currently undertaken or planned to be undertaken by our Group and will not cover Fabric Products. The principal business of our Group is the design, manufacturing and sale of Fabric Products and the production of yarns, which will be used as our raw materials. The major customers of Tianhao are chemical fiber textile products manufacturer. As confirmed by our Directors, our Group and Tianhao have no common customers and no competition due to the aforesaid reasons.

In view of the above, our Directors are of the view that there are clear delineations between our principal businesses and the businesses of the above companies owned by the Controlling Shareholders.

None of our Directors, our Controlling Shareholders or their respective associates are engaged in any business that, directly or indirectly, competes or may compete with the business of our Group.

Non-compete undertakings

Each of the Controlling Shareholders (being Excel Orient and Mr. LIU Dong) has entered into the deed of non-competition in favor of our Company, pursuant to which each of the Controlling Shareholders has jointly and severally undertaken unconditionally and irrevocably, subject to the exceptions mentioned below, that he/it will not, and would procure that neither his/its associate nor companies controlled by any of them (other than our Group) will not, directly or indirectly, carry on, participate, or be interested in or engaged in or acquire or hold, any activity or business which competes or is likely to compete directly or indirectly with our Group's business as set out in this prospectus or any business contemplated to be carried on by our Group, from time to time in the PRC and/or any other jurisdiction(s) in which our Group carries on business ("**Restricted Activity**").

The aforesaid undertakings do not apply to the holding of or interests in shares or other securities in any company which conducts or is engaged in any Restricted Activity, provided that, in the case of such shares, they are listed on a recognized stock exchange and:

- (a) the total number of the shares held by the Controlling Shareholders or their associates does not amount to more than 5% of the issued shares of the company; and
- (b) the Controlling Shareholders or their associates are not entitled to appoint a majority of the directors or management of that company.

Each of the Controlling Shareholders has represented and warranted that, as of the date of the deed of non-competition, neither he/it nor any of his/its associates is currently interested, involved or engaged, directly or indirectly, in (whether as a shareholder, partner, agent or otherwise and whether for profit, reward or otherwise) the Restricted Activity (otherwise than through the Group) or is otherwise engaged in any business which is in competition or potential competition with those of our Group.

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Each of the Controlling Shareholders has jointly and severally undertaken unconditionally and irrevocably to procure that any business investment or other commercial opportunity relating to the business of our Group (the “**New Opportunity**”) identified by or offered to the Controlling Shareholders and/or any of their associates (other than members of the Group) (the “**Offeror**”) is first referred to our Company in the following manner:

- (a) the Controlling Shareholders are required to, and shall procure their associates (other than members of our Group) to, refer, or procure the referral of, the New Opportunity to our Company, and shall give written notice to our Company of any New Opportunity, which contains all information reasonably necessary for our Company to consider whether (i) the New Opportunity would constitute competition with its core business and/or any other new business which our Group may undertake at the relevant time, and (ii) it is in the interest of our Group to pursue the New Opportunity, including but not limited to the nature of the New Opportunity and the details of the investment or acquisition costs (the “**Offer Notice**”); and
- (b) the Offeror will be entitled to pursue the New Opportunity only if (i) the Offeror has received a written notice from our Company declining the New Opportunity and confirming that the New Opportunity would not constitute competition with its core business, or (ii) the Offeror has not received the notice from our Company within ten Business Days from the receipt of the Offer Notice by our Company. If there is a material change in the terms and conditions of the New Opportunity pursued by the Offeror, the Offeror will refer the New Opportunity as so revised to our Company in the manner as set out above.

Upon receipt of the Offer Notice, our Company shall seek opinions and decisions from a committee of the Board consisting Directors who do not have a material interest in the matter as to whether (a) such New Opportunity would constitute competition with our Company’s core business, and (b) it is in the interest of our Company and its shareholders as a whole to pursue the New Opportunity.

The non-competition undertakings and the rights and obligations thereunder are subject to and conditional upon the Global Offering becoming unconditional as specified under the section headed “Structure and Conditions of the Global Offering” in this prospectus.

The obligation of the Controlling Shareholders under the deed of non-competition will remain in effect until:

- (a) the date on which the Shares cease to be listed on the Stock Exchange; or
- (b) the date on which the Controlling Shareholders and their associates cease to own 5% or more of the then issued share capital of our Company directly or indirectly, whichever occurs first.

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Each of the Controlling Shareholders has jointly and severally undertaken unconditionally and irrevocably to our Company that he would, during the term of the deed of non-competition indemnify and keep indemnified our Company and our Group against any loss suffered by our Company or our Group (as relevant) arising out of any breach of an of his/its undertaking under the deed of non-competition.

The Controlling Shareholders will make an annual declaration on compliance with their undertakings under the deed of non-competition in our annual reports. The independent non-executive Directors will review, at least on an annual basis, the compliance of the Controlling Shareholders with the deed of non-competition. We will make disclosures in our annual reports or by way of announcements regarding the review conducted by the independent non-executive Directors relating to such compliance with and enforcement of the deed of non-competition including, among others, any new business opportunity turned down by our Company under the deed of non-competition and the basis thereon.

Independence of management, financing and operation

Having considered the following factors, our Directors are satisfied that our Group operationally and financially independent from the Controlling Shareholders and their associates:

Non-competition — although there are certain businesses owned by the Controlling Shareholders as mentioned above in this section, none of the Controlling Shareholders or our Directors has any interest in a business which competes or is likely to compete, either directly or indirectly, with our Group's business. In addition, each of the Controlling Shareholders has given a non-competition undertaking in favor of us. For details, please refer to the sub-section headed "Non-Compete Undertakings" above.

Management independence — Our Board comprises three executive Directors, one non-executive Director and three independent non-executive Directors. Despite the interest of the Controlling Shareholders in certain businesses outside the Group, we consider that our Board will function independently from the Controlling Shareholders because:

- (a) each Director is aware of his fiduciary duties as a Director of our Company which requires, among other things, that he acts for the benefit and in the best interests of our Company and does not allow any conflict between his duties as a Director and his interest;
- (b) in the event that there is a potential conflict of interest arising out of any transaction or arrangement to be entered into between our Company or any member of our Group and any of our Directors or his/her respective associates, the interested Director(s) shall fully and fairly disclose his/her interest and shall abstain from voting at the relevant board meetings of our Company in respect of such transactions or arrangement; and

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- (c) our Board comprises seven Directors and three of them are independent non-executive Directors, which represent more than one-third of the members of the Board. This is in line with current corporate governance practice in Hong Kong.

Financial independence — Our Group has an independent financial system and makes financial decisions according to its own business needs. Approximately RMB56.9 million, RMB372.1 million and RMB176.6 million were owed by the Group to Mr. LIU Dong (our Controlling Shareholder), Ms. SUN Qilian (Mr. LIU Dong's mother), Excel Orient, Yinshan Chemical Fiber, Tianhao, Yinlong Industrial and Mr. LV Ruichuan (a consultant of our Company) as at 31 December 2009, 2010 and 2011, respectively. All of the outstanding sums owed to them have been or will be settled prior to the Listing. During the Track Record Period, various related parties provided guarantees to secure bank loans for our Group, the particulars of which are set out under Note 27 to the Accountants' Report in Appendix I to this prospectus. All the guarantees have been or will be released by the banks prior to the Listing. In the circumstances, we believe we are capable of obtaining financing from third parties without reliance on the Controlling Shareholders. For further details of the related party transactions during the Track Record Period, please refer to Note 27 to the Accountants' Report set out in Appendix I to this prospectus. During the Track Record Period, we have provided certain guarantees to our related parties, the particulars of which are set out under Note 27 to the Accountants' Report in Appendix I to this prospectus, and held joint and several liability pursuant to the Civil Mediation Agreement as defined in the paragraph headed "Financial Assistance Provided by the Company for the Benefit of a Connected Person" in the section headed "Connected Transactions" in this prospectus. All the guarantees provided by us have been or will be released prior to the Listing. For details of the arrangement in relation to the Civil Mediation Agreement, please refer to the paragraph headed "Financial Assistance Provided by the Company for the Benefit of a Connected Person" in the section headed "Connected Transactions" in this prospectus.

Operational independence — Our Group has an independent work force to carry out our operation and has not shared its operation team with the Controlling Shareholders' businesses outside our Group. Although during the Track Record Period, there have been certain transactions between us and our related parties, details of which are set out in Note 27 in the Accountant's Report and the paragraph headed "Relationship with Yinlong Industrial" below, our Directors have confirmed that these related party transactions were conducted on normal commercial terms. Save as disclosed in the section headed "Connected Transactions", none of the historical related party transactions with the connected persons as defined in the Listing Rules are expected to continue after the Listing.

RELATIONSHIP WITH YINLONG INDUSTRIAL

Information of Yinlong Industrial

During the Track Record Period, Mr. LIU Dong and his associates controlled Yinlong Industrial, which conducted certain transactions with our Group.

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Yinlong Industrial was incorporated in the PRC on 10 October 1999. It is currently principally engaged in the manufacturing and sales of different yarn products and utility supply. Yinlong Industrial was our largest suppliers for the years ended 31 December 2009 and 2010 and we sourced yarns from and entered into processing arrangement with them during the Track Record Period. Whilst we were its largest customer, Yinlong Industrial did not supply their yarn products or provide processing services to us on an exclusive basis, and a small quantity of their yarn products was sold to other third party customers (e.g. fabric manufacturers) during the Track Record Period. Other transactions between Yinlong Industrial and our Group during the Track Record Period include the sale of finished products, ancillary items and provision of ancillary services to Yinlong Industrial, the leasing of our property with the gross floor area of 16,302.81 sq.m situate at Yinlong Village, Economic Development Zone, Boshan District, Zibo City, Shandong Province, China to Yinlong Industrial (which was terminated on 31 December 2010) and the supply of steam by Yinlong Industrial to our Group, which were recorded as related party transactions during the Track Record Period. For further details of the related party transactions during the Track Record Period, please refer to Note 27 to the Accountants' Report in Appendix I to this prospectus, and the paragraphs headed "Vertical Integration of Yarn and Fabric Productions", "Our Suppliers" and "Fuel and Utilities" in the section headed "Business" in this prospectus.

Yinlong Assets Acquisition

On 31 December 2010, we completed the Yinlong Assets Acquisition under which we acquired from Yinlong Industrial approximately 90,000 spindles and other spinning machineries and supporting equipment at the total consideration of RMB28,100,984.67. The consideration in the sum of RMB28,100,984.67 is equal to the value of the subject assets assessed by an independent asset valuer on 31 October 2010, less an amount equivalent to the 2-month depreciation value which represents the depreciation of the subject assets between the date of valuation and the date of handover of the subject assets on 31 December 2010. On 1 April 2011, we and Yinlong Industrial reduced the agreement for the Yinlong Assets Acquisition to writing.

We decided not to acquire the entire equity interest of Yinlong Industrial to form part of our Group after taking into account the following factors:

- (a) we are principally engaged in the production of Fabric Products made with high-end cotton yarns, Tencel and/or new materials and fibers. Most of the machines and equipment not having been acquired by us under Yinlong Assets Acquisition (the "**Excluded Machines**") were specifically designed for the production of chemical fibers or were only suitable for the production of coarse-count yarns which were not required by us, whereas some of the Excluded Machines (including twisting machines and doubling machines) which were suitable for further processing of yarns were retained by Yinlong Industrial so that they would still be able to provide yarn processing services for its customers. Thus, any proposed acquisition of the Excluded Machines or the entire equity interest in Yinlong Industrial at that time would not be in line with our Group's principal product line or desired by Yinlong Industrial; and

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- (b) the principal business focus of our Group has been the design, manufacturing and sale of Fabric Products whereas the principal business of Yinlong Industrial has been the sale and distribution of yarns. We did not have any intention at the time of Yinlong Assets Acquisition to engage in a new line of yarn selling business. Thus, we only acquired those machines and equipment which were expected to complement our principal business.

In view of the above, our Directors considered that it would be in the commercial interest of our Group not to acquire the Excluded Machines or the entire equity interest of Yinlong Industrial under the Yinlong Assets Acquisition. Our Directors are also of the view that the Yinlong Assets Acquisition will benefit our Group for the reasons that consistency in the quality of yarn supplies and proximity of supplies can be ensured.

Following the completion of the Yinlong Assets Acquisition, to the best of our Directors' knowledge, Yinlong Industrial retained various spinning machines and equipment specifically designed for the production of chemical fibers or coarse-count yarns or for further processing of yarns, and was principally engaged in the sale and distribution of yarns and utility supply business. Our Directors have confirmed that, after 31 December 2010, in consideration of the close business relationship with Yinlong Industrial, the availability of inventory of high quality yarns maintained by Yinlong Industrial (produced before completion of Yinlong Assets Acquisition) which were required by our Group and the production requirement of our Group, we continued to procure yarns and accessory products, require further yarn processing (such as twisting, doubling and rewinding of yarns for the purpose of forming certain functional properties for the yarns such as twisted yarns as opposed to the supply of cotton for yarn production), and purchased steam from Yinlong Industrial, at a comparable price level with other suppliers or processing agent, but the scale of transactions between our Group and Yinlong Industrial had been reduced substantially. For the year ended 31 December 2011, our Group's purchase of yarns from Yinlong Industrial (comprising the costs of procurement of yarns and further yarn processing) amounted to approximately RMB15.38 million, representing approximately 3.19% of the total purchases of our Group, in which the aforesaid purchase of inventory of high quality yarns maintained by Yinlong Industrial (produced before completion of the Yinlong Assets Acquisition) amounted to approximately RMB13.24 million, representing approximately 2.75% of the total purchases of our Group during that period.

The Directors have confirmed that, in contemplation of the fact that the principal products of Yinlong Industrial will no longer be in line with our Group's strategies to produce high-end Fabric Products, there was also no specific need from our Group's customers which required our Group to seek further yarn processing from external processing agent and that our Group could procure yarns and accessory products from other external suppliers, since July 2011, our Group has ceased to have, and our Directors do not expect to have in the foreseeable future, any transaction (including procurement of yarns and accessory products and further processing agreement) with Yinlong Industrial after taking into account the above considerations and current business plan, except for the

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purchase of steam from Yinlong Industrial which will continue after Listing. For further details of the supply of steam by Yinlong Industrial to our Group, please refer to “Business — Production — Fuel and utilities” in this prospectus.

Change in shareholding in Yinlong Industrial

Upon conclusion of the Proceedings (as defined in the paragraph headed “Financial Assistance Provided by the Company for the Benefit of a Connected Person” in the section headed “Connected Transactions” in this prospectus) and as agreed by the then shareholders of Yinlong Industrial, since 27 June 2008, the equity interest of Yinlong Industrial was owned as to 21.96%, 49.55%, 28.05% and 0.44% by Mr. LIU Dong, Ms. SUN Qilian (the mother of Mr. LIU Dong), Mr. LV Ruichuan (a consultant of our Company) and an Independent Third Party, respectively. On 29 October 2010, Mr. LIU Dong disposed of his entire equity interest in Yinlong Industrial to Ms. SUN Qilian at the total consideration of RMB11,197,384 which was determined by reference to the capital contribution made by Mr. LIU Dong to Yinlong Industrial. On the same date, Mr. LV Ruichuan disposed of his entire equity interest in Yinlong Industrial to Ms. LV Yun (the sister of Mr. LV Ruichuan) at the total consideration of RMB14,307,644 which was determined by reference to the capital contribution made by Mr. LV Ruichuan to Yinlong Industrial. In view of the expanding business and business strategy of our Group and taking into account the business scale and focus of Yinlong Industrial, Mr. LIU Dong and Mr. LV Ruichuan decided to dispose of their equity interests in Yinlong Industrial in order to become more focused on the management and business development of Yinshilai Textile and Huiyin Textile and divest their responsibility in Yinlong Industrial. For such purpose, Mr. LIU Dong and Mr. LV Ruichuan approached their respective associates, Ms. SUN Qilian and Ms. LV Yun, who were willing to take up their respective equity interest in Yinlong Industrial then. Mr. LIU Dong and Mr. LV Ruichuan did not spend a lot of effort in identifying other prospective purchasers who were Independent Third Parties since interested purchasers for their equity interest were readily available at that time. Since the completion of the aforementioned transfers, Mr. LIU Dong and Mr. LV Ruichuan have ceased to hold any position in, and have not been involved in the management of, Yinlong Industrial, and the equity interest in Yinlong Industrial was held as to 71.51%, 28.05% and 0.44% by Ms. SUN Qilian, Ms. LV Yun and an Independent Third Party, respectively. On 21 April 2011, each of Ms. SUN Qilian and Ms. LV Yun disposed of her entire equity interest in Yinlong Industrial to an Independent Third Party for a consideration of RMB36,467,622 and RMB14,307,644, respectively, which were determined by reference to the capital contribution made by each of them to, and the net asset value of, Yinlong Industrial assessed by an independent asset valuer as at 31 December 2010 and Mr. LIU Dong and his associates ceased to be in management and control of Yinlong Industrial on the same day. Our Directors have confirmed that, since 21 April 2011, Yinlong Industrial has been an Independent Third Party.