
CONNECTED TRANSACTIONS

NON-EXEMPT CONTINUING CONNECTED TRANSACTIONS

The following transactions have been carried out by our Group and the Connected Persons during the Track Record Period and are expected to be continued and constitute non-exempt continuing connected transaction following the Listing. These transactions will constitute continuing connected transactions and financial assistance provided by our Company for the benefit of a connected person which are subject to the reporting, announcement and independent shareholders' approval requirements set out in Chapter 14A of the Listing Rules upon the Listing.

FINANCIAL ASSISTANCE PROVIDED BY THE COMPANY FOR THE BENEFIT OF A CONNECTED PERSON

Connected Persons

Under the Listing Rules, as at the Latest Practicable Date, Mr. LIU Dong and Yinshan Chemical Fiber are connected persons of our Company for the reason that Mr. LIU Dong is a Director and a Controlling Shareholder and that he (by himself and through his trustees) held 98% of the equity interest in Yinshan Chemical Fiber.

Background

In June 2006, the then shareholders of Yinlong Industrial, based on the SAIC records, comprised Mr. LIU Yanjiang (the uncle of Mr. LIU Dong), Ms. SUN Qilian (the mother of Mr. LIU Dong), Mr. LV Ruichuan (a consultant of our Company and the husband of Ms. SUN Hongchun who is a member of our senior management) and two other private investors who are Independent Third Parties. The above five shareholders held 17.08%, 28.43%, 15.03%, 39.22% and 0.24% of the then equity interest of Yinlong Industrial, respectively.

There was a dispute among the shareholders of Yinlong Industrial and legal proceedings were initiated by Ms. SUN Qilian against Yinlong Industrial and other shareholders (the “**Proceedings**”) in the People’s Court of Zibo New And High Technology Exploring Zone (the “**Jurisdiction Court**”).

In the Proceedings, it was claimed by Ms. SUN Qilian that there were shortfalls of actual capital contribution made by Mr. LIU Yanjiang and another shareholder (who is an Independent Third Party holding the then 39.22% equity interest of Yinlong Industrial) from the capital contribution under SAIC records. Our Directors have confirmed that Ms. SUN Qilian, Mr. LV Ruichuan and another shareholder (who is an Independent Third Party holding the then 0.24% equity interest of Yinlong Industrial) have come to an agreement to pay up the aforesaid outstanding contribution but failed to reach such consensus with Mr. LIU Yanjiang.

Even though no complaint was initiated by Ms. SUN Qilian against Mr. LV Ruichuan and another shareholder (an Independent Third Party holding 0.24% of then equity interest of Yinlong Industrial) that they have failed to pay up their respective capital contribution pursuant to SAIC records, they were named as defendants together with Mr. LIU Yanjiang

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at Ms. SUN Qilian's discretion in light of the relevant PRC civil litigation procedures. Upon further clarification of the PRC civil litigation procedures with the Jurisdiction Court, the shareholders of Yinlong Industrial were subsequently named as third parties instead of defendants to the Proceedings while Yinlong Industrial was named as the defendant in accordance with the PRC civil litigation procedures for the application for verification of the shareholding structure of Yinlong Industrial and an order requiring the shareholders to pay up the outstanding capital contributions. Our PRC legal advisers are of the view that, the Jurisdiction Court is entitled to adjudicate the procedural and substantive aspects of a case at its sole discretion.

As advised by Mr. LIU Dong, he subsequently participated in the settlement negotiation with his mother, Ms. SUN Qilian, and other parties and came up with a settlement arrangement so that he would acquire all the interest (in terms of equity interest and shareholders' loan) of Mr. LIU Yanjiang (together with his wife, Ms. LIU Hongrui) in Yinlong Industrial as well as Yinshan Chemical Fiber (owned by Mr. LIU Yanjiang as to 2%) and Yinshilai Textile (owned by Yinshan Chemical Fiber as to 75%) so as to have a full and final settlement of all disputes and eliminate all potential future disputes with the relevant parties in order to achieve long term stability in terms of corporate image and business operation of these companies, which were believed to be crucial to their continuing development and future success. A mediation agreement was finally reached on 29 April 2008 (the "**Mediation Agreement**").

The Mediation Agreement

The parties to the Mediation Agreement included Mr. LIU Dong, Mr. LIU Yanjiang, Ms. LIU Hongrui, Yinlong Industrial, Yinshilai Textile and Yinshan Chemical Fiber. Ms. LIU Hongrui was the spouse of Mr. LIU Yanjiang and had been a shareholder of Yinlong Industrial, therefore, even though she was not the then registered shareholder of Yinlong Industrial, she was also included as a party with a view to avoiding and eliminating all potential issues which might be raised by her in respect of (i) any outstanding loan owed to her (either previously advanced by herself directly or indirectly through Mr. LIU Yanjiang) from Yinlong Industrial, Yinshan Chemical Fiber and Yinshilai Textile, or (ii) any undistributed dividends which should be payable to her as a past shareholder. As confirmed by our Directors, Mr. LIU Yanjiang and Ms. LIU Hongrui requested to include Yinshilai Textile and Yinshan Chemical Fiber as parties to the Mediation Agreement and to be held jointly and severally liable for the liabilities set out therein in order to secure due payment of the settlement sums in case Mr. LIU Dong fails to comply with the payment schedule (as elaborated below).

As advised by our PRC legal advisers, the Mediation Agreement was subsequently endorsed by the Jurisdiction Court under a civil mediation agreement (民事調解書) (the "**Civil Mediation Agreement**") and the Civil Mediation Agreement is legally binding on all parties involved in the Proceedings and the parties are entitled to apply for an court order for enforcement if any other party fails to perform the obligations under the Civil Mediation Agreement.

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The Sole Sponsor has discussed with Mr. LIU Dong on the background of the Proceedings, the Mediation Agreement and the Civil Mediation Agreement together with the legal advisers, and has conducted independent litigation search in the PRC against the relevant parties, including Mr. LIU Dong and Mr. LV Ruichuan. On the basis of the background and information of the Proceedings, the Mediation Agreement and the Civil Mediation Agreement provided to it, including and in consideration of, in particular, the Outstanding Settlement Arrangement as described below, the Sole Sponsor has not identified any information which will render it to cast doubt on the suitability of Mr. LIU Dong as a Director by virtue of the Proceedings and the related transactions.

Pursuant to the settlement terms of the Civil Mediation Agreement, in consideration of the transfer of all equity interest held by Mr. LIU Yanjiang and Ms. LIU Hongrui in Yinlong Industrial, Yinshilai Textile and Yinshan Chemical Fiber and as the compensation to Mr. LIU Yanjiang and Ms. LIU Hongrui for their interest in and any loan made to the aforementioned companies, Mr. LIU Dong agreed to pay Mr. LIU Yanjiang and Ms. LIU Hongrui RMB5,000,000 before 19 May 2008 and RMB 5,000,000 before 3 June 2008, and Mr. LIU Dong, Yinlong Industrial, Yinshilai Textile and Yinshan Chemical Fiber agreed to be jointly and severally liable to Mr. LIU Yanjiang and Ms. LIU Hongrui for the remaining balance of RMB45,000,000 divided into 9 instalments of RMB5,000,000 each payable half-yearly. As advised by our PRC legal advisers and based on the terms of the Mediation Agreement, the settlement sum was payable to Mr. LIU Yanjiang and Ms. LIU Hongrui (who are married couple) jointly and collectively.

As confirmed by our Directors, in order to avoid future potential disputes, the settlement was reached on the basis that Mr. LIU Yanjiang would have an one-off exit from Yinlong Industrial, Yinshan Chemical Fiber and Yinshilai Textile, and the following factors were taken into account in determining the settlement amount:

- (i) actual contribution purported to have been made by Mr. LIU Yanjiang to Yinlong Industrial under the claim in the Proceedings,
- (ii) the then 2% equity interest in Yinshan Chemical Fiber in respect of capital contribution in the sum of RMB100,000,
- (iii) profits made by Yinlong Industrial and Yinshan Chemical Fiber to which Mr. LIU Yanjiang was entitled and not yet distributed,
- (iv) the net amount due to Mr. LIU Yanjiang from Yinlong Industrial, Yinshan Chemical Fiber and Yinshilai Textile being outstanding loan advanced by Mr. LIU Yanjiang for their operations historically plus interest,
- (v) the then proportional net asset value of Yinshilai Textile as at December 2007 attributable to the equity interest indirectly held by Mr. LIU Yanjiang through his 2% equity interest in Yinshan Chemical Fiber, which owned 75% equity interest in Yinshilai Textile at that time, in the sum of approximately RMB3.5 million.

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These factors were taken into consideration by Mr. LIU Dong and he considered the settlement sum of RMB55 million acceptable on the grounds that (i) such settlement sum would be paid by way of instalments over a long period of time up to the end of 2012 from the date of settlement, and (ii) it would provide an one-off settlement of the then outstanding disputes and eliminate all possible potential future disputes between the parties with an aim to achieve long-term stability both internally and externally in terms of the corporate image and business operation of these companies which were crucial to their continuing development and future success.

As confirmed by our Directors, the first 7 instalments up to 31 December 2011 for the aggregate sum of RMB35,000,000 had been duly paid by Mr. LIU Dong pursuant to the Civil Mediation Agreement. The People's Court of Zibo New And High Technology Exploring Zone also confirmed that the instalments had been duly paid. The remaining two instalments for the aggregate sum of RMB10,000,000 (the "**Outstanding Settlement Amount**") are to be paid on or before 30 June 2012 and 31 December 2012, respectively.

Outstanding Settlement Arrangement

On 25 June 2012, Mr. LIU Dong remitted the Outstanding Settlement Amount to the designated bank account of the Jurisdiction Court on a non-refundable basis and irrevocably agreed and undertook to Yinlong Industrial, Yinshan Chemical Fiber and Yinshilai Textile that he would be primarily liable for all liabilities and obligations to Mr. LIU Yanjiang and Ms. LIU Hongrui under the Civil Mediation Agreement. As confirmed by the Jurisdiction Court, since Mr. LIU Dong had irrevocably paid to it the Outstanding Settlement Amount on a non-refundable basis, it will not release the Outstanding Settlement Amount to Mr. LIU Dong's creditors or his associate's creditors in any circumstance and will only pay such amount in full directly to Mr. LIU Yanjiang and Ms. LIU Hongrui pursuant to the payment schedule under the Civil Mediation Agreement, and accordingly, all obligations and liabilities of Yinshilai Textile under the Civil Mediation Agreement had been discharged and released (the "**Outstanding Settlement Arrangement**"). Having considered that (i) the Outstanding Settlement Amount has been paid in full into the designated bank account of the Jurisdiction Court which will proceed to pay such amount to Mr. LIU Yanjiang and Ms. LIU Hongrui pursuant to the payment schedule under the Civil Mediation Agreement as confirmed by the Jurisdiction Court in a confirmation letter dated 25 June 2012, and (ii) the joint liability of Yinshilai Textile under the Civil Mediation Agreement is to be discharged by way of cash payment of the Outstanding Settlement Amount to Mr. LIU Yanjiang and Ms. LIU Hongrui, our PRC legal advisers advised that, on the basis that the Jurisdiction Court, which is the competent authority in making the relevant confirmation, will have paid the Outstanding Settlement Amount to Mr. LIU Yanjiang and Ms. LIU Hongrui in full pursuant to the payment schedule under the Civil Mediation Agreement, the joint obligations and liabilities of Yinshilai Textile under the Civil Mediation Agreement can be deemed as having been discharged and released in substance.

As at the Latest Practicable Date, the Outstanding Settlement Amount had been deposited at the designated bank account of the Jurisdiction Court and the disposal thereof was at its absolute discretion. There is no assurance that, if Mr. LIU Dong becomes

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insolvent, any of his creditors will not be able to successfully file a claim for seizing the assets of Mr. LIU Dong, including the money of Mr. LIU Dong deposited at the Jurisdiction Court, to the extent that those money has not yet been paid to Mr. LIU Yanjiang and Ms. LIU Hongrui, in satisfaction of the debt owed to them. If any of these events occurs, Yinshilai Textile will be jointly and severally liable with Mr. LIU Dong, Yinlong Industrial and Yinshan Chemical Fiber to the payment of the Outstanding Settlement Amount.

Our PRC legal advisers have advised that, based on the aforementioned confirmation given by the Jurisdiction Court, the risk that the Jurisdiction Court in exercising its discretion will release the Outstanding Settlement Amount to person other than Mr. LIU Yanjiang and Ms. LIU Hongrui is remote.

Historical transaction value

For each of the years ended 31 December 2009, 2010 and 2011, Mr. LIU Dong has duly paid the respective instalments pursuant to the Civil Mediation Agreement and the amount of the financial assistance provided by Yinshilai Textile (owed jointly and severally with Mr. LIU Dong, Yinlong Industrial and Yinshan Chemical Fiber) to Mr. LIU Dong to secure his payment obligations under the Civil Mediation Agreement to Mr. LIU Yanjiang and Ms. LIU Hongrui amounted to RMB35,000,000, RMB25,000,000 and RMB15,000,000, respectively.

Annual caps

The first instalment of RMB5,000,000 of the Outstanding Settlement Amount is expected to be settled on or before 30 June 2012 pursuant to the Civil Mediation Agreement. For the year ending 31 December 2012, in case where Mr. LIU Dong fails to perform his payment obligations under the Civil Mediation Agreement, the maximum amount as may be payable by us under the Civil Mediation Agreement and the Outstanding Settlement Arrangement will be no more than RMB10,000,000. The proposed annual cap is RMB10,000,000 which is the outstanding sum owed to Mr. LIU Yanjiang and Ms. LIU Hongrui as at the Latest Practicable Date.

Listing Rules implications

Yinshilai Textile's entering into of the Civil Mediation Agreement and being jointly and severally liable for the Outstanding Settlement Amount (the "**Relevant Financial Assistance**") constitutes non-exempt financial assistance under Rule 14A.63 of the Listing Rules and are subject to the reporting, announcement and independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

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Confirmation from our Directors

Our Directors, including independent non-executive Directors, consider that the Relevant Financial Assistance together with the Outstanding Settlement Arrangement and the Outstanding Settlement Amount are fair and reasonable and in the interests of the Shareholders and our Company as a whole for the following reasons:

- (i) the Civil Mediation Agreement would provide an one-off settlement of the then outstanding disputes and eliminate all possible potential future disputes between the parties with an aim to achieve long term stability both internally and externally in terms of the corporate image and business operation of these companies which were crucial to their continuing development and future success;
- (ii) it has been acknowledged and confirmed that since Mr. LIU Dong was entitled to all equity interest held by Mr. LIU Yanjiang and Ms. LIU Hongrui in Yinlong Industrial, Yinshan Chemical Fiber and Yinshilai Textile and benefited from the settlement of the dispute through the Civil Mediation Agreement, he should be primarily liable for all liabilities in relation to the Outstanding Settlement Amount; and
- (iii) the Outstanding Settlement Arrangement, once executed, will eliminate the potential liabilities arising from the failure of Mr. LIU Dong to settle the Outstanding Settlement Amount which might result in a claim against our Company under Yinshilai Textile's joint and several liability as to the Outstanding Settlement Amount under the Civil Mediation Agreement,

notwithstanding that the Relevant Financial Assistance has not been entered into on normal commercial terms.

Waiver Sought

We have applied for and have obtained an exemption from the Stock Exchange from complying with the announcement and independent Shareholders' approval requirements under Rules 14A.63 of the Listing Rules.

In the event that we enter into any new transactions or agreements with any connected person in the future, our Company will comply with the relevant provisions of Chapter 14A of the Listing Rules. In addition, if the Relevant Financial Assistance shall continue after the expiry of the current waiver and/or if the transaction amount contemplated under the Relevant Financial Assistance shall exceed the cap amount for the year ending 31 December 2012, our Company will comply with the relevant provisions of Chapter 14A of the Listing Rules in respect of the reporting, announcement and independent Shareholders' approval requirements. Our Group will re-comply with all relevant requirements under Chapter 14A of the Listing Rules upon the expiry of the one-year waiver period.

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The Sole Sponsor is of the view that the Relevant Financial Assistance, the Outstanding Settlement Amount and the transactions contemplated thereunder are fair and reasonable and in the interests of the Shareholders and our Company as a whole notwithstanding that the Relevant Financial Assistance has not been entered into on normal commercial terms.

EXEMPT CONTINUING CONNECTED TRANSACTION

On 19 June 2012, our Company entered into a consultancy agreement with Mr. LV Ruichuan (“**Mr. LV**”) (呂瑞川), a former employee of the Company, pursuant to which we appointed Mr. LV as our consultant at an annual fee of RMB100,000 renewable every three years. Mr. LV was a director of our wholly-owned subsidiary, Huiyin Textile, until March 2012. Accordingly, Mr. LV is a connected person of our Company as defined under the Listing Rules.

Mr. LV’s duties would be related to gathering and analyzing market and industry data and giving advice to us in relation to our marketing and customers service policies, giving advice to us in relation to our raw material sourcing and selection of raw material suppliers, as well as providing general advice in respect of sales and marketing.

Mr. LV was appointed as a director of Huiyin Textile since May 2006 and a general manager of Huiyin Textile since December 2007, primarily responsible for enterprise daily management and implementation of business plan, until March 2012. Mr. LV is experienced in the area of marketing and has accumulated 15 years of experience in the textile industry which can be traced back to 1996 when he worked with Zibo Wanjie Fiber Co., Ltd. (淄博萬杰纖維有限公司) as a deputy general manager. Mr. LV has also been appointed as an assistant to the general manager being responsible for the sale of chemical fiber in November 2004 in Wanjie High-Tech. Mr. LV was recognized as “Top Sales” (銷售狀元) of Boshan District twice. Mr. LV obtained a bachelor degree majoring in economic management from the Shandong College of Engineering (山東工程學院) in December 2001.

There were administrative decisions (博工商企處字(2007)第34號) issued against Yinlong Industrial by Boshan Branch of Zibo Bureau of Industry and Commerce (淄博市工商行政管理局博山分局) on 1 March 2007 (the “**Decisions**”). According to the Decisions, Yinlong Industrial was fined and penalised for committing certain irregularities identified in four sets of the statutory filings made by it on 25 January 2003 (the “**2003 Filings**”), 14 October 2005, 24 October 2005 and 7 November 2005 (“**2005 Filings**”), respectively. These irregularities related to, amongst others, the discrepancy in the actual capital contributions and the registered capital in the record of local SAIC in 2003 Filings, and the making of forged signatures on the local SAIC registration materials submitted in 2003 Filings and 2005 Filings.

The 2003 Filings were made at the time when Mr. LV was neither a shareholder nor a director or legal representative of Yinlong Industrial. According to the Decisions and 2005 Filings, Mr. LV was appointed and then resigned as the legal representative and executive director of Yinlong Industrial (the “**Relevant Appointment and Resignation**”) on 14 October 2005 and 24 October 2005, respectively, and there were three transfers of certain equity interests in Yinlong Industrial between Mr. LV, Mr. LIU Yanjiang and other shareholders

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of Yinlong Industrial (the “**Relevant Transfers**”). Pursuant to the Decisions, the signatures of the relevant parties (including Mr. LV’s signature) on the registration materials, shareholders’ resolutions and transfer documents submitted in the 2005 Filings which reported such changes were ruled by the Boshan Branch of Zibo Bureau of Industry and Commerce as forged.

As confirmed by Mr. LV, he did not participate in or procure these irregularities (including the making of forged signatures on the documents as stated in the Decisions), he had not signed any document on behalf of Yinlong Industrial when he was its legal representative in 2005, and was also not aware of the Relevant Appointment and Resignation and Relevant Transfers until he had been so informed after the making of each of the 2005 Filings.

The Directors confirm that, to the best of their knowledge, other than Mr. LV, none of the other Directors, senior management members or employees of our Group was a party in the corporate changes in the 2003 Filings and 2005 Filings and that none of our Directors, senior management or employees was involved in the making of the forged signatories referred to in the Decisions.

Mr. LV is the spouse of Ms. SUN Hongchun (a member of our senior management).

The Directors confirm that the appointment of Mr. LV as our consultant is on normal commercial terms. The fee payable to Mr. LV will fall within the de-minimis exemption under Rule 14A.33(3) of the Listing Rules and is therefore exempted from the reporting, announcement and independent shareholders’ approval requirements under the Listing Rules. Each of the Directors (including the independent non-executive Directors) has undertaken to the Company and the Stock Exchange that they will procure that the affairs and management of the Company shall not be directly and indirectly influenced by Mr. LV in any manner. In the event that the undertakings of the Directors are not fulfilled or breached, each of the Directors might face consequence from the parties they have made the undertakings including litigation or other action. The Directors shall indemnify the Company for any damage or loss for the breach of the undertakings.