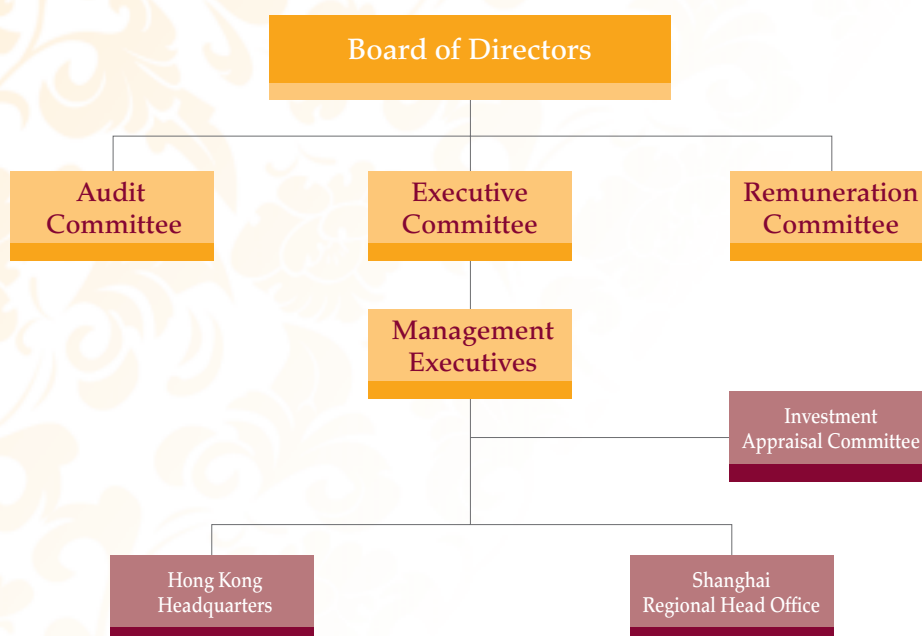


CORPORATE GOVERNANCE REPORT

CORPORATE GOVERNANCE STRUCTURE

As sound corporate governance is essential to corporate development, the Group has made considerable efforts to improve its internal control mechanism. Through this, the Group expects to enhance corporate governance standards, ensure the standardized operation of its businesses, and effectively monitor operating and financial risks. The governance structure of the Company is designed to take into account the multi-discipline and cross-territory attributes of its businesses, with emphasis on highly efficient management. Set out below is the governance structure of the Company:



COMPLIANCE OF CODE OF CORPORATE GOVERNANCE

Throughout the year, the Company has applied the principles and complied with all code provisions of the Code on Corporate Governance Practices as set out in Appendix 14 to the Listing Rules on the Stock Exchange.

I. Board of Directors

The Board of Directors represents the highest level of authority in the governance structure of the Company. They are mainly responsible for formulating the Company's long term development strategy and operational direction, monitoring the Group's operations and financial performance, as well as leading and supervising the management to ensure thorough implementation of the Board's resolutions and effective performance of their duties.

COMPOSITION OF THE BOARD

For the purpose of business development and due to State policy requirement to rotate staff seconded outside Mainland China, Mr. Cai Yu Tian was appointed Executive Director, Vice Chairman and Chief Executive Officer of the Company in 2005. Mr. Lu Ming Fang ceased to act as Chief Executive Officer but remained an Executive Director of the Company. Mr. Lu Da Yong and Mr. Lu Shen resigned from the position of Executive Directors in the Company. The respective resolutions were considered and approved by all Directors. Currently, the Board has 11 members, of whom eight are Executive Directors, namely Mr. Cai Lai Xing, Mr. Cai Yu Tian, Mr. Qu Ding, Mr. Lu Ming Fang, Mr. Ding Zhong De, Mr. Qian Shai Zheng, Mr. Yao Fang and Mr. Tang Jun, and three Independent Non-Executive Directors, namely Dr. Lo Ka Shui, Prof. Woo Chia-Wei and Mr. Leung Pak To, Francis. The Chairman of the Company is Mr. Cai Lai Xing. The nomination of Directors is principally made by the controlling shareholder of the Company recommending candidates to the Company, and considered by the Board on the basis of the candidates' working experience, profession and academic background.

The Members of the Board comprise experts from various professions who have served in relevant Mainland government authorities, enterprises or financial institutions. With extensive experience in corporate administration, economic research and asset management, these members have actively participated at Board meetings and devoted their efforts to offer independent and impartial advice. They have also monitored the Group's affairs, making significant contributions to enhancing the Group's corporate governance standards. No Members of the Board are related among themselves in terms of finance, business and family. Brief biographies of the Directors and senior management are set out on pages 42 to 47 of this Annual Report and published in the Company's website.

RE-ELECTION OF THE DIRECTORS

In accordance with the Company's Articles of Association and provisions set out in the Code on Corporate Governance Practices, the Company arranged all newly appointed Directors to become re-elected by the Shareholders at the first general meeting after their appointment. In addition, each Director (including those Directors who are appointed with a specific term) is to be re-elected by rotation at least once every three years.

The Directors retired and re-elected in accordance with the Articles of Association at the Annual General Meeting for 2005 were Mr. Cai Lai Xing, Mr. Qu Ding, Mr. Lu Ming Fang, Mr. Yao Fang, Mr. Tang Jun and Dr. Lo Ka Shui. At the 2006 Annual General Meeting of the Company to be held on 30th May 2006, the five Directors to be retired by rotation and eligible for re-election are Mr. Cai Yu Tian, Mr. Ding Zhong De, Mr. Qian Shi Zheng, Prof. Woo Chia-Wei and Mr. Leung Pak To, Francis.

TERM OF INDEPENDENT NON-EXECUTIVE DIRECTORS

Dr. Lo Ka Shui, Prof. Woo Chia-Wei and Mr. Leung Pak To, Francis, the three Independent Non-Executive Directors of the Company, have been appointed these positions since the listing of the Company in 1996. There is no material commercial transaction between them and the Company, its controlling shareholder and their respective subsidiaries, and they have no material interest in the principal operating activities. There was no evidence from any aspect which demonstrated that the guidance relating to the assessment of the independence of directors as set out in Rule 3.13 of the Listing Rules were not complied with.

During the year, the Company entered into letters of appointment with each of the three Independent Non-Executive Directors, specifying an appointment term of three years from 1st January 2005 to 31st December 2007. The retiring Independent Non-Executive Directors are eligible for re-election.

RESPONSIBILITIES OF THE CHAIRMAN AND THE CHIEF EXECUTIVE OFFICER

Mr. Cai Lai Xing and Mr. Cai Yu Tian are the Chairman and the Chief Executive Officer of the Company respectively. The Chairman is mainly responsible for the management of the Board, providing leadership and ensuring effective performance of the Board. The Chief Executive Officer is mainly responsible for the operation and management of the Group's businesses, leading the members of the management to perform their duties in accordance with the established business strategies and operation directions of the Board. During the year, an Interpretation on the Responsibilities between the Chairman and the Chief Executive Officer was made by the Company for division of responsibilities between the two roles.

MEETING PROCEDURES

The timetable for the regular meetings of the Board/Committees each year was proposed to each Director/Committee Member at the beginning of the year, so that arrangements could be made by each Director/Committee Member for attending the meetings. Notice of regular meeting and the relevant materials for Board meetings/Committee meetings were generally given 14 days and 3 days respectively before the date of the meeting. Where necessary, Directors/Committee Members could contact the management or relevant officers about the businesses to be transacted at the Board/Committee meetings on their own.

Minutes of Board/Committee meetings were to be kept by the Company Secretary/Committee Secretary. Minutes recorded sufficient detail matters considered at the meeting, including any concerns raised by Directors/Committee Members or dissenting views expressed. Board meeting documents and relevant materials were open for inspection at any time by any Director/Committee Member. Draft and final versions of minutes of meetings were to be sent to Directors/Committee Members by the Company Secretary/Committee Secretary for their comment and records respectively, in both cases within a reasonable time after the meeting was held. If a substantial shareholder or a director has a material conflict of interest in a matter to be considered by the Board, the matter would be dealt with at a Board meeting to be attended by all Directors. The related Director must abstain from voting and that he would not be counted in the quorum present at the meeting. According to the provisions of the articles of association, a Director holding 5% or more interests is regarded as having material interest.

In 2005, five full Board meetings were held by the Company, of which one was conducted in the form of written resolutions. The average percentage of attendance was 96%. During the year, attendance of the Board meetings was as follows:

Name of Director		Attendance/No. of meetings
<i>Executive Directors</i>		
Cai Lai Xing		5/5
Cai Yu Tian	(appointed on 19th December 2005)	—/—
Qu Ding		5/5
Lu Ming Fang		5/5
Lu Da Yong	^(Note)	—/—
Ding Zhong De		5/5
Lu Shen	(resigned on 19th December 2005)	5/5
Qian Shi Zheng		5/5
Yao Fang		5/5
Tang Jun		5/5

Name of Director	Attendance/No. of meetings
<i>Independent Non-Executive Director</i>	
Lo Ka Shui	5/5
Woo Chia-Wei	5/5
Leung Pak To, Francis	3/5

Note: Mr. Lu Da Yong was suspended from all administrative duties of the Company from 27th February 2004, and resigned as an Executive Director of the Company on 19th December 2005.

RESPONSIBILITIES OF DIRECTORS

A Memorandum of Responsibilities for Newly Appointed Directors was made during the year. Briefing sessions and training would be delivered whenever necessary during his appointment to ensure that he has a proper understanding of the operations and business of the Company and that he is fully aware of the updates of his statutory responsibilities from time to time. Maintaining close association with each of the Directors, the Company Secretary is responsible for ensuring that board procedures and all applicable rules and regulations are followed, and offers advice and services to the Board members where necessary. Furthermore, the Board resolved the Procedures for Directors to Seek Professional Advice in order to facilitate the Directors in performing their duties. The Directors may seek independent professional advice according to such agreed procedures at the expense of the Company. Moreover, the Company also arranged liabilities insurance for its Directors and senior officers, providing required protection to their work.

CODE FOR SECURITIES TRANSACTIONS

Pursuant to the relevant provisions in the Model Code in Appendix 10 and the Code of Corporate Governance in Appendix 14 to the Listing Rules, the Company established its own Code for Securities Transactions by Directors or Relevant Employees during the year. Directors and employees with the title of senior managers or above must comply with such code in dealing with the securities of the Company. The code of the Company was set on terms no less exacting than the required standards set out in the Model Code. Having made enquiries with all the Directors, it was confirmed that the requirements of the Model Code were fully complied with during the year. The interests of Directors in the securities of the Company and its subsidiaries were set out on pages 54 to 55 of this Annual Report.

DELEGATION BY THE BOARD

The Company has established an Executive Committee, Audit Committee and a Remuneration Committee under the Board.

• Executive Committee

The Executive Committee is a decision-making administrative body under the Board that carries out its responsibilities on its behalf. Existing members of the Executive Committee are Mr. Cai Lai Xing, Mr. Cai Yu Tian, Mr. Qu Ding, Mr. Lu Ming Fang, Mr. Qian Shi Zheng and Mr. Yao Fang. Mr. Cai Lai Xing is the Chairman. The primary purpose of the Committee is to take charge of major decision making in relation to the day-to-day business of the Company, to ensure the proper execution of the resolutions approved by the Board and the Shareholders' Meeting, and to review major business activities and investments. Day-to-day operation is delegated to the Management Executives and the functional departments. Members of the Management Executives are Mr. Cai Yu Tian, Mr. Qu Ding, Mr. Qian Shi Zheng, Mr. Zhou Jie, Ms. Wang Xiao Dong, Shanel and Mr. Zhou Jun. Functional departments at the Hong Kong headquarter include Administration & Human Resources, Company Secretarial, Corporate Communications, Finance, Information Technology, Internal Audit, Investment Operations as well as Legal.

- **Audit Committee**

The Audit Committee is a standing committee under the Board and plays a vital role in corporate governance. The Audit Committee comprises three Independent Non-Executive Directors, Dr. Lo Ka Shui, Prof. Woo Chia-Wei and Mr. Leung Pak To, Francis. Dr. Lo Ka Shui is the Chairman, while the Company Secretary acts as Secretary for the Committee. The Audit Committee is responsible for reviewing accounting policies and practices adopted by the Group. It also discusses matters related to financial reporting, as well as internal control and risk management, and reports to the Board with recommendations in respect of the above matters.

- **Remuneration Committee**

To further enhance corporate governance standards, the Company established the Remuneration Committee under the Board in August 2004. The Committee comprises three Independent Non-Executive Directors – Dr. Lo Ka Shui, Prof. Woo Chia-Wei and Mr. Leung Pak To, Francis, and two representatives from the management – Mr. Qu Ding and Mr. Hu Zi Li. Dr. Lo Ka Shui is the Chairman, while the Company Secretary acts as the Committee Secretary. The Committee is responsible for reviewing the remuneration policy and structure of the Company as a whole, and makes recommendations to the Board on the establishment of proper and transparent procedures for formulating remuneration policy and structure in regard to the Directors and senior management.

II. Remuneration of Directors and senior management

CHANGES IN THE COMPOSITION OF THE REMUNERATION COMMITTEE

On 21st April 2005, Mr. Qu Ding and Mr. Cheng Qi Yong were duly appointed by the Board as members of the Remuneration Committee. On 10th November of the same year, it was resolved by the Board that Mr. Hu Zi Li would succeed Mr. Cheng Qi Yong as a member of the Remuneration Committee, as a result of business development requirements and human resources rotations. The members of the Remuneration Committee are Dr. Lo Ka Shui, Mr. Woo Chia-Wei, Mr. Leung Pak To, Francis, Mr. Qu Ding and Mr. Hu Zi Li. Mr. Hu Zi Li is the deputy head of the Company's Administration and Human Resources Department. The terms of reference for the Remuneration Committee were published in the Company's website www.sihl.com.hk.

WORK PERFORMED BY THE REMUNERATION COMMITTEE

During 2005, the Remuneration Committee held three meetings, one of which was in the form of written resolutions. The percentage of attendance was 100%. Matters considered include: the proposal on distribution of bonus to the Executive Directors for 2004, a review on the overall remuneration of directors and senior management, the entering into of service contracts with newly appointed Directors and newly reporting Directors. During the year, attendance for the meetings of the Remuneration Committee was as follows:

Members of the Remuneration Committee		Attendance/No. of meetings
Lo Ka Shui	(Chairman of the Committee)	3/3
Woo Chia-Wei		3/3
Leung Pak To, Francis		3/3
Qu Ding		3/3
Hu Zi Li	(succeeded as member on 10th November 2005)	1/1
Cheng QiYong	(ceased as member on 10th November 2005)	2/2

DIRECTORS' REMUNERATION

The Company enters into Directors' service agreements with each of the Executive Directors. Such agreements set out the relevant terms for remuneration. Any party to the agreement may terminate the agreement in writing by issuing a six-month notice to the other party in advance. The remuneration of the Directors was determined with reference to the operating results of the Company, market environments and the respective responsibilities of the Directors. Apart from the basic salaries, the Directors are entitled to discretionary bonuses, the availability of which is subject to the operation results of the Group and the performance of the respective Directors. For the year ended 31st December 2005, the remuneration, including equity-settled share-based payment expense and retirement benefits scheme contributions, for each of the Directors was as follows:

Name of Director	Director's Remuneration
<i>Executive Director</i>	<i>(HK\$)</i>
Cai Lai Xing	7,142,000
Cai Yu Tian ^(Note)	—
Qu Ding	5,956,000
Lu Ming Fang	5,185,000
Lu Da Yong (resigned on 19th December 2005)	1,892,000
Ding Zhong De	429,000
Lu Shen (resigned on 19th December 2005)	408,000
Qian Shi Zheng	317,000
Yao Fang	214,000
Tang Jun	317,000
<i>Independent Non-Executive Director</i>	
Lo Ka Shui	272,000
Woo Chia-Wei	272,000
Leung Pak To, Francis	272,000

Note: Mr. Cai Yu Tian was appointed Executive Director, Vice Chairman and Chief Executive Officer of the Company on 19th December 2005, and did not receive any remuneration for 2005.

III. Accountability and Audit

PREPARATION OF FINANCIAL STATEMENTS

The financial statements of the Company and its subsidiaries for 2005 were prepared in accordance with accounting principles generally accepted in Hong Kong. The Board is responsible for preparing and reviewing the Company's accounts to ensure that they truly and fairly reflect the financial position, profits and cash flow of the Company. The management had provided the Board with sufficient and adequate information to review the Company's accounts. The Company had consistently applied applicable accounting policies, and had made prudent and reasonable judgments and estimates, and prepared its accounts on a going concern basis. The external auditors also represented their reporting responsibilities in the auditors' report for the relevant financial statements.

WORK OF THE AUDIT COMMITTEE

The Audit Committee comprises three Independent Non-Executive Directors, and is mainly responsible for reviewing accounting policies and practices adopted by the Group. The Committee is also responsible for discussing matters related to financial reporting as well as internal control and risk management, and reports to the Board with recommendations. During 2005, the Audit Committee held three meetings with a 100% attendance. Matters considered at the meetings included review of the Group's 2004 annual results, 2005 interim results, the policies for engaging the external auditors to provide non-audit services, the Audit Proposal regarding the audit for 2005, review of the Company's financial control, internal control, risk management system, and the internal audit reports. The terms of reference of the Audit Committee were published in the Company's website www.sihl.com.hk. During the year, attendance for the meetings of the Audit Committee was as follows:

Members of Audit Committee	Attendance/No. of meetings
Lo Ka Shui (Chairman of the Committee)	3/3
Woo Chia-Wei	3/3
Leung Pak To, Francis	3/3

Based on the results of the review on the auditors' independence and after taking into account the opinion of the management, the Audit Committee recommended the Board to re-appoint Deloitte Touche Tohmatsu as the external auditors of the Company for 2006, subject to approvals by the Shareholders at the Annual General Meeting to be held on 30th May 2006. The audit fee of the external auditors for the year 2005 was HK\$7,740,000. The non-audit services provided to the Group by the Company's external auditors (including their affiliates) and the relevant fees were as follows:

Non-Audit Services	Fees (HK\$)
Financial due diligence for acquisition of projects	7,484,291
Taxation advisory fee	8,332,600
Others	58,680
	15,875,571

INTERNAL CONTROL

The Group endeavours to implement a sound risk management and internal control system to provide early warning for potential risks involved in business operations and financial management and to monitor the rationale behind decisions to be made in operations and resources allocation. Internal management systems include Project Investment, Appraisal Policy Project Manager Management Manual, Financial Management System, Budget System, Connected Transactions Reporting System, Guidebook on Internal Audit System and Information Flow Guidelines.

The Company has established an Investment Appraisal Committee comprising representatives – including Hong Kong and Shanghai professionals – from different functional departments of the Company. The Committee is established to appraise the Company's investment projects from different perspectives, based on its overall business investment strategies. After conducting comprehensive analysis and discussion of key project elements, such as industry background, organizational structure, business development plans, return on investment, financial risk and legal issues, the Committee submits independent professional advice and reports to the management team. Such appraisal will also be submitted to the Executive Committee for approval, subject to guidelines regarding corporate investment decision-making process. During the year, the Committee conducted appraisals on five projects.

The Company has established an Internal Audit Department which is mainly responsible for monitoring the internal control system of the Group (including all its major subsidiaries) to ensure prudent and proper operation. The audit covers financial controls, business operations, compliance and risk management. The department also conducts independent reviews, assessment and follow-up procedures, and reports to the Audit Committee and the Board on a regular basis. The internal audit system is currently conducted in a cycle of three years. Internal audit will be conducted at every major entities under the Group for risk exposure purpose according to the significance of the individual projects. All these entities directly managed by the Group are assigned with designated officers to feedback on examinations made by the Internal Audit Department.

IV. Investors Relations

Shanghai Industrial Investment (Holdings) Co. Ltd., the controlling Shareholder of the Company, currently indirectly holds 548,076,000 shares of the Company. The percentage of shareholding is 56.6%, whilst the public shareholding is about 43.4%.

The Group places great emphasis on valuable opinion expressed by Shareholders. Each year, the Board communicates with and addresses questions raised by Shareholders at the annual general meetings. The Chairman of the Company and Chairman of Committees under the Board (or their representatives) had attended the 2005 Annual General Meeting and addressed questions raised by Shareholders.

PROCEDURES OF SHAREHOLDERS' MEETING

The notice for the Annual General Meeting of 2005 was set out in the 2004 Annual Report and dispatched to each Shareholder on 28th April 2005. The procedures of demand for poll by the Shareholders at the shareholders' meeting was set out in the proposed general mandate to repurchase shares and to issue shares and re-election of the retiring Directors set out in a circular dispatched to Shareholders on 28th April 2005 by the Company. At the 2005 Annual General Meeting held on 26th May 2005, the Chairman proposed separate resolutions for each matter to be transacted at the meeting. All resolutions were voted by poll during the meeting. Secretaries Limited, the Share Registrar of the Company, was appointed as the scrutineer and was responsible for the arrangement of the voting procedures. The Company announced the results of the poll in the following business day and published the same in the website of the Company and the Stock Exchange for inspection by each of the Shareholders.

INFORMATION FOR SHAREHOLDERS AND INVESTORS

The Group disseminates business development information on a timely basis through various channels to maintain the transparency of its operation. Apart from the annual report, interim report and circulars to Shareholders, most updated trend on its businesses were also published in press conferences and announcements, as well as the Company's website. Apart from covering the Group's business information, the Company's website also provides access to the websites of the major entities under the Group. The Company meets with analysts and overseas institutional investors from time to time, and set up an e-mail address enquiry@sihl.com.hk for the purpose of investor relations, so that investors can make recommendations and enquiries. During the year, the Group entered into 12 major conferences and seminars organized by associations within and outside the PRC. Meetings with over 400 institutional investors within and outside the PRC were conducted, enabling the investor community to better understand the investment strategies, operation and prospects of the Group.

The Group disseminates information to the public strictly in accordance with its internal guidelines on information disclosure. During the year, the Company arranged training for all staff with respect to the definition and handling of price-sensitive information. This ensured that the related information would be disclosed to the market a fair, timely and an accurate manner.

MECHANISM FOR THE TRADING OF THE COMPANY'S SHARES

In order to facilitate the trading of its shares in a global manner, the Company maintained a 24-hour global mechanism for the trading of its shares in the Hong Kong, New York and London markets. Investors can trade ADR Level 1 shares created by the Company in the over-the-counter market in US. Each ADR represents 10 ordinary shares of the Company. Bank of New York, US, is the depositary of the Company's ADR. In addition, the shares of the Company are also admitted to the Automated Quotation System of London Stock Exchange. Investors in Hong Kong can obtain ADR quotes and shares listing in London for each trading day of the Company's shares through the media.

V. Human Resources

REMUNERATION AND BENEFITS POLICIES

A set of effective remuneration policies has been formulated to determine remuneration and benefits for all staff. Through its performance appraisal mechanism, the Company carries out an annual review in accordance with its business performance, the individual performance of the staff, and market remuneration levels, in order to determine a reasonable and competitive compensation package for its employees. In 2005, the total number of employees was 13,966 (2004: 7,409), of whom 13,378 were stationed in Mainland China (2004: 6,823). The increase in the total number of employee was attributable to the increase in the number of fellow subsidiaries companies. This year, staff salaries, allowances and bonuses (including Directors) totaled HK\$531 million (2004: HK\$367 million). Meanwhile, to ensure effective recruitment and successful retention of talents, the Company offers staff a compensation package that includes a pension scheme, cash allowances, and medical and personal accident insurance.

The Company operates a defined contribution pension scheme for its qualified employees. Furthermore, in compliance with Hong Kong's Mandatory Provident Fund Schemes Ordinance, all employees are required to participate in the mandatory provident fund scheme. The assets of the two schemes are administered separately by independent custodian in accordance with relevant laws and regulations. During the year, payment to the retirement benefits schemes was approximately HK\$36.6 million (2004: HK\$24.21 million).

SHARE OPTIONS

Share options allow the Company to provide incentives to Directors, employees and eligible persons in a more flexible manner. Pursuant to the Share Option Scheme adopted by the Company on 31st May 2002, share options for 27,250,000 and 10,000,000 shares were granted in September 2002 and September 2005 respectively. The exercise price for the first batch of share options was HK\$11.71 per share and the next was HK\$14.89 per share. As at 31st December 2005, share options for 19,365,000 shares were exercised.

In addition, the Company adopted a share option scheme for Mergen on 28th May 2004. The first batch of share options for 63,500 Mergen shares was granted in December 2004. Mergen is a subsidiary in which the Company owns an 85 percent interest, the major assets of the company is a 73.26 percent stake in Sunway Biotech. Sunway Biotech is principally engaged in the development and production of cancer fighting drugs. The primary purpose for adopting the Mergen share option scheme was to offer relevant employees the opportunity to acquire a stake in Mergen, encouraging them to perform their work with the aim to appreciate Mergen's value.

Details of the share option schemes for the Company and Mergen are contained in note 41 to the financial statements.

EMPLOYEE TRAINING

The Company values the vital contribution made by its employees, and places great emphasis on fostering staff capabilities and supporting their growth. We also recognize that, in a knowledge-based and increasingly competitive environment, a competent, dedicated and committed team of employees can significantly contribute to the performance of the Company. During the year, the Company offered a variety of internal training programmes and corporate exchange activities to staff at all levels, with a view to expanding their job-related knowledge. These included seminars on specific topics, interpretations of laws and regulations, financial management and seminars on corporate investments for its member enterprises. Meanwhile, allowances are available to staff to take job-related courses. This scheme seeks to encourage employees to continue their education after work, so as to better equip themselves and broaden their horizons, allowing them to make a greater contribution to the Company.

EMPLOYEE RELATIONS

The Company has made a great deal of effort to communicate with employees at all levels and encourages them to express opinions directly to the management about the Company's operation, future development strategies, and other matters of interest to employees. Regular staff meetings are held to explain new investment initiatives, business prospects, and management philosophy, among other matters, to give employees a better understanding of the companies they belong to, and help them perform their duties with dedication and an awareness of the development direction of the Group. Since most staff are stationed either in Hong Kong or Shanghai, in order to enhance communication, the Company arranges visits between both cities and exchange meetings for the management staff of member enterprises. This helps staff share knowledge and exchange experience, cultivates teamwork, and enhances their identification and sense of belonging to the corporation.

By Order of the Board
Wong Mei Ling, Marina
Company Secretary

Hong Kong, 21st April 2006