

Report of the Directors

The Board is pleased to present to the shareholders of the working report of the Company for the year ended 31 December 2005.

Principal activities

The principal activities of the Company are operation of hypermarkets, supermarkets and convenience stores in the PRC, a majority of which are operated under one of the three major brands of "Century Mart", "Lianhua Supermarket" or "Lianhua Quik" respectively.

Percentages of purchases and sales attributable to major suppliers and customers of the Company during the year are as follows:

	2005 Percentage	2004 Percentage
Purchases		
Largest supplier	4.8	8.28
Five largest suppliers	11.65	17.92
Sales		
Largest customer	9.18	9.57
Five largest customers	14.32	10.52

To the best knowledge of the Directors, apart from Century Lianhua (for details of the Company's acquisition of the equity interests in Century Lianhua, which then became a non wholly-owned subsidiary of the Company, please refer to pages 128 to 129 of this annual report) and Lianhua e-Business, neither the Directors, the supervisors of the Company (the "Supervisors"), their respective associates, nor any shareholders holding 5% or more in the Company's share capital held any direct or indirect interest in the share capital of the Company's suppliers and customers mentioned above during the year ended 31 December 2005.

Subsidiaries and associated companies

As at 31 December 2005, the Company's principal subsidiaries are Lianhua Quik Convenience Stores, Hangzhou Lianhua Huashang, Lianhua Supermarket (Jiangsu) Co., Ltd, Lianhua Distribution and Shanghai Lianhua Life.

As at 31 December 2005, the Company's principal associated companies are Shanghai Carhua, Shanghai Dia and Lianhua E-Business.

Please refer to note 42 to the financial statements in this annual report for the particulars of certain major subsidiaries and associated companies of the Company.

Accounts

The audited results of the Company for the year ended 31 December 2005 are set out in the profit and loss account on page 65 of the annual report.

The financial conditions of the Company as at 31 December 2005 is set out in the balance sheet on pages 66 to 67 of the annual report.

The cash flow of the Company for the year ended 31 December 2005 were set out in the cash flow statement on page 72 of the annual report.

Dividend

Pursuant to the financial statements of the Company for the year 2005 prepared in accordance with the Hong Kong Financial Reporting Standards (the "HKFRS") and audited by PricewaterhouseCoopers, profit distributable to shareholders of the Company was RMB313,000,000. Pursuant to the financial statements of the Company for the year 2005 prepared in accordance with Chinese Accounting Standards and audited by Shanghai Certified Public Accountants, profit distributable to shareholders of the Company was RMB361,340,900.

Pursuant to the Articles of Association, the profit after tax of the Company available for distribution shall be the lower of the two amounts of profit distributable to shareholders of the Company as above-mentioned. Accordingly, the distributable profit of the Company for the year 2005 was RMB313,000,000.

The Board recommends to distribute a final dividend of RMB0.07 per ordinary share of the Company in cash for the year ended 31 December 2005. The distribution proposal will be implemented subject to consideration and approval in the Company's annual general meeting of 2005.

The general meeting held on 13 December 2005 approved the distribution of an interim dividend of RMB0.06 per ordinary share of the Company for the six months ended 30 June 2005. The payment of all interim dividends to shareholders of the Company has been completed.

The final dividend will be distributed to shareholders of the Company whose names appear on the Company's Register of Members on Friday, 26 May 2006. The H shares share register of the Company will be closed from Monday, 29 May 2006 to Wednesday, 28 June 2006 (both days inclusive), during which no transfer of H shares will be effected. In order to qualify for the final dividend, holders of H shares shall lodge share certificates and the relevant share transfer documents with Computershare Hong Kong Investor Services Limited at Rooms 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, not later than 4:00 p.m. on Friday, 26 May 2006.

The dividends to be distributed will be denominated and declared in Renminbi. Distribution to domestic shareholders of the Company will be made in Renminbi, while distribution to holders of non-listed foreign shares of the Company in relevant foreign currencies and to holders of H shares of the Company in Hong Kong dollars. The dividends to

be distributed in Hong Kong dollars will be converted into Hong Kong dollars at the average exchange rate of Renminbi to Hong Kong dollars announced by the People's Bank of China in the week prior to the dividend distribution date.

Reserves

During the year under review, shareholders' equity of the Group increased from approximately RMB1,728,349,000 to approximately RMB1,890,761,000.

The details of the movements in the reserves during the year under review are set out in note 32 to the financial statements of this annual report.

Fixed assets

Movements of fixed assets during the year were set out in note 16 to the financial statements of the annual report.

Bank loans, overdrafts and other borrowings

As at 31 December 2005, the Group had secured liabilities of RMB18,910,000 arising from the Group's acquisition of a subsidiary, Guangxi Lianhua Supermarket Joint Stock Company Limited (formerly known as Guangxi Jiayong). As at 31 December 2005, the loan was secured by certain buildings of the Group with a net value of RMB55,238,000.

Interest capitalisation

During the year under review, no interest of construction in progress has been capitalised.

Listing of shares and changes

The Company listed its H shares on the Main Board of the Stock Exchange on 27 June 2003.

The Company offered 34,500,000 new H shares on 4 October 2004. Accordingly, the total number of shares of the Company in issue was increased from

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587,500,000 shares to 622,000,000 shares. H shares in issue increased from 172,500,000 shares to 207,000,000 shares, representing 33.28% of the Company's total share capital.

As the Company did not implement any new issue plan during the year under review, there was no change in its share capital.

The performance of H shares of the Group in 2005:

Highest trading price per H share during the year	HK\$9.45
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Lowest trading price per H share during the year	HK\$6.95
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Total turnover volume of H shares during the year	148,760,000 shares
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Closing price per H share as at 31 December 2005	HK\$7.25
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Public float

The Company confirms that the Company's public float during the year under review complied with the applicable requirements of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules").

Share capital

As at 31 December 2005, the classes and number of shares of the Company are as follows:

Class of shares	No. of issued	
	shares (‘000 shares)	Percentage (%)
Domestic shares	355,543	57.16
Attributable to:		
Shanghai Friendship Group Incorporated Company	211,640	34.03

Shanghai Industrial United (Group)		
Commercial Network Development Company Limited	131,683	21.17
Shanghai Liding Investment Company Limited	12,220	1.96
Unlisted foreign shares	59,457	9.56
Attributable to:		
Mitsubishi Corporation	41,900	6.74
Hong Kong Wong Sun Heng Investment Co., Ltd.	17,557	2.82
H shares	207,000	33.28

Total	622,000	100.00
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Number of shareholders

As at 31 December 2005, details of shareholders as recorded in the Register of Members of the Company are as follows:

Total number of shareholders	38
Holders of domestic shares	3
Holders of unlisted foreign shares	2
Holders of H shares	33

Legal status of unlisted foreign shares

Set out below is the summary of legal opinions given by Grandall Legal Group on the rights attached to unlisted foreign shares (the "Unlisted Foreign Shares"). Although the Mandatory Provisions for Articles of Association of Companies to be Listed Overseas (the "Mandatory Provisions") provide for the definitions of "domestic shares", "foreign shares" and "overseas listed foreign shares" (which definitions have been adopted in the articles of association of the Company (the "Articles of Association")), the rights attached to the Unlisted Foreign Shares, which are subject to certain restrictions on transfer as referred to the Prospectus and may become H shares of the Company (the "H Shares") upon obtaining the requisite approvals from, among other bodies, the China Securities Regulatory Commission (the "CSRC") and the Stock Exchange, are not expressly

provided for under the existing PRC laws or regulations. However, the Company's creation of and the subsistence of the Unlisted Foreign Shares do not contravene any PRC laws or regulations.

At present, there are no laws and regulations in the PRC specifically applicable for governing the rights attached to the Unlisted Foreign Shares. Grandall Legal Group advised that until new laws or regulations are introduced in this aspect, holders of the Unlisted Foreign Shares shall enjoy the same ranking as holders of domestic shares of the Company ("Domestic Shares") (in particular, in respect of the rights to attend and vote at general meetings and class meetings and to receive notice of such meetings in the same manner as holders of Domestic Shares), except that the holders of the Unlisted Foreign Shares enjoy the following rights to which the holders of Domestic Shares are not entitled:

- (a) to receive dividends declared by the Company in foreign currencies; and
- (b) in the event of the winding up of the Company, to remit their respective shares of the remaining assets (if any) of the Company out of the PRC in accordance with the applicable foreign exchange control laws and regulations of the PRC.

No provision is made for the settlement of disputes between the holders of Unlisted Foreign Shares and holders of Domestic Shares in the Mandatory Provisions or Articles of Association. According to the PRC laws, in case of disputes between the holders of Unlisted Foreign Shares and holders of Domestic Shares and the parties failed to reach any settlement after negotiation or mediation, either party may choose to resort to an arbitration commission in the PRC or any other arbitration commission to conduct arbitration for dispute

resolution pursuant to a written arbitration agreement. If there is no prior arbitration agreement and the parties are not able to reach an agreement in respect of the arbitration of their dispute, either party may bring suit in a competent PRC court.

According to the requirements under Clause 163 of the Mandatory Provisions and Clause 194 of the Articles of Association, in general, disputes between the holders of H Shares and holders of Domestic Shares are required to be settled through arbitration. Such dispute resolution requirements are equally applicable to disputes between the holders of H Shares and holders of Unlisted Foreign Shares.

As advised by Grandall Legal Group, the Unlisted Foreign Shares cannot be converted into new H Shares prior to satisfaction of the following conditions:

- (a) the expiry of a period of three years from the date on which the Company was converted from a limited company into a joint stock limited company;
- (b) approvals from the original approval authority or authorities in the PRC for the establishment of the Company being obtained by the holders of Unlisted Foreign Shares for the conversion of Unlisted Foreign Shares into H Shares after expiry of the three-year restriction period for the transfer of Unlisted Foreign Shares (in the case of the Company, the three-year restriction period will end on 18 December 2005 as prescribed by Article 147 of the Company Law of the PRC);
- (c) approval from the CSRC being obtained by the Company for the conversion of the Unlisted Foreign Shares into new H Shares;

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- (d) approval being granted by the Stock Exchange for listing of and permission to deal in the new H Shares converted from the Unlisted Foreign Shares;
- (e) approval being granted by the Shareholders at a general meeting and the holders of H Shares, Domestic Shares and Unlisted Foreign Shares at their respective class meetings to authorise the conversion of the Unlisted Foreign Shares into new H Shares in accordance with the Articles of Association; and
- (f) full compliance with the relevant PRC laws, rules, regulations and policies governing companies incorporated in the PRC and seeking permission for listing their shares outside the PRC and with the Articles of Association and any agreement among the Shareholders.

Upon satisfaction of all the conditions mentioned above and other conditions as may be imposed from time to time by the Stock Exchange, the Unlisted Foreign Shares may be converted into new H Shares.

Disclosure of interests

Directors, Chief Executive and Supervisors of the Company

As at 31 December 2005, none of the Directors, chief executive or Supervisors of the Company had any interests or short positions in the shares, underlying shares or debt securities of the Company or any of its associated corporations (within the

meaning of Part XV of the Securities and Futures Ordinance, the "SFO") which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO), or which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

As at the latest practicable date, Mr. Wang Zong-nan, Mr. Liang Wei and Mr. Lu Ming-fang are directors, supervisors or employees of Shanghai Friendship Group Incorporated Company, Shanghai Industrial United (Group) Joint Stock Company Limited, Shanghai Industrial Holdings Limited and/or Shanghai Industrial Investment (Holdings) Company Limited respectively. As disclosed below, these companies had interests in the shares of the Company as at the latest practicable date which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 2 and 3 of Part XV of the SFO.

Substantial Shareholders of the Company

So far as the Directors are aware, as at the latest practicable date, the following persons (not being a Director, chief executive or Supervisor of the Company) had interests in the shares of the Company as at the latest practicable date which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 2 and 3 of Part XV of the SFO:

Approximate

Name of shareholders	Class of shares	No. of domestic shares/unlisted foreign shares/H shares	Approximate percentage of voting rights of the Company (%)	percentage of voting rights of domestic shares/unlisted foreign shares (%)	Approximate percentage of voting rights of H shares (%)
Shanghai Friendship Group Incorporated Company	domestic	211,640,000	34.03 (Note 3)	51.00	–
Shanghai Industrial United (Group) Commercial Network Development Company Limited	domestic	131,683,000	21.17	31.73	–
Mitsubishi Corporation	unlisted foreign	41,900,000	6.74	10.10	–
Shanghai Industrial United (Group) Joint Stock Company Limited	domestic	131,683,000	21.17 (Note 1) (Note 5)	31.73	–
Shanghai Industrial YKB Limited	domestic	131,683,000	21.17 (Note 1)	31.73	–
Shanghai Industrial Holdings Limited	domestic	131,683,000	21.17 (Note 1) (Note 5)	31.73	–
Shanghai Investment Holdings Limited	domestic	131,683,000	21.17 (Note 2)	31.73	–
Shanghai Industrial Investment (Holdings) Company Limited	domestic	131,683,000	21.17 (Note 2) (Note 4)	31.73	–
Shanghai Industrial Investment Treasury Company Limited	domestic	131,683,000	21.17 (Note 2)	31.73	–
SIIC Capital (BVI) Limited	domestic	131,683,000	21.17 (Note 2)	31.73	–
JPMorgan Chase & Co.	H shares	24,794,792 (L) 671,000 (P)	3.99 (L) 0.11 (P)	–	11.98 (L) 0.32 (P)
IXIS Asset Management Asia Ltd	H shares	19,132,000 (L)	3.08 (L)	–	9.24 (L)
The Capital Group Companies, Inc.	H shares	18,707,000 (L)	3.01 (L)	–	9.04 (L)
Government of Singapore Investment Corporation Pte Ltd	H shares	17,198,300 (L)	2.77 (L)	–	8.31 (L)
Matthews International Capital Management, LLC	H shares	10,563,000 (L)	1.70 (L)	–	5.10 (L)
Commonwealth Bank of Australia	H shares	10,400,000 (L)	1.67 (L)	–	5.02 (L)
Fidelity International Limited	H shares	10,382,000 (L)	1.67 (L)	–	5.02 (L)

(L) = Long position

(S) = Short position

(P) = Lending pool

Notes:

- Shanghai Industrial Holdings Limited (“SIHL”) owns 100% interests in Shanghai Industrial YKB Limited (“YKB”) whilst YKB owns 56.63% interests in Shanghai Industrial United (Group) Joint Stock Company Limited (“Shanghai United”). Shanghai United owns 90% interests in Shanghai Industrial

United (Group) Commercial Network Development Company Limited (“SH United Commercial”). Accordingly, SIHL and Shanghai United are deemed to have the disclosable interests in shares of the Company above.

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2. Shanghai Industrial Investment (Holdings) Company Limited ("SIIC") owns 100% interests in Shanghai Industrial Investment Treasury Company Limited ("STC") and STC owns 100% interests in Shanghai Investment Holdings Limited ("SIH"). SIH directly and indirectly through SIIC Capital (BVI) Limited owns an aggregate of 56.67% interests in SIHL. Accordingly, SIIC, STC, SIIC Capital (BVI) Limited and SIH are deemed to have the disclosable interests in shares of the Company above.
3. Mr. Wang Zong-nan, the Chairman of the Board and an executive Director, is also the chairman of the board of directors of Shanghai Friendship. Mr. Liang Wei, an executive Director, is a supervisor of Shanghai Friendship.
4. Mr. Lu Ming-fang, a non-executive Director, is also an executive director and chairman of the board of directors of Shanghai United, and an executive Director of SIHL and SIIC.
5. Mr. Lu Ming-fang, a non-executive Director, beneficially owned 15,000 shares in Shanghai United. Mr. Lu also beneficially owned 4,200,000 ordinary shares and 480,000 share options in SIHL, which entitle him to subscribe for a total of 480,000 ordinary shares at an exercise price of HK\$14.89 per share during the period from 2 March 2006 to 1 March 2009. Mr. Shi Zu-qi, a non-executive Director, beneficially owned 3,000 shares in Shanghai United.
6. On 20 June 2005, SIHL and Shanghai United entered into an asset exchange agreement. Shanghai United transferred its 21.17% interests in the Company held by its subsidiary, SH United Commercial, to S.I. Commerce Holdings Limited ("SI Commerce"), a wholly-owned subsidiary of SIHL. The agreement is subject to approval by shareholders of SIHL and Shanghai United and will take effect at the same time with the other six agreements. If the agreement is approved, Shanghai Commercial, SIHL, SIIC Capital (BVI), SIH, STC and SIIC will be deemed as holding 21.17% disclosable interests of the Company, while SH United Commercial, YKB and Shanghai United will not be deemed to own any interests in the Company.

Save as disclosed above, the Directors are not aware of any persons holding any interests or short positions in shares or underlying shares of the Company which were required to be disclosed pursuant to Divisions 2 and 3 of Part XV of the SFO as at the latest practicable date.

Ultimate controlling shareholder

On 11 August 2004, Shanghai Friendship Group Incorporated Company, the controlling shareholder of the Company, announced that pursuant to the approval document Guo Zi Chan Quan 【2004】 No.556 of the State Council, the Shanghai Friendship Group Incorporated Company, a State-owned enterprise and former holder of State-owned shares of the company, had transferred the State-owned shares it held in that company, representing 6.08% of the total capital, to Bailian (Group) Company Limited; pursuant to document Hu Guo Zi Wei 【2003】 No. 300, the Shanghai Friendship Group Incorporated Company, the State-owned enterprise and former holder of State-owned shares of the company, had transferred 52% of the shares it held in Shanghai Friendship Fuxing (Holdings) Company Limited, the major shareholder of the company, to Bailian (Group) Company Limited. The administrative procedures for the approval stated above had been completed. Bailian (Group) Company Limited became the ultimate controlling shareholder of Shanghai Friendship Group Incorporated Company. Accordingly, Bailian (Group) Company Limited also became the ultimate controlling shareholder of the Company. The Directors consider that this change will not have any material effect on the daily operations of the Company.

Pre-emptive rights

There are no provisions under the Articles of Association requiring the Company to offer pre-emptive rights of new shares to its existing shareholders in accordance with the proportion of their respective shareholdings.

Purchase, sale or redemption of shares

Since the listing of H Shares on 27 June 2003 to the date of this report, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares.

Share capital interests attributable to the Directors and Supervisors

As at 31 December 2005, none of the Directors, Supervisors or senior management of the Company had any interests or short positions in the shares, underlying shares or debt securities of the Company or any associated corporation (within the meaning of the SFO) which are required by section 352 of the SFO to be recorded in the register referred to therein, or required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers under the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules").

Directors and Supervisors

The Directors and Supervisors during the year and up to the date of this report were as follows:

Executive Directors:

Mr. Wang Zong-nan (Chairman)
Mr. Liang Wei
Ms. Xu Ling-ling
Ms. Cai Lan-ying

Non-executive Directors:

Mr. Lu Ming-fang
Mr. Tsunao Kijima
Mr. Wong Tak Hung
Mr. Hua Guo-ping
Mr. Shi Zu-qi

Independent non-executive Directors:

Mr. Lee Kwok Ming, Don
Mr. Zhang Hui-ming
Mr. Xia Da-wei

Supervisors:

Mr. Wang Long-sheng
Mr. Zhang Zeng-yong
Mr. Shen Bo

Details of the profile of the Directors, Supervisors and senior management of the Company are set out on pages 28 to 37.

Directors' and Supervisors' service contracts

The Company has entered into a service contract with each of the executive Directors on 8 June 2005, the term of which corresponds to their respective term of office as Director for a period of 3 years and renewable subject to the applicable laws.

Directors' and Supervisors' interests in contracts

No contract of significance to the business of the Company to which the Company or its subsidiaries was a party and in which a Director or Supervisor had material interests subsisted on the balance sheet date or at any time during the year under review.

Interest in shares or bonds acquired by the Directors and Supervisors

During the year, no arrangement was entered by the Company or its subsidiaries which enables the Directors or Supervisors to acquire the shares or bonds of the Company.

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Independence of the independent Directors

The Company has received written confirmation from each of the independent non-executive Directors pursuant to Rule 3.13 of the Listing Rules concerning their independence. The Company considers that all existing independent non-executive Directors complied with the provisions of Rule 3.13 of the Listing Rules and are independent.

Highest paid individuals

All the five highest paid individuals of the Company during the year were senior management members of the Company. The details of their remuneration are set out in note 15 to the financial statements in this annual report.

Retirement schemes

In accordance with the applicable laws and regulations in the PRC, all employees of the Group participate in various defined contribution retirement schemes organised by the relevant municipal and provincial governments of the PRC, under which the Group and the employees are required to make monthly contributions to these schemes at a percentage of the employees' salaries during the relevant periods.

Change of auditors

During the three years ended 31 December 2005, there had not been any change of the international auditors of the Company. The financial statements for the year 2005, which was compiled by the Company in accordance with the Hong Kong Financial Reporting Standards, was audited by the international auditors of the Company, PricewaterhouseCoopers. The Board will propose at the annual general meeting of the year 2005 for the re-appointment of PricewaterhouseCoopers as the international auditors of the Company.

Significant litigation

During the year, the Company was not engaged in any significant litigation.

Qualified accountant

Subject to Rule 3.24 of the Listing Rules, the Company is required to employ a qualified accountant on a full-time basis, who must be a fellow or associate of the Hong Kong Institute of Certified Public Accountants ("HKICPA") or a similar body of accountants recognized by it for exemptions from membership examination of the HKICPA. Ms. Xu Ling-ling ("Ms. Xu"), being the chief financial officer of the Company, meets all the requirements set out in Rule 3.24 of the Listing Rules save for being a fellow or associate of the HKICPA or a similar body of accountants recognized by it for exemptions from membership examination of the HKICPA. The Company has appointed Mr. Chan Wai Leung ("Mr. Chan"), a Certified Public Accountant of the HKICPA, to assist Ms. Xu in discharging her duties as the Qualified Accountant. The Stock Exchange has granted to the Company a conditional waiver from compliance with Rule 3.24 of the Listing Rules for a period of 3 years commencing from 7 January 2005.

Connected transaction

Since listing of the Company's H shares on the Stock Exchange, the following transactions constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules. The aforesaid continuing connected transactions were conducted in the ordinary course of business of the Group. The Company has applied to the Stock Exchange for a conditional waiver from strict compliance with the Listing Rules in respect of the above transactions, and the Stock Exchange has granted to the Group a waiver from reporting, announcement and independent shareholders' approval requirements.

During the period under review, amounts of continuing connected transactions of the Company are as follows:

	Amounts (RMB million)
1. Sales of merchandise to connected parties	3,209.05
(1) Sales of merchandise to Century Lianhua	1,313.76
(2) Sales of merchandise to supermarkets owned by certain subsidiaries of the Company	1,438.31
(3) Sales of merchandise to Lianhua Quik	360.67
(4) Sales of merchandise to supermarkets owned by certain subsidiaries of the Company	96.31
2. Purchase of merchandise from Lianhua Distribution	1,137.11
3. Management of Century Lianhua	2.15
4. Lease of property to Lianhua Distribution	4.40

The Company will take steps to ensure continued compliance with the applicable provisions under Chapter 14A of the Listing Rules in respect of the connected transactions.

The independent non-executive Directors have reviewed the above transactions and confirmed that the transactions have been entered into:

- (1) in the ordinary and usual course of business of the Group;

- (2) on normal commercial terms (to the extent that there are comparable transactions) or if there are not sufficient comparable transactions to determine whether they are on normal commercial terms, on terms not less favourable to the Group than terms available to or from (as appropriate) independent third parties; and

- (3) in accordance with the respective governing arrangements and on terms that are fair and reasonable and in the interests of the independent shareholders of the Company as a whole;

The auditors of the Company have reviewed the above transactions and confirmed in writing to the Board that the above transactions:

- (1) have been approved by the Board;
- (2) have been entered into in accordance with the relevant governing agreements;
- (3) were in accordance with the pricing policies as stated in the Company's accounts; and
- (4) were conducted within the respective cap for each transaction.

Connected transaction entered into during the year under review – acquisition of Century Lianhua

To enlarge the Company's operating scale with the benefit of synergies and reduce the amount of connected transactions of the Company, on 27 October 2005, the Company entered into an Equity Transfer Agreement with SI Commerce and Shanghai Friendship in relation to the acquisition of 22.21% and 35.70% of the equity interest, respectively, in Century Lianhua. Further, Hangzhou Lianhua, a non wholly-owned subsidiary of the Company, entered into an Equity Transfer Agreement on 27 October 2005 with Shanghai

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Liding in relation to the acquisition of 22.09% of the equity interest in Century Lianhua by Hangzhou Lianhua. Upon completion of the Equity Transfer Agreement, Century Lianhua will become a non-wholly owned subsidiary of the Company, being owned as to 77.91% by the Company and 22.09% by Hangzhou Lianhua. The total consideration in respect of the above three Equity Transfer Agreements was approximately RMB94,972,000. As SI Commerce is an associate of Shanghai Industrial Commercial Network and each of Shanghai Industrial Commercial Network (holder of 21.17% of the issued share capital of the Company), Shanghai Friendship (holder of 34.03% of the issued share capital of the Company) and Shanghai Liding is a Promoter of the Company, hence each of SI Commerce, Shanghai Friendship and Shanghai Liding is a connected person of the Company under the Listing Rules. Accordingly, the transactions contemplated under each of the Equity Transfer Agreements constitute connected transactions of the Company under the Listing Rules. As each of the assets ratio (as all defined in Rule 14.07 of the Listing Rules), the revenue ratio and the consideration ratio for the aggregate consideration payable by the Company and Hangzhou Lianhua under the Equity Transfer Agreements is more than 2.5%, each of the Equity Transfer Agreements is subject to the reporting, announcement and independent shareholders' approval requirements under the Listing Rules. The Company has discharged its obligations of reporting and announcement, and each of the three Equity Transfer Agreements has been unanimously approved by the independent shareholders at the extraordinary general meeting held on 13 December 2005.

Continuing connected transaction entered into during the year under review – purchasing agreement

On 27 October 2005, the Company also entered into an agreement with Lianhua Quik in relation to the supply of merchandise to Lianhua Quik by the

Company. As at the date of the Merchandise Agreement, Lianhua Quik was owned as to 30% by Shanghai Liding (a promoter of the Company) and 70% by the Company. By virtue of this relationship, Lianhua Quik is a connected person of the Company under the Listing Rules. The transactions contemplated under the Merchandise Agreement therefore constitute continuing connected transactions of the Company under the Listing Rules. Given that each of the assets ratio, revenue ratio and consideration ratio (as all defined in Rule 14.07 of the Listing Rules) of the estimated aggregate annual amount of sales to Lianhua Quik by the Company under the Merchandise Agreement for the three years ending 31 December 2008 exceeds 2.5%, the Company has discharged its obligation for announcement and the transactions have been ratified by the independent shareholders of the Company at a ratio of 99.85% in the extraordinary general meeting held on 13 December 2005. The annual cap of the transactions for 2006 is RMB448,400,000.

Continuing connected transaction effective during the year under review – rental agreement

Upon completion of the Equity Transfer Agreements, Century Lianhua became a non-wholly owned subsidiary of the Company. Shanghai Friendship Shopping Center Development Co., Ltd. ("SFSC") and Homemart Decoration and Materials Co., Ltd. ("Homemart") are both non-wholly owned subsidiaries of Shanghai Friendship (controlling shareholder and one of the promoters of the Company). Accordingly, the leasing agreements between Century Lianhua and SFSC in respect of No. 88, Xian Xia Xi Lu, Chang Ning District, Shanghai, between Century Lianhua and Homemart in respect of No. 645, Xie Tu Lu, Lu Wan District, Shanghai, and between Century Lianhua and Homemart in respect of No. 1875, Ji Yang Lu, Pudong New District, Shanghai constitute continuing connected transactions since the date when Century Lianhua became the subsidiary of

the Company. Given that each of the percentage ratios (as defined in the Listing Rules) of the estimated aggregate rental payment payable by Century Lianhua to SFSC and Homemart under the aforementioned leasing agreements is less than 2.5%, the said leasing agreements are only subject to the reporting and announcement requirements of the Listing Rules. A relevant announcement was published on 27 October 2005. The Board will review the aggregate amounts paid under the Leasing Agreements from time to time and will comply with the reporting, announcement requirements and independent shareholders' approval under the Listing Rules in the event that any of the percentage ratios (as defined in Rule 14.07 of the Listing Rules, except profit ratio) of such aggregate amounts exceed 2.5%.

The Directors believed the aforementioned leasing agreements will ensure the continuity of the use of the relevant premises and avoid any unnecessary interruption of the operation of the hypermarkets which are currently located on the relevant premises, hence consolidate the presence and secure the customers in each of the hypermarkets concerned. The annual payment under each of the aforementioned leasing agreements was determined after arm's length negotiation between the parties thereto, and, as confirmed by independent property valuer, with reference to the prevailing market rate of similar properties in their respective area.

*Continuing connected transaction
discontinued during the year under review*

The acquisition of 80% interests in Century Lianhua by the Company and the non-wholly owned subsidiary of the Company was approved and rectified by independent shareholders at the extraordinary general meeting of the Company held on 13 December 2005. Pursuant to the relevant Equity Transfer Agreements, Shanghai Friendship, Shanghai Industrial Commercial Network and Shanghai Liding severally agreed to grant the Company their respective voting rights in Century Lianhua on 13 December 2005, being the date of

approval of the Equity Transfer Agreements by the independent shareholders of the Company, whereupon the Company had substantial control over Century Lianhua. As confirmed by the external auditors of the Company, Century Lianhua became a non-wholly owned subsidiary of the Company on 13 December 2005, and its accounts have been combined to the consolidated accounts of the Company. No related party held more than 10% voting rights in Century Lianhua from the same day. As such, Century Lianhua was no longer a connected party of the Company since 13 December 2005. Accordingly, the Company's sales of merchandise to and management of Century Lianhua and the Company's sales of merchandise to hypermarkets and supermarkets of certain subsidiaries of the Company were no longer continuing connected transactions under the Listing Rules.

On 25 August 2005, Shanghai Liding transferred 20% equity interests in Shanghai Lianhua Supermarket Distributor Company Limited ("Lianhua Distribution") to an independent third party and no longer hold any interest in Lianhua Distribution. Since Century Lianhua, another shareholder of Lianhua Distribution, ceased to be a connected party of the Company since 13 December 2005, the Company's purchases from Lianhua Distribution no longer constitute continuing connected transactions under the Listing Rules as none of the Company's connected parties or their associates hold 10% or more equity interest in Lianhua Distribution. In addition, the leasing agreement between the Company and Lianhua Distribution also ceased to be a continuing connected transaction under the Listing Rules on the same day.

By order of the Board
Wang Zong-nan
Chairman

18 April 2006
Shanghai, the PRC





Lianhua Supermarket has devoted to improving the *transparency of its corporate governance* and *the quality of information disclosures*. We also attach great importance on communication with our shareholders.