

Important:

If you are in any doubt about this prospectus, you should consult your stockbroker, bank manager, solicitor, professional accountant or other professional adviser.



Yixing Xinwei Holdings Limited

(incorporated in the Cayman Islands with limited liability)

Placing and New Issue

Number of Placing Shares:	135,000,000 Shares, subject to adjustment
Number of New Issue Shares:	15,000,000 Shares, subject to adjustment
Issue price:	HK\$0.93 per Share
Nominal value:	HK\$0.10 each

Sponsors



China Everbright Capital Limited



Vickers Ballas Capital Limited

Underwriters

China Everbright Securities (HK) Limited

Vickers Ballas Capital Limited

Shenyin Wanguo Capital (H.K.) Limited

Kim Eng Securities (Hong Kong) Limited

Kingsway SW Securities Limited

Hong Kong branch share registrar and transfer office

Central Registration Hong Kong Limited

The Stock Exchange of Hong Kong Limited and Hong Kong Securities Clearing Company Limited take no responsibility for the contents of this prospectus, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this prospectus.

A copy of this prospectus, having attached thereto the documents specified in the paragraph headed "Documents delivered to the Registrar of Companies" in Appendix VII to this prospectus, has been registered by the Registrar of Companies in Hong Kong as required by Section 342C of the Companies Ordinance of Hong Kong. The Securities and Futures Commission and the Registrar of Companies in Hong Kong take no responsibility as to the contents of this prospectus or any other document referred to above.

5th October, 1999

EXPECTED TIMETABLE

Latest time to lodge WHITE and YELLOW Application Forms	12 noon on Friday, 8th October, 1999
Application lists open ⁽¹⁾	11:45 a.m. on Friday, 8th October, 1999
Application lists close ⁽¹⁾	12 noon on Friday, 8th October, 1999
Indication of interests in the Placing and the results of applications and basis of allotment of New Issue Shares to be published in the South China Morning Post and Hong Kong Economic Times on or before	Tuesday, 12th October, 1999
Share certificates in respect of wholly or partially successful applications to be despatched on or before ⁽²⁾	Wednesday, 13th October, 1999
Refund cheques in respect of wholly or partially unsuccessful applications to be despatched on or before ⁽²⁾	Wednesday, 13th October, 1999
Dealings in Shares on the Stock Exchange to commence on	Friday, 15th October, 1999

Notes:

- 1. If there is a “black” rainstorm warning or a tropical cyclone warning signal number 8 or above in force in Hong Kong at any time between 9 a.m. and 12 noon on 8th October, 1999, the application lists will not open and close on that day. See the paragraph headed “Effect of bad weather on the opening of the application lists” in the section headed “How to Apply for New Issue Shares” — see page 70 of this prospectus.*
- 2. Applicants who apply for 200,000 New Issue Shares or more and indicate in their Application Forms their wish to do so may collect refund cheque and, where applicable, share certificates in person on the day as described in the paragraph headed “Collection/posting of share certificates/refund cheques and deposit of share certificates into CCASS” in the section headed “How to Apply for New Issue Shares” — see page 72 of this prospectus.*

For details of the structure of the Share Offer, including conditions of the Share Offer, see the section headed “Structure of the Share Offer” — see page 64 of this prospectus.

CONTENTS

You should rely only on the information contained in this prospectus and the Application Forms to make your investment decision.

The Group has not authorised anyone to provide you with information that is different from what is contained in this prospectus.

Any information or representation not made in this prospectus must not be relied on by you as having been authorised by the Group, the Sponsors, the Underwriters, the directors of any of them, or any other person involved in the Share Offer.

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SUMMARY

This summary aims to give you an overview of the information contained in this prospectus. Because this is a summary, it does not contain all the information that may be important to you. You should read the whole document before you decide to invest in the New Shares.

There are risks associated with any investment. Some of the particular risks in investing in the New Shares are set out in the section headed “Risk Factors”. You should read this section carefully before you decide to invest in the New Shares.

THE GROUP’S BUSINESS

The Group’s principal business is the manufacture and sale of various rare earth products and refractory materials.

1) Rare earth products

Rare earth products are the fundamental raw materials for the manufacture of a number of high technology products. At present, the Group manufactures 31 types of rare earth products. The Group sources rare earth materials from domestic rare earth mines in provinces such as Inner Mongolia, Jiangxi and Guangdong Province of the PRC. These rare earth materials are then separated, purified and processed into various rare earth elements and products which may be used as raw materials in a wide range of industries. The Group’s production facilities in Dapu, Yixing, the Jiangsu Province house an aggregate of 16 rare earth extraction lines with maximum production capacity of approximately 3,550 tonnes (REO) per annum. The rare earth products manufactured by the Group may be used to produce reinforced glass, long-life light bulbs, memory chips of computers, fluorescent powders for colour television sets, batteries for mobile phones, magnetic materials for automation system of cars, additives for high-strength aluminium alloys used in aerospace engineering and optical fibres for telecommunications.

2) Refractory materials

The Group’s refractory materials are manufactured from natural ores sourced from Liaoling, Henan and Shanxi, the PRC. These natural ores include quartzite, dolomite, and graphite ore. The refractory materials are processed into various kinds of refractory products which possess a high degree of refracting ability. The Group has a set of ultra high-temperature tunnel kiln of 88 m in length and a set of high-temperature kilns of 10 m³, two sets of low-temperature kilns each of 70 m³ in size and ancillary production facilities located in Dapu, Yixing, the Jiangsu Province. In aggregate, these facilities have a maximum annual production capacity of approximately 30,000 tonnes. At present, the Group manufactures 30 types of refractory materials which are mainly used in the construction of kilns and furnaces used in the steel industry, the construction industry and the metallurgy industry.

For the year ended 31st December, 1998, the sales of rare earth products and refractory materials represented approximately 69% and 31% respectively of the total turnover of the Group.

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For the year ended 31st December, 1998, about 60% of the rare earth products of the Group was sold to overseas customers, whereas the remaining 40% was for domestic sales in the PRC. Of the total rare earth sales, about 37% was exported to Japan, 20% to the United States, 2% to Germany, and 1% to Korea. For the year ended 31st December, 1998, about 92% of the refractory materials manufactured by the Group was for domestic sales in the PRC and the remaining 8% was sold to Japan.

The Directors consider that the principal strengths of the Group are as follows:

- the majority of the Directors and the management have more than 15 years of experience in the operation and management of the business of rare earth and refractory materials industry;
- the Group has obtained ISO9002 certification in January 1999 and is committed to providing high quality rare earth and refractory material products to its customers in an effective manner;
- its capability to capture the international market, adopt new technology, open up new markets, introduce new products and respond to changes in the market;
- the Group has its own research and development centre for analysing, testing and research with the latest techniques introduced from abroad and is equipped with modern analysing equipment from Japan, Europe and the United States, thus ensuring the quality of its products;
- the Group has advanced production facilities and processes, which allows it to meet various specifications of different customers; and
- its established market position and long term and stable working relationship with its customers.

SUMMARY

TRADING RECORD

The following table summarises the combined audited results of the Group for the three years ended 31st December, 1998 and the four months ended 30th April, 1999. The summary has been prepared as if the current structure of the Group had been in existence throughout the relevant period and should be read in conjunction with the accountants' report set out in Appendix I to this prospectus.

	Year ended 31st December,						Four months ended	
	1996		1997		1998		30th April, 1999	
	HK\$'000	%	HK\$'000	%	HK\$'000	%	HK\$'000	%
Turnover								
Rare earth products	219,762	69	261,890	69	288,081	69	96,716	67
Refractory materials	100,947	31	118,208	31	131,401	31	46,931	33
	<u>320,709</u>	<u>100</u>	<u>380,098</u>	<u>100</u>	<u>419,482</u>	<u>100</u>	<u>143,647</u>	<u>100</u>
Profits from operations	60,524		82,727		93,747		37,317	
Finance costs	<u>(8,201)</u>		<u>(6,536)</u>		<u>(6,264)</u>		<u>(1,558)</u>	
Profit before taxation	52,323		76,191		87,483		35,759	
Taxation	<u>(15,130)</u>		<u>(20,650)</u>		<u>(22,632)</u>		<u>(6,747)</u>	
Profit after taxation	37,193		55,541		64,851		29,012	
Minority interests	<u>(1,445)</u>		<u>(937)</u>		<u>(2,851)</u>		<u>(931)</u>	
Profit attributable to shareholders	<u>35,748</u>		<u>54,604</u>		<u>62,000</u>		<u>28,081</u>	
Dividends	<u>3,563</u>		<u>11,538</u>		<u>17,462</u>		<u>6,401</u>	

For additional information on the trading record of the Group, please refer to the section headed "Financial Information" and Appendix I.

FUTURE PLANS AND PROSPECTS

The Directors consider that the increasing global demand for enhanced efficient and energy saving products will boost the sale of rare earth products. In anticipation of this rising demand, the Directors believe that the Group will be in a strong position to capture a larger market share by adopting the following approaches:

- by utilising the abundant rare earth resources in China and the Company's production techniques to develop advanced permanent magnetic materials for use in the production of devices that generate mechanical motions;

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- by improving the existing rare earth separation techniques and the installation of fully automated and computerised production lines to enhance production capacity and achieve cost saving;
- by continuing with its research on the processing of rare earth products as part of its long term business development and to maintain its leading position as a technologically advanced rare earth producer;
- by establishing a closer business relationship with its overseas customers so as to increase its market share.

The steel industry is the principal consumer of refractory materials which accounted for over 60% of their total global consumption. Steel production in Southeast Asia has increased in recent years and China is the largest producer and major consumer of refractory materials in the world.

In anticipation of the increasing demand for refractory materials, the Directors intend to expand the production scale of its refractory materials by the installation of a 30,000 tonne production line by the second quarter of 2000.

Further information is set out in the section headed “Future Plans” in this prospectus.

REASONS FOR THE SHARE OFFER AND THE USE OF THE PROCEEDS

The net proceeds of the Share Offer, assuming that the Over-Allotment Option is not exercised and after deducting related expenses, are estimated to amount to HK\$120,000,000. On the basis that the Over-Allotment Option is exercised in full, the net proceeds will increase by approximately HK\$20 million. The Directors presently intend to apply the net proceeds as follows:

- as to approximately HK\$60,000,000 for the expansion of rare earth production facilities to increase the aggregate annual production capacity from 3,550 tonnes (REO) to about 4,900 tonnes (REO) of rare earth extracts, and the related technical upgrading;
- as to approximately HK\$20,000,000 for the upgrading of the production facilities of fluorescent powders and the related technical upgrading;
- as to approximately HK\$35,000,000 for the upgrading of the existing production facilities for refractory materials and the installation of a new production line of unshaped refractory materials; and
- as to the balance as general working capital of the Group.

In the event that the net proceeds of the Share Offer are not immediately used for the above purposes, the Directors presently intend to place the net proceeds of the Share Offer on short term deposits with financial institutions in Hong Kong. It is intended that the expansion and upgrading of production facilities will take place by the second quarter of 2000.

SUMMARY

DIVIDENDS

The Group declared and paid dividends of approximately HK\$3.5 million, HK\$11.5 million and HK\$17.5 million for each of the three years ended 31st December, 1998 to its then existing shareholders. The payment of the dividends was made in cash. For the four months ended 30th April, 1999, the Group declared dividends of approximately HK\$6 million of which HK\$3,105,000 and HK\$163,000 were paid to Mrs Jiang and Mr Jiang respectively as at 31st July, 1999.

FORECASTS FOR THE YEAR ENDING 31ST DECEMBER, 1999

Forecast combined profit after taxation and minority interests
but before extraordinary items ⁽¹⁾ not less than HK\$80 million

Forecast earnings per Share

— weighted average ⁽²⁾ HK\$0.165

— pro forma fully diluted ⁽³⁾ HK\$0.141

STATISTICS OF THE SHARE OFFER ⁽⁴⁾

Issue Price HK\$0.93

Market capitalisation HK\$558 million

Prospective price/earnings multiple

— weighted average ⁽⁵⁾ 5.65 times

— pro forma fully diluted ⁽⁶⁾ 6.59 times

Prospective annual dividend yield ⁽⁷⁾ 5.4%

Adjusted net tangible asset value per Share ⁽⁸⁾ HK\$0.47

Notes:

1. The bases and assumptions on which the forecast combined profit after taxation and minority interests but before extraordinary items for the year ending 31st December, 1999 has been prepared are set out in Appendix II. The Directors are not aware of any extraordinary items which have arisen or are likely to arise during the year ending 31st December, 1999.

2. The calculation of the forecast earnings per Share on a weighted average basis is based on the forecast combined profit after taxation and minority interests but before extraordinary items of the Group for the year ending 31st December, 1999 and the weighted average number of 485,753,425 Shares in issue during that year.

The calculation of forecast earnings per Share on a weighted average basis takes no account of any Shares which may fall to be issued upon the exercise of the Over-Allotment Option or the exercise of options granted under the Share Option Scheme or of any Shares which may be allotted or issued or repurchased by the Company pursuant to the mandates referred to in Appendix VI to this prospectus.

3. The calculation of the forecast earnings per Share on a pro forma fully diluted basis is based on the forecast combined profit after taxation and minority interests but before extraordinary items of the Group for the year ending 31st

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December, 1999 assuming that the Company had been listed since 1st January, 1999 and a total of 600,000,000 Shares had been in issue throughout the year. For the purpose of this calculation, the forecast combined profit after taxation and minority interest but before extraordinary items for the year ending 31st December, 1999 has been adjusted to take into account the interest income that would have been earned if the net proceeds of the Share Offer had been received on 1st January, 1999 and held on deposit thereafter, based on an interest rate (net of tax) of 5.2% per annum between that date and the expected date of receipt of the net proceeds of the Share Offer.

The calculation of forecast earnings per Share on a pro forma fully diluted basis takes no account of any Shares which may fall to be issued upon the exercise of the Over-Allotment Option or the exercise of options granted under the Share Option Scheme or of any Shares which may be allotted or issued or repurchased by the Company pursuant to the mandates referred to in Appendix VI to this prospectus. If the Over-Allotment Option is exercised in full, the number of Shares in issue would be 622,500,000 and the forecast earnings per Share on the pro forma fully diluted basis mentioned above would be approximately HK\$0.141.

- 4. The statistics of the Share Offer have been prepared on the assumption that the Over-Allotment Option is not exercised. The Issue Price does not include the 1% brokerage and the 0.011% Stock Exchange transaction levy.*
- 5. The prospective price earnings multiple on a weighted average basis is calculated on the basis of forecast earnings per Share on a weighted average basis for the year ending 31st December, 1999 of approximately HK\$0.165 and the Issue Price, and based on the assumption set out in note 2 to the paragraph headed "Profit forecast for the year ending 31st December, 1999" in this section.*
- 6. The prospective earnings multiple on a pro forma fully diluted basis is calculated on the basis of forecast earnings per Share on a pro forma fully diluted basis for the year ending 31st December, 1999 of approximately HK\$0.141 and the Issue Price, and based on the assumption set out in note 3 to the paragraph headed "Profit forecast for the year ending 31st December, 1999" in this section.*
- 7. The prospective annual dividend yield is based on the total dividend HK\$0.05 per Share which would have been paid if the Company had been a listed company throughout the year ending 31st December, 1999 and is arrived at on the basis set out in the paragraph headed "Profit forecast, dividends and working capital" in the section of this prospectus headed "Financial information" and on the Issue Price.*
- 8. The adjusted net tangible asset value per Share has been arrived at after making the adjustments referred to under the heading "Adjusted net tangible assets" in the section of this prospectus headed "Financial information" and 600,000,000 Shares expected to be in issue immediately following the completion of the Share Offer and the Capitalisation Issue, but taking no account of any Shares which may fall to be issued upon the exercise of the Over-Allotment Option or the exercise of options granted under the Share Option Scheme or of any Shares which may fall to be issued or repurchased by the Company pursuant to the mandates referred to in Appendix VI to this prospectus. If the Over-Allotment Option is exercised in full, the adjusted net tangible asset value of the Group and the adjusted net tangible asset value per Share would be approximately HK\$304 million and HK\$0.49, respectively.*

SUMMARY

RISK FACTORS

The operations of the Group involve certain risks, a summary of which is set out in the section headed “Risk Factors” of this prospectus. These risks can be classified as (i) risks related to the Group; (ii) risks related to the industries; and (iii) risks related to the PRC and are summarised as follows:—

Risks related to the Group

- Reliance on major suppliers
- Reliance on major customers
- Heavy reliance on import and export agents
- Land Use Rights

Risks related to the industries

- Product replacement and technological advancement
- Competition

Risks related to the PRC

- Political considerations and the PRC economy
- Currency conversion in the PRC
- Environmental protection
- Tax Incentives

For further information on the above risks, please refer to the section headed “Risk Factors” of this prospectus.

DEFINITIONS

In this prospectus, unless the context otherwise requires, the following expressions have the following meanings:—

“Application Form(s)”	WHITE Application Form(s) and YELLOW Application Form(s), or where the context requires, any of them
“BVI”	the British Virgin Islands
“Capitalisation Issue”	the issue of Shares to be made upon the capitalisation of certain sums standing to the credit of the share premium account of the Company as referred to in the paragraph headed “Resolutions of the sole shareholder of the Company passed on 29th September, 1999” in Appendix VI to this prospectus
“CCASS”	the Central Clearing and Settlement System established and operated by Hongkong Clearing
“China Everbright”	China Everbright Capital Limited, an investment adviser registered under the Securities Ordinance
“Companies Law”	the Companies Law (1998 Revision) of the Cayman Islands
“Companies Ordinance”	the Companies Ordinance, Chapter 32 of the Laws of Hong Kong
“Company”	Yixing Xinwei Holdings Limited, a company incorporated in the Cayman Islands with limited liability on 27th July, 1999
“Covenantors”	Mrs Jiang and YY Holdings Limited
“Director(s)” or “Board”	the director(s) of the Company
“Group”	the Company and its subsidiaries or, where the context so requires, in respect of the period before the Company became the holding company of its present subsidiaries, the present subsidiaries of the Company or some or any of them
“HK\$” or “HK dollars” and “HK cents”	Hong Kong dollars and cents, respectively, the lawful currency of Hong Kong
“Hong Kong”	the Hong Kong Special Administrative Region of the PRC
“Hongkong Clearing”	Hong Kong Securities Clearing Company Limited
“Issue Price”	HK\$0.93 per New Share
“Latest Practicable Date”	29th September, 1999, being the latest practicable date before the printing of this prospectus for ascertaining certain information in this prospectus
“Listing Rules”	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
“Mr Jiang”	Mr Jiang Quanlong, the Chairman and an executive Director of the Company

DEFINITIONS

“Mrs Jiang”	Ms Qian Yuanying, the wife of Mr Jiang, and the deputy chairman and an executive Director of the Company
“New Issue”	the issue of New Issue Shares to the public in Hong Kong by way of an offer for subscription at the Issue Price, payable in full on application, on and subject to the terms and conditions stated in this prospectus and in the Application Forms
“New Issue Shares”	the 15,000,000 Shares initially being offered for subscription in Hong Kong pursuant to the New Issue (subject to adjustment as described in the section headed “Structure of the Share Offer” in this prospectus)
“New Issue Underwriters”	China Everbright Securities (HK) Limited, Vickers, Shenyin Wanguo Capital (H.K.) Limited, Kim Eng Securities (Hong Kong) Limited and Kingsway SW Securities Limited
“New Shares”	the New Issue Shares and the Placing Shares
“Over-Allotment Option”	the option granted by the Company to China Everbright on behalf of the Placing Underwriters pursuant to the Underwriting Agreement whereby the Company may be required to issue up to an aggregate of 22,500,000 additional Shares at the Issue Price to cover over-allotments in the Placing
“Placing”	the conditional placing of the Placing Shares at the Issue Price as further described in the section headed “Structure of the Share Offer” in this prospectus
“Placing Shares”	the 135,000,000 Shares initially being offered for subscription under the Placing (subject to adjustment as described in the section headed “Structure of the Share Offer” in this prospectus)
“Placing Underwriters”	China Everbright Securities (HK) Limited, Vickers, Shenyin Wanguo Capital (H.K.) Limited, Kim Eng Securities (Hong Kong) Limited and Kingsway SW Securities Limited
“PRC” or “China”	the People’s Republic of China, which for the purpose of this prospectus only, excludes Hong Kong, Macau and Taiwan
“Renminbi” or “RMB”	Renminbi, the lawful currency of the PRC
“REO”	rare earth oxide, measuring unit of rare earth products which shows the verified percentage of rare earth element in the rare earth product
“Reorganisation”	the reorganisation of the group of companies now comprising the Group, details of which are set out in the paragraph headed “Group reorganisation” in Appendix VI to this prospectus
“SDI Ordinance”	the Securities (Disclosure of Interests) Ordinance, Chapter 396 of the Laws of Hong Kong

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“Securities Ordinance”	the Securities Ordinance, Chapter 333 of the Laws of Hong Kong
“Share(s)”	share(s) of nominal value HK\$0.10 each in the capital of the Company
“Share Offer”	the Placing and the New Issue
“Share Option Scheme”	the share option scheme conditionally adopted by the Company on 29th September, 1999, the principal terms of which are summarised in the paragraph headed “Share Option Scheme” in Appendix VI to this prospectus
“Sponsors”	China Everbright and Vickers
“sq.ft.”	square feet
“sq.m.”	square metre(s)
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Underwriter(s)”	the New Issue Underwriter(s) and the Placing Underwriter(s)
“Underwriting Agreement”	the underwriting and placing agreement dated 4th October, 1999 entered into amongst the Company, YY Holdings Limited, the executive Directors, China Everbright and the Underwriters, brief particulars of which are summarised in the section headed “Underwriting” of this prospectus
“US” or “United States”	the United States of America
“US\$” or “US dollars”	United States dollars, the lawful currency of the United States of America
“US Securities Act”	the United States Securities Act of 1933, as amended
“Vickers”	Vickers Ballas Capital Limited, an investment adviser registered under the Securities Ordinance
“Vigers”	Vigers Hong Kong Ltd.
“ WHITE Application Form(s)”	application form(s) for application of New Issue Shares to be issued in the applicant’s own name
“ YELLOW Application Form(s)”	application form(s) for applicant(s) who want(s) the New Issue Shares to be issued in the name of HKSCC Nominees Limited and deposited directly into CCASS for credit to his/its/their investor participant stock account(s) or the stock account(s) of his/its/their designated CCASS participant(s) maintained in CCASS

For the purpose of this prospectus, unless otherwise indicated, conversion of US dollars into HK dollars is calculated at the approximate exchange rate of HK\$7.748 to US\$1.00, and conversion of RMB into HK dollars is calculated at the approximate exchange rate of HK\$0.9361 to RMB1.00.

RISK FACTORS

In evaluating an investment in the New Shares, prospective investors should consider carefully all the information contained in this prospectus, especially the risks related to the investment in the Group.

RISKS RELATED TO THE GROUP

Reliance on major suppliers

For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, purchases of raw materials by the Group from the top five rare earth suppliers amounted to approximately 62%, 65%, 58% and 57% of the Group's total purchases of rare earth raw materials respectively, and purchases from the top five refractory raw material suppliers amounted to approximately 51%, 81%, 83% and 68% of the Group's total purchases of refractory raw materials respectively. For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, the largest supplier of rare earth raw materials accounted for about 15%, 17%, 15% and 15% of the Group's total purchases of rare earth raw materials, and the largest supplier of refractory raw materials accounted for about 22%, 21%, 21% and 17% respectively of the Group's total purchases of refractory raw materials. At present, the Group has entered into six long term purchase agreements for rare earth raw materials and three long term purchase agreements for refractory raw materials, all (except for one rare earth materials purchase contract which will expire in 2013) covering a period of five years from 1996 to 2000. All of these agreements are legally binding and specify the annual quantity to be purchased during the term of the relevant agreement. In the event that the Company is unable to secure further long term purchase agreements or any dispute arises between the Group and any of these suppliers, the Group's operations and profitability would be adversely affected.

Reliance on major customers

For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, sales of rare earth products to the Group's top five customers accounted for approximately 48%, 65%, 46% and 52% of the Group's total rare earth sales respectively. The largest customer of the rare earth products accounted for about 17%, 34%, 17% and 16% for the three years ended 31st December, 1998 and the four months ended 30th April, 1999 respectively. For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, the Group's top five customers of refractory materials accounted for approximately 69%, 52%, 59% and 68% of the Group's total refractory sales respectively. The largest customer of the refractory materials accounted for about 37%, 20%, 14% and 20% for the three years ended 31st December, 1998 and the four months ended 30th April, 1999 respectively. At present, the Group has entered into two long term sales agreements with its customers for rare earth products, one with an expiry date in 2000 and the other in 2001. These long term sales agreements are legally binding and specify the total quantities to be sold. As regards refractory materials, there are three letters of intent entered into by the Group, all with an expiry date in or about the year 2001 which are not legally binding. It is noted that any significant reduction in the level of sales to or any change in the purchasing strategy and/or policy of these customers could have an adverse impact on the Group's performance and profitability.

Heavy reliance on import and export agents

Before obtaining its own import/export licence in October 1997, all of the Group's exports of rare earth products for the two years ended 31st December, 1997 were conducted through independent import/export agents which possess the necessary import and/or export right. Following the obtaining

RISK FACTORS

of the import/export licence, about 0.3% and 4% of the total sales for the year ended 31st December, 1998 and the four months ended 30th April, 1999 were conducted through the Group's own import and export licence. The Directors anticipate that the proportion of sales conducted through the Group's own import and export licence will increase in future.

As regards the import/export licence of the Group, the municipal MOFTEC grants an "indicative export quota" to the Group each year based on its actual export sales of rare earth products in the previous year. However, such quota is not restrictive for if the actual export sales exceed the indicative export quota prescribed by the municipal MOFTEC, the Group may file an application to revise the quota. The Group can also engage independent import/export agents to handle its export sales when necessary. For the year 1999, an indicative export quota of 550 tonnes of rare earth products was granted to the Group. The Group has already filed an application to revise the quota. In the event that the application is not granted and/or the Group is unable to engage any independent import/export agents to handle its exports, the business and profitability of the Group will be adversely affected.

Land Use Rights

The Group's production facilities are located in Dapu, Yixing, Jiangsu Province. The ownership of the buildings and facilities is vested in the Group, while the ownership of the site on which the buildings and facilities are situated (the "Site") is vested in Yixing City Land Administrative Bureau (the "Yixing Land Bureau"). The Yixing Land Bureau has entered into two long term leases with the Group pursuant to which the land use rights of the Site were leased to the Group for a term of 30 years commencing from 1st September, 1999. The principal terms of the long term leases are summarised in the section headed "Property interests" in this prospectus. In the event that the Group is deprived of the use of the Site, the business of the Group would be adversely affected.

RISKS RELATED TO THE INDUSTRIES

Product replacement and technological advancement

Any future inventions or discovery of new products or elements that may replace rare earth products as raw materials or catalysts or components in various high technology products would have an adverse impact on the demand for rare earth products.

Competition

Rare earth products are the key raw materials for the manufacture of a number of high technology products and refractory materials are widely applied in industries such as the steel industry. The growing recognition of the importance of rare earth products and refractory materials would attract new entrants. These unavoidably create pressure on the pricing of rare earth products and refractory materials. In addition, the monetary crisis and the economic downturn in Southeast Asia since 1997 has resulted in sluggish growth in consumption and spending. This also led to competitive price-reduction among producers in the PRC. Any significant reduction in the prices of rare earth products and refractory materials could have an adverse impact on the profitability of the Group.

The Group would also face direct competition from overseas producers if it becomes less restrictive for them to set up production bases in the PRC following the PRC's entry into the World Trade Organisation.

RISK FACTORS

RISKS RELATED TO THE PRC

Political considerations and the PRC economy

PRC's laws, regulations, taxation or foreign exchange system will have an impact on the Group's business. Furthermore, most of the laws and regulations regarding companies, securities, investment and taxation have only been promulgated recently, and are subject to further changes and refinements. In addition, experience in the interpretation, implementation and enforcement of these laws and regulations are still limited.

Currency conversion in the PRC

RMB is not at present freely convertible. Prior to 1st January, 1994, all foreign exchange transactions in the PRC involving RMB were placed through the People's Bank of China ("PBoC") or other authorised financial institutions at the official exchange rate set by the State Administration of Foreign Exchange ("SAFE", previously known as the PRC State Administration of Exchange Control). RMB could also be converted at swap centres established by SAFE (the "Swap Centres"), which were open to PRC enterprises and foreign investment enterprises, at a pre-determined exchange rate. Transactions effected through the Swap Centres were subject to SAFE approval. The exchange rate quoted by the SAFE is generally different from the exchange rate quoted by the Swap Centres.

On 1st January, 1994, the PRC government abolished the two-tier system of exchange rates between RMB and foreign currencies by adopting a unified floating exchange rate system largely based on market demand and supply. Under this unified system, the PBoC publishes a daily exchange rate for RMB (the "PBoC Exchange Rate") based on the previous day's dealings in the inter-bank foreign exchange transactions market. Financial institutions authorised to deal in foreign currency may enter into foreign exchange transactions at exchange rates within an authorised range above or below the PBoC Exchange Rate according to the market conditions.

Since 1996, a number of rules, regulations and notices (the "Policies") have been issued by the PRC government which are designed to provide for greater convertibility of the RMB. Under the Policies, a foreign investment enterprise ("FIE") must now establish "a current account" and a "capital account" with a bank authorised to deal in foreign exchange. In addition, the Policies also give the SAFE the authority to determine the maximum amount of foreign exchange a FIE may maintain in its current account in accordance with the paid-up capital of the FIE and its need for foreign currency working capital. Any foreign currency balance in the current account in excess of the maximum limit determined by the SAFE are required to be sold either to a bank authorised to conduct foreign exchange business or, prior to 1st December, 1998, through a foreign exchange swap centre. With effect from 1st July, 1996, FIEs may exchange RMB for foreign currency at authorised banks without any need for prior approval from SAFE if such funds are in respect of current account items. There can be no assurance, however, that these Policies will not be revoked or amended.

As from 1st December, 1998, the Swap Centres became restricted to conducting foreign exchange transactions between authorised banks and inter-bank lending between PRC banks and are no longer available to FIEs to exchange their RMB into foreign currencies. Instead, FIEs are required to conduct all their foreign exchange transactions through authorised banks. Apart from the change of function of the Swap Centres, the procedures requirements for exchanging RMB into foreign currencies remain unchanged.

RISK FACTORS

The Group will require foreign exchange, after completion of the Share Offer, for the payment of dividends on the Shares. The Group does not anticipate any problems in obtaining foreign currency to satisfy its requirements in future, but there can be no assurance that the existing law, regulations and policies will not be changed and that it would not become more restrictive for the conversion of RMB into foreign currency.

Environmental protection

In the course of manufacturing of the Group's rare earth products and refractory materials, effluent or pollutants may be discharged. The environmental laws of the PRC require that all commercial entities discharging pollutants to obtain approval from the relevant environmental authorities regarding their preventive measures to be adopted, and the laws also require that the amount of pollutants discharged must not exceed certain specified level, otherwise an additional fee would be imposed. The relevant environmental authorities are also empowered to impose penalties on commercial entities for their infringement of environmental laws, order the closing down of any facility that has caused serious environmental problems, or to prohibit production by these commercial entities. There is no assurance the PRC government would not introduce new laws and regulations that impose stricter controls on environmental protection.

Increase in production costs as a result of the implementation of additional environmental protection measures and/or failure to comply with new environmental laws and regulations may have an adverse effect on the business and profitability of the Group.

Tax incentives

Pursuant to relevant policies of the municipal government authorities of the PRC, the Group was granted financial refunds equal to a portion of the PRC enterprise income tax paid by the Group during the three years ended 31st December, 1998 and the four months ended 30th April, 1999. There is no assurance that the Group will continue to enjoy such financial refunds in the future.

The Company's PRC subsidiaries are foreign investment enterprises. As foreign investment enterprises, the Company's PRC subsidiaries can enjoy certain preferential tax treatments including exemption from profits tax payments for the first two years from the year when the enterprise starts to make profit and a 50% tax relief for the next three years. However, there is no assurance that these preferential tax treatments will continue to apply to foreign investment enterprises in the PRC in the future. Any future unfavourable changes in the PRC laws in relation to such preferential tax treatments may have an adverse effect on the Group's profitability and financial position.

Please see "Financial Information — Taxation" in this prospectus for more information.

INFORMATION ABOUT THIS PROSPECTUS AND THE SHARE OFFER

Directors' responsibility for the contents of this prospectus

This prospectus includes particulars given in compliance with the Companies Ordinance, the Securities (Stock Exchange Listing) Rules 1989 of Hong Kong (as amended) and the Listing Rules for the purpose of giving information to the public with regard to the Group. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this prospectus and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission of which would make any statement in this prospectus misleading.

Fully underwritten

The Share Offer comprises an offer by the Company of 150,000,000 New Shares of which 15,000,000 New Shares, subject to adjustment, are New Issue Shares and 135,000,000 New Shares, subject to adjustment, are Placing Shares. The New Issue Shares are being offered in Hong Kong for public subscription at the Issue Price. The Placing Shares are being placed (subject to restrictions stated in the paragraph headed "New Shares to be offered in Hong Kong only" below) with professional and institutional investors in Hong Kong at the Issue Price. Details of the structure of the Share Offer are described on page 64 in the section headed "Structure of the Share Offer" in this prospectus.

This prospectus is published in connection with the New Issue and, together with the Application Forms, sets out the terms and conditions of the New Issue.

The Share Offer is sponsored by the Sponsors. The New Issue is fully underwritten by the New Issue Underwriters. The Placing is fully underwritten by the Placing Underwriters. For further information about the Underwriters and the underwriting arrangements, see the section headed "Underwriting" on page 61 of this prospectus.

New Shares to be offered in Hong Kong only

No action has been taken to permit any public offering of the New Shares or the distribution of this prospectus in any jurisdiction other than Hong Kong. Accordingly, this prospectus may not be used for the purpose of, and does not constitute, an offer or invitation in any jurisdiction or in any circumstances in which such offer or invitation is not authorised or to any person to whom it is unlawful to make such an offer or invitation.

Application for listing on the Stock Exchange

The Company has applied to the Listing Committee of the Stock Exchange for the listing of, and permission to deal in, the Shares in issue and to be issued as mentioned herein (including the New Shares, Shares to be allotted pursuant to (i) the exercise of the Over-Allotment Option; and (ii) the exercise of the options granted under the Share Option Scheme as described in Appendix VI to this prospectus. No part of the Company's share or loan capital is listed or dealt in on any other stock exchange. At present, the Company is not seeking or proposing to seek listing of, or permission to deal in, the Shares in any other stock exchange. All the New Shares will be registered on the Hong Kong branch register of members of the Company in order to enable them to be traded on the Stock Exchange.

INFORMATION ABOUT THIS PROSPECTUS AND THE SHARE OFFER

Professional tax advice recommended

If you are unsure about the taxation implications of subscribing for the New Shares, or about purchasing, holding or disposing of or dealing in them, you should consult an expert.

The Company, the Sponsors and the Underwriters, all of their respective directors, agents or advisers or any other persons involved in the Share Offer do not accept responsibility for any tax effects on, or liabilities of, any person resulting from subscribing for, or purchasing, holding or disposing of or dealing in the New Shares.

Stamp duty

Dealings in shares registered on the Company's branch register of members maintained in Hong Kong will be subject to Hong Kong stamp duty. For further information, please refer to the information set out in Appendix VI to this prospectus.

Stabilisation

In connection with the Share Offer, China Everbright (on behalf of the Placing Underwriters) may over-allot up to 22,500,000 Shares and/or effect transactions which stabilise or maintain the market price of the Shares at levels other than those which might otherwise prevail in the open market. Such transactions which may include stock borrowing arrangements, purchase of Shares in the secondary market may be effected in all jurisdictions where it is permissible to do so, in each case in compliance with all applicable laws and regulatory requirements. Such transactions, if commenced, may be discontinued at any time.

Stabilisation is a practice not commonly associated with the distribution of securities in Hong Kong. In Hong Kong, such stabilisation activities on the Stock Exchange are restricted to cases where the underwriters purchase shares in the secondary market genuinely and solely for the purpose of covering over-allocations in the relevant offer. Relevant provisions of the Securities Ordinance prohibit market manipulation in the form of pegging or stabilising the price of securities in certain circumstances.

Procedure for application for New Issue Shares

The procedure for applying for New Issue Shares is set out on page 67 in the section headed "How to apply for the New Issue Shares" in this prospectus and on the relevant Application Form.

Structure of the Share Offer

Details of the structure of the Share Offer, including conditions of the New Issue, are set out on page 64 in the section headed "Structure of the Share Offer" in this prospectus.

DIRECTORS

Directors

Name	Address	Nationality
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Executive directors

Mr Jiang Quanlong	Room 401 46 Duifangxincun Yixing, Jiangsu PRC	Chinese
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Ms Qian Yuanying	Flat 501 Block 27 Heng Fa Chuen Hong Kong	Kiribati*
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Mr Fan Yajun	Room 306 7 Dongshanyicun Yixing, Jiangsu PRC	Chinese
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Mr Gu Aoxing	Yangzhucun Dapuzheng Yixing, Jiangsu PRC	Chinese
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Ms To Siu Mui, Annie	Flat 501 Block 27 Heng Fa Chuen Hong Kong	Chinese
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Independent non-executive directors

Mr Liu Yujiu	Room 1108, 15th Floor No.2 Jia, Shaoyaoju Chaoyang District Beijing PRC	Chinese
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Mr Wong Yee Sui, Andrew	A1, 45 Island Road Hong Kong	Canadian
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* Kiribati is an independent republic which comprises the Gilbert, Phoenix and Line groups of islands in the vicinity of Hawaii and Papua New Guinea.

PARTIES INVOLVED IN THE SHARE OFFER

Sponsors

China Everbright Capital Limited
40th Floor, Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong

Vickers Ballas Capital Limited
19th Floor, Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong

New Issue Underwriters

China Everbright Securities (HK) Limited
36th Floor, Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong

Vickers Ballas Capital Limited
19th Floor, Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong

Shenyin Wanguo Capital (H.K.) Limited
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3 Garden Road
Hong Kong

Kim Eng Securities (Hong Kong) Limited
8th Floor, Alexandra House
16-20 Chater Road
Central
Hong Kong

Kingsway SW Securities Limited
12th Floor, New Henry House
10 Ice House Street
Central
Hong Kong

Placing Underwriters

China Everbright Securities (HK) Limited
36th Floor, Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong

PARTIES INVOLVED IN THE SHARE OFFER

Vickers Ballas Capital Limited
19th Floor, Far East Finance Centre
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8th Floor, Alexandra House
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Hong Kong

Kingsway SW Securities Limited
12th Floor, New Henry House
10 Ice House Street
Central
Hong Kong

Audit Committee

Mr. Liu Yujiu

Mr. Wong Yee Sui, Andrew

Hong Kong legal advisers

To the Company:
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41st Floor, Jardine House
1 Connaught Place
Central
Hong Kong

To the Underwriters:
Koo and Partners
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1 Garden Road
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PRC legal advisers

To the Company:
Commerce & Finance Law Office
714 Huapu International Plaza
19 Chaoyangmenwai Avenue
Chaoyang District
Beijing
PRC

PARTIES INVOLVED IN THE SHARE OFFER

Cayman Islands legal advisers

To the Company:
Conyers Dill & Pearman, Cayman
Zephyr House
Mary Street
George Town
Grand Cayman
British West Indies

**Auditors and reporting
accountants**

Arthur Andersen & Co.
Certified Public Accountants
21st Floor, Edinburgh Tower
The Landmark
15 Queen's Road Central
Hong Kong

Property valuer

Vigers Hong Kong Limited
Suite 801-6
Miramar Tower
1 Kimberley Road
Tsimshatsui
Kowloon
Hong Kong

Receiving bank

Standard Chartered Bank
8th Floor, Edinburgh Tower
The Landmark
15 Queen's Road Central
Hong Kong

CORPORATE INFORMATION

Registered office	Zephyr House Mary Street George Town Grand Cayman British West Indies
Head office and principal place of business	Dapu, Yixing Jiangsu Province PRC
Place of business in Hong Kong	Room 1301, Ruttonjee House Ruttonjee Centre 11 Duddell Street, Central Hong Kong
Company secretary	Cheng Man For, Jeffrey, <i>FCCA and HKICS</i>
Authorised representatives	To Siu Mui, Annie Cheng Man For, Jeffrey
Principal bankers	<i>PRC</i> Bank of China, Yixing Sub-branch No.106, Taige Xi Road Yixing Jiangsu PRC China Construction Bank, Yixing Sub-branch No.158, Ren Ming Zhong Road Yicheng Town Yixing Jiangsu PRC <i>Hong Kong</i> Standard Chartered Bank 4-4A Des Voeux Road Central Hong Kong
Principal share registrar and transfer office	Bank of Butterfield International (Cayman) Limited Butterfield House, Fort Street P.O. Box 705, George Town Grand Cayman Cayman Islands
Hong Kong branch share registrar and transfer office	Central Registration Hong Kong Limited Shops 1712-1716 17th Floor, Hopewell Centre 183 Queen's Road East Hong Kong

OVERVIEW OF THE INDUSTRY

INDUSTRY BACKGROUND

Rare Earth

The rare earth series of the periodic table for chemical elements consists of a group of 17 elements. Each of these elements has different chemical and physical characteristics. They were discovered in Sweden by a Swedish Army Officer Karl Axel Arrehenius in 1787. However, rare-earth elements were difficult to separate given their similarity. It was not until 1794 that the first element, Yttrium, was isolated by a Finnish chemist Johann Gadolin. As the separating and smelting techniques continued to improve, more elements were discovered in the 20th century. The following is a chart of rare earth elements and their chemical symbols:

Name	Symbol	Name	Symbol
Lanthanum	(La)	Dysprosium	(Dy)
Cerium	(Ce)	Holmium	(Ho)
Praseodymium	(Pr)	Erbium	(Er)
Neodymium	(Nd)	Thulium	(Tm)
Promethium	(Pm)	Ytterbium	(Yb)
Samarium	(Sm)	Lutecium	(Lu)
Europium	(Eu)	Yttrium	(Y)
Gadolinium	(Gd)	Scandium	(Sc)
Terbium	(Tb)		

The rare earth series are characterised by high density, high melting points, high electrical and thermal conductivity and are indispensable in high-technology applications. Some rare earth elements such as lanthanum, cerium can be made into much more environmental friendly products which are non-toxic.

China is one of the countries with the richest reserves of rare earth in the world. China is the largest rare earth production and exporting country and is the second largest country in terms of rare earth consumption. In 1998, the global consumption of rare earth amounted to 65,000 tonnes (REO). At present, 75% of the rare earth consumed worldwide is of Chinese origin. The rare earth ores in China are principally located in Baotou, Sichuan, Shangdong and Jiangxi. (Source: Summary of the Research Report of the Rare Earth Expert Team of the State Planning Commission, No. 5 (), Rare Earth Circular, 4th Issue of 1999 (1999 4) and an article titled China's Rare Earth Industry: Past, Present and Future, which summarizes the speech presented in a convention called Rare Earth 98' held in Fremantle, Australia on 25th to 30th October, 1998).

Uses of Rare Earth Products

Following separation of rare earth materials and the extraction of rare earth elements, the process of refining turns such elements into rare earth products, which can then be used as raw materials in a wide range of industries ranging from traditional industries such as metallurgy, petroleum and chemical engineering, glass and ceramics to high-technology industries such as electronic devices, information technology, computer and office automation. They also act as a form of catalyst in various industrial applications in achieving greater energy efficiency, higher performance and greater environmental protection. In short, they are essential to modern technologies.

OVERVIEW OF THE INDUSTRY

Industrial applications of rare earth are countless. Some of the more common usages are as follows:

- Automotive: Automation of motor vehicles including anti-lock braking and airbag systems, anti-lock system, catalytic converters function as exhaust purifiers and exhaust discharge control and batteries for motor vehicles.
- Magnets: Computer hard disks, fax machines, printers, medical equipment, including X-ray, laser, and consumer electronics with mechanical motion.
- Electronics: Superconductor, portable electronic equipment, such as telephones and computers. Also widely used in various kinds of batteries, including those for cellular phones.
- Phosphors: Widely used in television sets and computer monitors to produce brighter colour display, and the production of energy-saving light bulbs, luminous road signs and glowing materials on highway surface.
- Glass: Optical glass, such as camera lenses and video camera lenses; reinforced glass; anti-UV light glass and infrared glass for night vision; and optical fibres.

International market

The United States is the world's largest consumer of rare earth products. In 1998, it consumed 26,000 tonnes (REO) of rare earth products whereas the rare-earth consumption of China and Japan amounted to 15,300 tonnes (REO) and 10,000 tonnes (REO) respectively. In 1996, the United States produced 20,400 tonnes rare earth products and imported 23,800 tonnes of which China accounted for about 70.3%. Except for a portion which are used for re-export purposes after processing, 46% of the rare earth consumed in the United States are used in the exhaust purifier system of cars, 25% as oil refined catalysts, 12% as permanent magnetic materials, 7% in glass and ceramics, 7% in metallurgy, and 3% fluorescent materials. (Source: Rare Earth Circular, 4th issue of 1999 (1999 4)).

In 1989, the United States had rare earth reserves of 5,500,000 tonnes (REO) second only to China. Given the rate of consumption in the United States in 1998, the reserve available is sufficient for consumption for over 200 years. (Source: Summary of the Research Report of the Rare Earth Expert Team of the State Planning Commission, No. 5, (1999)). However, as the cost of mining in the United States is much higher than that in China due to its relatively high labour costs, the profit margin achieved by producers in the US fell drastically in recent years. As a result, the last rare earth mining and separation operation in the United States was shut down in 1998. This changed the United States from a rare earth exporting country to a rare-earth importing country.

Japan ranks third in terms of its consumption of rare earth, around 80% of which is the single high-purity type of rare earth products. In 1998, its consumption of rare earth amounted to 10,000 tonnes (REO). Japan has no rare earth resources, which necessitates the import of large quantities of rare earth products especially from China. These products are mainly used in the manufacture of NdFeB permanent magnetic materials, fluorescent materials, and Ni-MH batteries. Since early 1990's, Japan's demand for rare earth products used in high-technology industries has grown at an average annual rate of 10%. In 1998, China's rare earth export to Japan accounted for 59.4% of Japan's total import of rare earth. (Source: Rare Earth Circular, 4th issue of 1999 (1999 4) and Rare Earth Pioneer, 3rd-4th issue of 1999 (1999 3-4)).

OVERVIEW OF THE INDUSTRY

The PRC Market

The rare earth industry of China took off in the 1950's. Since 1978, significant progress has been made in respect of scientific and technological development, production and industrial application of rare earth products. At present, China is in a leading position in the world both in the production and export of rare earth products.

In 1998, the annual global consumption of rare earth was about 65,000 tonnes (REO). China's domestic consumption in 1998 was approximately 15,300 tonnes (REO), which accounted for 23.54% of the world's total consumption.

According to the information of the Rare Earth Office of the State Planning Commission, for the three years ended 31st December, 1998, China's output of rare earth products were about 45,338 tonnes, 46,500 tonnes and 60,000 tonnes respectively. During the same period, China's domestic consumption of rare earth products were 14,530 tonnes, 15,070 tonnes and 15,300 tonnes respectively; rare earth exports were 30,808 tonnes, 31,430 tonnes and 44,700 tonnes respectively. The following table shows details of the total output and domestic and overseas sales of China's rare earth from 1996 to 1998:

Total output, domestic sales and export of China's rare earth products from 1996 to 1998

Year	1996		1997		1998	
	tonnes	%	tonnes	%	tonnes	%
Total output	45,338		46,500		60,000	
Total consumption in China						
Smelting	4,950	34.1	4,960	32.9	5,000	32.7
Petrochemical	3,500	24.1	3,710	24.6	3,800	24.8
Glass and ceramics	1,400	9.6	1,540	10.2	1,540	10.1
New materials	1,600	11.0	1,850	12.3	2,000	13.1
Others	3,080	21.2	3,010	20.0	2,960	19.3
	<u>14,530</u>	<u>100.0</u>	<u>15,070</u>	<u>100.0</u>	<u>15,300</u>	<u>100.0</u>
Export	<u>30,808</u>		<u>31,430</u>		<u>44,700</u>	

Source: The Rare Earth Office of the State Planning Commission, *China's Annual Review of Rare Earth, China's Rare Earth (1996-1997) and the Rare Earth Circular, 3rd Issue, 1999*.

Rare Earth Resources

According to the statistics issued by the US Minerals Department in 1989, world reserves of rare earth available for extraction amounted to 44.81 million tonnes (REO), of which 36 million tonnes (REO) were found in China which accounts for 80% of the world's total reserves. The United States has 5.5 million tonnes (REO) of reserves, which accounts for 12% of the world's total reserves. India has 1.8 million tonnes (REO) of reserves, which accounts for 4% of the world's total reserves. The reserves of these three countries occupy the top three positions of the world, which together account for 96% of the world's reserves. As for the United States, its resources are mainly of the relatively light rare earth; for India, its ores are mainly the monazite which also belongs to the light rare earth type; for China, not only does it have the largest light rare earth mines, it also has the monazite as well as the heavy rare earth deposits, including the Lonic Ore. Therefore, in relative terms, China has both the most abundant reserves of rare earth and the greatest varieties of rare earth ores in the world.

OVERVIEW OF THE INDUSTRY

The following chart shows China's position in the world in terms of its rare earth reserves:

China's rare earth resources and its position in the world

Country	Reserves ('000 tonnes, REO)	Percentage of global reserves (%)
China	36,000	80
US	5,500	12
India	1,800	4
Australia	680	2
Former Soviet Union	450	1
Canada, Brazil, Malaysia, Thailand and others	389	1
Total	<u>44,819</u>	<u>100</u>

Prospects

In 1997, the State earmarked RMB55 billion for the investment in electric railway construction and the demand for rare earth materials used in the construction of the railway is expected to increase. Furthermore, in accordance with the requirements of the relevant international treaty, China is to achieve, by 2003, a discharge level of automobiles' exhaust equal to that of Europe in the early 1990s, and to catch up with the international control level by 2010. These factors are conducive to a growth in domestic consumption as rare earth products is used as a catalyst for the purification of cars' exhaust.

Regulatory requirements in respect of rare earth production

The amended Directions Concerning Foreign Investment promulgated by the State Planning Commission (), the State Economic and Trade Commission () and the Ministry of Foreign Trade and Economic Co-operation () on 31st December, 1997 has come into effect on 1st January, 1998. Under these regulations, mining, selection, smelting, extraction and separation of rare earth are classified as restricted businesses, in which no wholly foreign-owned enterprise is allowed to engage. The setting up of equity joint ventures or cooperative joint ventures for operating such businesses requires the approval of the relevant industrial administrative authorities of the State Council and the Ministry of Foreign Trade and Economic Co-operation or its relevant delegated authorities. However, the relevant PRC laws and regulations do not specify a ceiling on the percentage of registered capital to be held by the foreign party in the enterprise. The Group has obtained the requisite consent from the relevant rare earth administrative authorities of the State Council and the approval of the local Ministry of Foreign Trade and Economic Co-operation for the establishment of Yixing Xinwei Leeshing Rare Earth Co., Ltd.

OVERVIEW OF THE INDUSTRY

Licensing requirement

According to PRC law and regulations, an enterprise has the right to carry out manufacturing and sale of rare earth products once having obtained the requisite business licence from the PRC government, and there are no other licensing requirement imposed for engaging in such business.

The export of rare earth products is regulated by a quota and export permit system. The relevant enterprise has to obtain a quota certificate and export permit before the export of rare earth products may be effected. There are no regulatory requirements and restrictions on the pricing of rare earth products.

THE REFRACTORY INDUSTRY

Refractory materials are inorganic non-metallic materials that can withstand high temperatures of above 1,580°C. Refractory materials are processed from natural ores such as quartzite, dolomite and graphite ore which can be found in many parts of the world. They have high degree of heat resistance, very good volumetric stability and high degree of wear resistance. Some refractory materials also have properties such as gas permeability, thermal conductivity, electric conductivity and hardness.

Refractory materials have different varieties. They are largely divided into four main types according to their heat resistance ability:

Types of refractory materials	Heat resistance level
Ordinary	(1,580°C to 1,770°C)
Medium grade	(1,770°C to 2,000°C)
High grade	(2,000°C to 3,000°C)
Super grade	(3,000°C and above)

They are vital materials widely used in light and heavy industries such as steel, metallurgy, non-ferrous, petrochemical and construction industries.

Refractory materials can be pressed into bricks and are generally used in the construction of heat treatment facilities such as metallurgy kilns and furnaces. However, the use of unshaped refractory products has been gradually developed. Unshaped refractory materials are refractory pouring materials that can be shaped into any form suitable for constructing different heating furnaces. The unshaped refractory materials can also be used as linings of different thermal treatment furnaces given its high heat-insulation property, temperature resistance and strength. The production volume and application of unshaped refractory products have increased significantly during recent years. According to the information released by the State Bureau of Metallurgy in 1999, total production of unshaped refractory products in China increased by 132% from 1995 to 1997.

OVERVIEW OF THE INDUSTRY

Proportion of refractory materials consumption by different industrial sectors of various countries (%)

Country Industrial sector	Japan	Germany	US	Russia
Steel	69.7	57.7	50.7	60.1
Non-ferrous metal	1.9	2.7	6.5	4.0
Construction material	10.3	16.0	17.8	8.1
Petrochemical	1.4	1.5	2.7	4.7
Boilers of generators	0.1	1.1	0.8	—
Machines and others	16.6	21.0	21.5	23.1
Total	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Source: *The Application of Refractory Materials* (), reprinted in 1995.

Among the world's major industrial countries, consumption of refractory materials by the steel industry amounted to over 60%. Consumption of refractory materials by China's steel industry is less than 50%, whereas consumption in cement, glass, ceramics and other industries as well as industries using steel furnaces accounted for more than 50%.

The development of China's refractory materials can be classified into the following three stages:

- (i) Before 1949, there was a small number of small-scale factories which were engaged in producing low-quality refractory materials such as clay bricks, and their output was low. At that time, the refractory materials used in the smelting industry were imported.
- (ii) At the beginning of 1970's, in order to meet the needs of China's industrial development, new refractory material factories were constructed and the production scale of the existing factories was expanded with increased product varieties. However, the quality of such products and its varieties still had not attained international standards.
- (iii) Since 1977, significant progress has been made in China's refractory industry. China succeeded in designing large-scale modernised production facilities. At the beginning of 1980's, China introduced new types of refractory materials for kilns and high-temperature facilities, the quality of which is comparable to international standards. 98% of the ordinary refractory materials and 90% of the specialised refractory materials are sold in the domestic market, both have met the requirements of and promoted the development of high temperature industrial technology.

Before 1990's, refractory materials were mainly imported by China from Japan, the United States, France, Germany and Australia. Over the last decade, in order to meet the needs of a number of steel enterprises in China, the quality of refractory products improved significantly. Advanced technology has been introduced from Japan, Britain, the United States and Germany. This resulted in the addition of a range of new products such as magnesium-carbonate bricks, yttrium carbonate bricks, high-quality silicon carbide bricks, light bricks and magnesium heat insulating plates. After years of research and development, China has become self-sufficient in refractory material supplies.

OVERVIEW OF THE INDUSTRY

Prospects

It is noted that high-grade refractory materials are vital to the production of quality products of industries that require the use of heat treatment facilities such as steel, non-ferrous metals, construction materials and petrochemical industries. As these PRC industries continue to improve production efficiency, demand for quality high-grade refractory materials will continue to increase. At the same time, it is expected that demand for unshaped refractory materials will also increase given that such materials can be shaped into different forms and their scope of use has gradually increased and widened.

Regulatory Requirement in respect of refractory materials production

No restriction is imposed by the PRC government on foreign investment in the refractory materials industry including the manufacture and sales (including export) of refractory materials. However, a foreign investor has to obtain approval from the Ministry of Foreign Trade and Economic Commission or its delegated local authorities or local bureau when setting up refractory business. Furthermore, there are no regulatory requirements and restrictions on the pricing of refractory materials. In this connection, the Group has obtained all requisite approvals for the establishment of Yixing Xinwei Leeshing Refractory Materials Co., Ltd.

BUSINESS OF THE GROUP

HISTORY AND DEVELOPMENT

The rare earth production business of the Group was founded by Mr Jiang and Mrs Jiang in 1987 by establishing Yixing Xinwei Rare Earth Separating Factory in Yixing, Jiangsu Province which was engaged in rare earth extraction and production. In 1988, the Group expanded its rare earth business by setting up Yixing Rare Earth Refinery Factory in Yixing for rare earth smelting. The extraction and smelting facilities have been expanded over the years. In 1994, Yixing Xinwei Group Limited was set up and took over all the assets and liabilities of Yixing Xinwei Rare Earth Separating Factory following which Yixing Xinwei Rare Earth Separating Factory was dissolved. The assets and liabilities of Yixing Rare Earth Refinery Factory were taken over by the Yixing Xinwei Group Limited in 1999 as part of the pre-listing reorganisation and the operations of Yixing Rare Earth Refinery Factory continue as a production plant of Yixing Xinwei Group Limited.

Whilst carrying out its rare-earth business, the Group noted the development of the steel industry and non-ferrous industry at the time and believed that such development would lead to a sharp rise in demand for high-grade refractory materials. The Group established Yixing Wellfire Refractory Materials Co., Ltd., a refractory materials plant in Yixing in 1991 for manufacturing refractory materials mainly for glass kilns with an annual production capacity of 10,000 tonnes.

In 1991, the Group expanded its rare earth business and established Yixing Yimei Fluorescent Materials Co. Ltd. to engage in the production of fluorescent powders with an annual production capacity of about 50 tonnes.

In 1993, the Company established another refractory production facility, Yixing Xinwei Refractory Materials Factory, with an annual production capacity of 10,000 tonnes, and supplied refractory materials especially for petrochemical kilns. In 1996, the production facility of refractory materials for steel plants, Yixing Longwei Special Refractory Materials Factory was established. The facility has a production capacity of approximately 10,000 tonnes per annum.

During this time, the Group noted that with a vast population of 1.2 billion in China, electric power is in great demand, and the PRC Government was calling for energy saving. To this end, using rare earth fluorescent lamps can substantially save electric power. In 1996, the Group established Yixing Shengyi Ytterbium Co. Ltd. which was engaged in the production of rare earth oxides.

At present, all of the Group's production facilities, both for production of rare earth and refractory materials, are located at the factory complex in Dapu, Yixing, Jiangsu Province. In January, 1999, the Group was awarded the ISO 9002 certificate for quality system accreditation which was issued by the PRC Import and Export, Merchandise Quality Accreditation Centre.

In July 1999, additional rare earth extraction lines were installed and the Group's maximum production capacity for rare earth products has increased from 3,000 tonnes (REO) to 3,550 tonnes (REO) per annum. At present, the Group has an aggregate of 16 rare earth extraction lines.

In preparation for the listing of the Shares on the Stock Exchange, the various entities referred to above underwent the corporate reorganisation more particularly referred to in the section headed "Group reorganisation" in Appendix VI to this prospectus whereby (i) all the assets, liabilities and operations of the refractory business were transferred to Yixing Xinwei Leeshing Refractory Materials Co. Ltd.; (ii) all the assets, liabilities and operations of the rare earth business were transferred to Yixing Xinwei Leeshing Rare Earth Co., Ltd; and (iii) the Company became the holding company of the Group. Prior to the reorganisation, Yixing Xinwei Leeshing Rare Earth Co. Ltd. was established

BUSINESS OF THE GROUP

by Yixing Xinwei Group Limited as a PRC party and an independent foreign party. As the foreign party failed to contribute its capital commitments, Lee Shing Holdings Limited assumed the equity interests of the foreign investor and acquired a portion of the equity interests of Yixing Xinwei Group Limited. After the transfer, Lee Shing Holdings Limited owns 95% equity interests in Yixing Xinwei Leeshing Rare Earth Co. Ltd. while Yixing Xinwei Group Limited, which is a domestic enterprise, owns the remaining 5% interest. Lee Shing Holdings Limited is a company incorporated in the British Virgin Islands and is wholly owned by Mrs Jiang prior to the pre-listing corporate reorganisation. All requisite approvals have been obtained for the establishment and transfer of equity interests of Yixing Xinwei Leeshing Rare Earth Co. Ltd.

Upon implementation of the corporate reorganisation, Yixing Xinwei Group Limited owns 5% equity interest in Yixing Xinwei Leeshing Rare Earth Co., Ltd. but does not otherwise own any assets and operations of the rare earth and refractory businesses. Yixing Xinwei Group Limited is now owned as to 5% by Mr Jiang and as to 95% by Mr Qian Zhiming, the brother of Mrs. Jiang.

The Directors confirm that the reorganisation mentioned above and as detailed in Appendix VI is completed and that all approvals for the transfer of assets have been granted by the relevant regulatory authorities. The Group's corporate chart is set out in the section headed "Group structure".

BUSINESS OF THE GROUP

GROUP STRUCTURE

The following chart shows the corporate structure of the Group immediately after completion of the Share Offer and the Capitalisation Issue (but before taking into account the Shares to be allotted upon exercise of the options granted under the Share Option Scheme, the Shares to be allotted upon exercise of the Over-Allotment Option or any issue or repurchase of Shares by the Company under the general mandates as referred to in Appendix VI to this prospectus):

**Note:* YY Holdings Limited is held by the trustee of the Jiang family trust, the discretionary object of which is a company wholly owned by Mrs. Jiang. Assuming that the Over-Allotment Option is exercised in full, YY Holdings Limited will hold 72.3% of the entire issued Shares.

BUSINESS OF THE GROUP

LINES OF PRODUCTS

The Group's products can be divided into two general categories, which include rare earth products and refractory materials.

Rare earth products

The Group is engaged in the manufacture and sale of rare earth products. In the production of rare earth products, rare earth materials have to undergo various processing which includes separation and extraction and processing into single rare earth elements and such elements are then refined into different rare earth products in accordance with customers' specifications.

The following are the main rare earth products manufactured by the Group and their respective applications:

Description of main products	Applications:
1. Lanthanum	(1) Aluminium alloys for aeroplanes and glass decolourising agent (for reinforcement); (2) road signs and reflection pellets on the road surface of highways; (3) optical glass, such as cameras and video camera lenses; (4) batteries for portable phones; (5) pigments and glass agents for ceramics, (6) optical fibres; and (7) high-grade capacitors.
2. Cerium	(1) Production of fluorescent powders; (2) optical glass and radiation resistant glass; (3) special additives for glass for reinforcement; (4) catalyst for petroleum cracking, so as to enhance petroleum refining; (5) electronic components for computers, ovens, micro-ovens and air-conditioners; and (6) exhaust purifiers of cars.
3. Praseodymium	(1) Production of high-grade ceramic pigments; (2) alloy for the movements of watches; and (3) permanent magnet.
4. Neodymium	(1) Manufacturing of permanent magnetic materials and automatic door locks and windows of cars for the car industry; (2) superconductors for the electronic industry; (3) batteries for portable phones; (4) hard disk drives of computers.
5. Samarium	(1) High-grade permanent magnets material for defence industry; (2) control material for nuclear energy industry.
6. Europium	(1) Fluorescent screen for colour television sets, computer display units and trichromatic fluorescent lamps; (2) control rods for the nuclear energy industry.
7. Gadolinium	(1) Laser equipment; (2) GGG crystals; and (3) magnetic refrigeration materials.
8. Terbium	(1) Fluorescent activator; (2) memory chips of computers; and (3) high-grade magnetic materials.

BUSINESS OF THE GROUP

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| 9. Dysprosium | (1) Neutron energy spectrum detector for the nuclear energy industry; (2) material for metallic halogen lamps; (3) optico-magnetic memory alloy; (4) permanent magnetic materials; and (5) lasers. |
| 10. Holmium | (1) Thermal-nuclear reaction activator; (2) surgical use laser for removal of blood clots (as in arteriosclerosis). |
| 11. Erbium | (1) Illuminants; (2) superconductors; (3) optical fibres; (4) infra-red glass (as in night vision). |
| 12. Thulium | (1) x-rays; (2) superconductors. |
| 13. Ytterbium | (1) Manufacturing of superalloys; (2) heat insulation coating. |
| 14. Lutecium | (1) The probe of PET medical equipment (which carries out ordinary x-ray and cross-sectional x-ray imaging and cell examination for the human body); (2) electronic colour display. |
| 15. Yttrium | (1) Principal component for illuminants; (2) man-made gems; and (3) metal alloys. |

Apart from the above rare earth products, the Group also manufactures and sells rare earth fluorescent powders. Fluorescent powders are manufactured with rare earth as the principal raw material. Through calcining and washing, the materials are reduced to red, green and blue monochromatic powders. After compounding, they form mixtures of fluorescent powders that react to different temperatures and give out different colours. As mixed fluorescent powders contain three different basic colours, which are red, green and blue, they are called rare earth trichromatic fluorescent powders. Such fluorescent powders may be applied in manufacturing lamps and fluorescent screens so as to achieve brighter colour. For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, the Group's sales of fluorescent products represented 13%, 7%, 11% and 12% of the Group's total sales of rare earth products respectively.

Refractory materials

Refractory materials produced by the Group are mainly medium to high grade products. Refractory materials are widely used in petrochemical industry, metallurgy, non-ferrous industry, glass and cement industries. The Group produces five major series of refractory materials, the application of which are set out as follows:

Main products	Applications
1. High-purity, low-silicon corundum products	Mainly used in large-scale chemical fertiliser production company, for the lining of synthetic ammonia ovens with an annual capacity of 300,000 tonnes and gas ovens.
2. Electric-melted re-combined chrome-magnesium products	Mainly used in the lining of large-scale steel production furnaces of 2,500 m ³ and 4,073 m ³ , and RH furnace.

BUSINESS OF THE GROUP

Main products

3. Products of the magnesium series

Applications

Mainly used in non-ferrous metallurgy for smelting copper, aluminum, lead, zinc, nickel; also used in the lining of glass kiln and large-size cement rotational kilns.

4. Products of the zirconium series

Mainly used in large-size float glass kilns

5. Unshaped refractory materials

Used in the thermal-working facilities of various heavy industries. It is the key lining materials in the thermal working facilities for power plants, oil refinery plant, chemical fertilizer plant and petrochemical plant.

SALES AND MARKETING

Rare earth products

Customers or end users of the Group's rare earth business are generally engaged in the production of high technology products including reinforced glass, textiles, long-life light bulbs, exhaust purifiers and mechanical motor parts of automobiles, batteries for mobile phones and television sets.

Before obtaining its import/export licence, the Group's exports of rare earth products are conducted through independent import/export agents which possess the necessary import and/or export right. All of the import/export agents are independent of and not related to the directors, chief executives or substantial shareholder of the Company or any of its subsidiaries or an associate of any of them. The Group generally enters into tri-party contracts with the import/export agents and the overseas customers for supply of the rare earth products to such customers. Alternatively, the Group sometimes enters into two-party contracts with the import/export agents which would then sell the Group's rare earth products on its own to the overseas customers designated by the Group. In either of these two situations, the Group generally warrants the quality of its products for a period of one month following delivery. The sale commissions to the import/export agents were borne by the customers under separate agreements between the customers and the import and export agents. For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, none of the Group's products had been returned by its customers as defective. The Group's rare earth products are not subject to any pricing regulation imposed by the PRC Government.

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Depending on the duration of the sales contracts, the Group would usually agree with its customers the quantity of products to be sold at a fixed price if delivery takes place within a short period of time. For the relatively long term contracts of more than two years, prices of the rare earth products will generally be adjusted by reference to the then prevailing market price at the time when delivery is made. At present, the Group has entered into two long term sales agreements with its rare earth product customers, one with an expiry date in 2000 and the other in 2001. All of these long term sales agreements are legally binding which specify the total quantities to be sold and the sales price in relation thereto. However, for the long term sales agreement expiring in 2001, the sales price may be adjusted by reference to the then prevailing market price at the time when delivery is made and the buyer can purchase additional quantities of rare earth products on top of the quantities stated in the agreements. The Group will review the prices of its rare earth products by reference to the prices suggested by China National Association for Rare Earth Trades () and the prevailing market price. In October 1997, the Group obtained its own import and export licence. The Directors anticipate that the proportion of sales conducted through the Group's own import and export licence will increase in future. In addition, the rare earth business of the Group is not subject to any import tariffs and operation licensing restrictions.

Sales of Top Ten Rare earth products

The Group produces 31 different types of rare earth products. For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, sales of the top ten rare earth products of the Group are set out in the following table:—

Rare earth products	Sales of top ten rare earth products in terms of volume						For the	
	For the year ended 31st December,						four months ended	
	1996		1997		1998		30th April,	1999
	Rank	tonnes (REO)	Rank	tonnes (REO)	Rank	tonnes (REO)	Rank	tonnes (REO)
Neodymium	3	459	2	698	2	667	3	196
Neodymium Alloy	5	56	7	33	5	91	5	30
Yttrium	4	201	4	156	4	177	4	85
Cerium	1	597	1	991	1	872	1	264
Lanthanum	2	472	3	600	3	547	2	204
Fluorescent								
– Red fluorescent	7	26	8	18	7	31	8	12
– Green fluorescent	9	17	9	12	9	19	9	7
Dysprosium	6	56	5	47	6	39	6	16
Yttrium + Europium	8	19	6	35	8	28	7	14
Others		13		124		391		9
Total		<u>1,916</u>		<u>2,714</u>		<u>2,862</u>		<u>837</u>

Geographical distribution of customers

The Group's rare earth products are currently exported to US, Japan, Germany and Korea. For the year ended 31st December, 1998 and the four months ended 30th April, 1999, sales to customers in the US accounted for approximately 20% and 11% respectively of the Group's total turnover of rare earth products while sales to customers in Japan accounted for about 37% and 52% respectively.

BUSINESS OF THE GROUP

The following table sets out the geographical breakdown of the Group's rare earth sales in terms of value and as a percentage of total sales of rare earth products for the three years ended 31st December, 1998 and the four months ended 30th April, 1999:

	For the year ended 31st December						Four months ended	
	1996		1997		1998		30th April, 1999	
	HK\$'000	%	HK\$'000	%	HK\$'000	%	HK\$'000	%
US	82,467	38	106,124	40	59,774	20	10,347	11
Japan	75,723	34	101,171	39	106,314	37	50,554	52
Korea	7,334	3	5,697	2	2,143	1	640	1
Germany	2,483	1	6,702	3	4,838	2	1,190	1
PRC	51,755	24	42,196	16	115,012	40	33,985	35
	<u>219,762</u>	<u>100%</u>	<u>261,890</u>	<u>100%</u>	<u>288,081</u>	<u>100%</u>	<u>96,716</u>	<u>100%</u>

Sales to top customers

The five largest customers of the Group's rare earth products accounted for about 48%, 65%, 46% and 52% respectively of the Group's total rare earth products sales for the three years ended 31st December, 1998 and the four months ended 30th April, 1999. For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, sales to the single largest customer amounted to about 17%, 34%, 17% and 16% of the total sales of rare earth products respectively. Most of these customers have over ten years of business relationship with the Group. The Group will review the prices of its rare earth products regularly by reference to the prevailing market price. The Directors believe that the Group's ability to maintain customer loyalty is largely attributable to the Group's commitment to product quality.

Sales Policy

For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, all of the Group's sales of rare earth products were settled in Renminbi. At present, 75% and 25% of the payments to the Group for sales conducted through the import and export agents are in the form of cash cheques and by telegraphic transfer respectively. For the sales made by the Group directly with the overseas customers, 70% and 30% of the payment are settled by letters of credit and telegraphic transfer respectively. A credit period of 30 days is usually extended by the Group to its customers. For customers who have business relationship with the Group for over ten years, the Group usually offers a maximum credit period of 60 days. However, the settlement pattern of the Group's customers is that settlement towards the end of a year is usually faster than that in the middle of a year. Given the long term and good business relationship between the Group and its customers, the Directors consider that the receivables, net of general provision, will be fully collected and would not have any adverse impact on the cashflow of the Group.

BUSINESS OF THE GROUP

Marketing

The Group has a sales and marketing team of 30 persons. To promote the Group's products, the management and sales staff of the Group pay regular visits to trade exhibitions organised in the US, Austria, Germany and Japan. The Group also takes part in the spring and autumn trade exhibitions held in China every year to promote the Group's products and to meet new customers, both domestic and overseas. The Group has also expanded its sales network through referrals by the import and export agents engaged by the Group and referrals from existing customers.

Refractory products

Sales

For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, sales of refractory materials by the Group amounted to about HK\$101 million, HK\$118 million, HK\$131 million and HK\$47 million respectively and represented about 31%, 31%, 31% and 33% of the total turnover of the Group respectively.

The Group's refractory materials are mainly for domestic sales to steel manufacturing enterprises. Sales to the five largest customers of the Group for the three years ended 31st December, 1998 and the four months ended 30th April, 1999 accounted for approximately 69%, 52%, 59% and 68% of the Group's total sales of refractory materials respectively, with the single largest customer accounting for approximately 37%, 20%, 14% and 20% respectively for the same period. The Group has generally over four years of relationship with these customers.

For the year ended 31st December, 1996, all refractory materials were for domestic sales. For the two years ended 31st December, 1998 and the four months ended 30th April, 1999, domestic sales accounted for about 98%, 92% and 98% respectively, and overseas sales accounted for about 2%, 8% and 2% respectively of the total refractory materials sales.

Sales of the Group's refractory materials are mainly settled in Renminbi. At present, 65% and 35% of the payments to the Group by its domestic customers for refractory materials are in the form of cash cheques and by telegraphic transfer respectively. Payment by overseas customers to the Group is all by telegraphic transfer. The Group usually offers a maximum credit period of 30 days to its customers. Similar to the sales of rare earth products, settlement of customers usually picks up towards the end of a year.

The Group sells directly its refractory materials to overseas customers. Sales to the Group's overseas customers are settled in Renminbi. The Group reviews the prices of its refractory materials regularly by reference to the market price. There is no published information on the price of refractory materials. References are made to the quotations offered by other refractory material producers when fixing the price of its products.

None of the Directors, their respective associates nor any shareholder of the Company owning more than 5% of the issued share capital of the Company (immediately after the Share Offer and the Capitalisation Issue) has any interests in any of the Group's customers for rare earth products or refractory materials.

BUSINESS OF THE GROUP

For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, the Group did not make any specific provision for bad debts. For the same period, the Group made general provision for receivables attributable to both rare earth products and refractory materials sales amounted to approximately HK\$2,455,000, HK\$5,803,000, HK\$871,000 and HK\$936,000, respectively.

Sales of top ten refractory products

The following sets out the breakdown of sales by product for the three years ended 31st December, 1998 and the four months ended 30th April, 1999:

Refractory materials products	For the year ended 31st December,			For the four months ended
	1996 (tonnes)	1997 (tonnes)	1998 (tonnes)	30th April, 1999 (tonnes)
Direct-bonded magnesite chrome brick	2,199	1,628	1,705	398
Magnesite brick	203	894	838	—
Magnesite-alumina spinal brick	1,540	1,743	1,483	633
Mullite cordierite brick	905	1,489	1,491	798
Electrocast magnesite-zircon brick	1,362	2,489	2,084	1,239
Silicon carbide brick	245	1,591	1,662	739
Sillimanite brick	589	1,486	1,032	499
AZS brick	496	1,127	1,120	564
Zircon brick	—	685	1,370	189
Others	<u>11,681</u>	<u>7,020</u>	<u>5,469</u>	<u>1,789</u>
Total	<u>19,220</u>	<u>20,152</u>	<u>18,254</u>	<u>6,848</u>

BUSINESS OF THE GROUP

PRODUCTION PROCESS

Rare earth products

The following is a diagrammatic presentation of the production process for rare earth products:

BUSINESS OF THE GROUP

Refractory materials

The following is a diagrammatic presentation of the production process of refractory materials:

BUSINESS OF THE GROUP

RAW MATERIALS AND PURCHASES

Rare earth products

Rare earth materials are the major raw materials in the production of rare earth products. The rare earth materials used by the Group are mainly sourced from the rare earth mines in Baotou of Inner Mongolia, Jiangsu, Jiangxi and Guangdong Province of the PRC. Of the total rare earth materials, about 31%, 26% and 30% were purchased from Jiangsu; 18%, 20% and 21% from Jiangxi; 30%, 30% and 26% from Inner Mongolia, 9%, 14% and 13% from Guangdong; 8%, 7% and 7% from Anhui; and 4%, 3% and 3% from Heilongjiang for the three years ended 31st December, 1998. Most of these suppliers are state-owned enterprises. Other raw materials for rare earth products are hydrochloric acid, oxalic acid and organic P507 extraction reagent.

Purchase of raw materials for production of rare earth from the Group's five largest suppliers for the three years ended 31st December, 1998 and the four months ended 30th April, 1999 respectively represented about 62%, 65%, 58% and 57% of the Group's total purchases of rare earth raw materials. Purchases from the largest rare earth materials supplier of the Group represented about 15%, 17%, 15% and 15% of the Group's total purchases of rare earth raw materials for the three years ended 31st December, 1998 and the four months ended 30th April, 1999 respectively. The Group has over five years' long term business relationship with these suppliers. At present, the Group has entered into six long term purchase agreements for rare earth raw materials, five of which cover the period from 1996 to 2000 and the remaining one covers the period from 1993 to 2013. All of these agreements are legally binding. Under these agreements, prices of the raw materials are not fixed but are determined by reference to the prevailing market price at the time of delivery. In addition, the Group is required to purchase the quantities specified in the agreements though it may adjust the actual quantity to be supplied in each month of a given year during the term.

At the beginning of every year, the Group's management and staff from the purchase department will prepare a forecast of the Group's purchases of rare earth raw materials for the year based on the market demand and the orders already placed by customers for that year. The purchase department will then place orders with the suppliers and give instructions on the requirements of the rare earth raw materials and on delivery time with reference to customers' requirements. The duration between the time orders are placed and the time of delivery varied depending on the quantity of the orders and customers' demand. In general, the average duration between each delivery of raw materials is one month. The suppliers normally request the Group to pay 50% of the purchase price upon delivery and the remaining balance within three months after delivery. Settlement is made in Renminbi.

Refractory materials

Magnesium sand, high-aluminium ore and chromium ore are the three major raw materials for the production of refractory materials. Of the total refractory raw materials purchased by the Group, magnesium sand accounted for about 26%, 17%, 16% and 10%; high-aluminium accounted for about 20%, 16%, 20% and 23%; and chromium ore accounted for about 14%, 11%, 13% and 16% for the three years ended 31st December, 1998 and the four months ended 30th April, 1999.

For each of the three years ended 31st December, 1998 and four months ended 30th April, 1999, the raw materials supplied by the five largest suppliers of the Group respectively represented about 51%, 81%, 83% and 68% of the Group's total purchases of refractory raw materials. Purchases from the largest refractory materials supplier of the Group represented about 22%, 21%, 21% and 17% of the Group's total purchases of refractory raw materials for the three years ended 31st December, 1998 and the four months ended 30th April, 1999. The Group has entered into three long term purchase agreements with the suppliers and the Group generally has over five years' business relationship with

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these suppliers. Under these agreements, prices of the raw materials are not fixed, but are determined by reference to the prevailing market price at the time of delivery. In addition, although the total quantities of raw materials to be purchased each year are fixed in the purchase agreements, the Group may adjust the actual quantity to be supplied in each month of a given year during the term.

The Group's purchases are settled in Renminbi. All of the Group's purchases of refractory materials were settled in the form of cash cheques. Depending on the relationship with its suppliers, payment in an amount generally not exceeding 90% of the invoiced value of the goods will be made upon delivery while the remaining balance is generally settled within the same year.

None of the Directors, their respective associates nor any shareholder of the Company owning more than 5% of the issued share capital of the Company (immediately following completion of the Share Offer and the Capitalisation Issue) has any interests in any of the Group's top five suppliers of rare earth or refractory raw materials.

QUALITY CONTROL

It is the Group's policy to produce rare earth products strictly in compliance with the product specifications stipulated by its customers by applying the Group's stringent quality control procedures. In respect of every bulk purchase of rare earth materials by the Group, there are specifications for every 1,000 kg of rare earth ores. During the three years ended 31st December, 1998 and the four months ended 30th April, 1999, the Group had not suffered any loss as a result of substandard raw materials.

The Group conducts chemical tests and analysis on the rare earth mixtures during each stage of production and samples produced after each production stage would be sent to the customers for further independent laboratory tests.

In January 1999, the Group successfully obtained the ISO9002 quality certification. As a result of the implementation of such strict quality control procedures, the quality of rare earth products produced by the Group has been very stable and has attained the standard required by the relevant customers.

The raw materials for refractory materials will be tested on delivery. Finished products will be tested on a random basis before being delivered to customers.

RESEARCH AND DEVELOPMENT

The Group attaches special importance to the development of new technologies and new products, and advanced technologies are adopted in the production process. The Directors are of the view that in order to maintain the Group's competitive edge, it is particularly important to develop new products that meet the changing demands of the market.

At the Group's headquarters in Yixing, a research and development centre has been established with 12 research staff. In addition, the Group's production team assists in various research and development projects. The Group's research and development includes the improvement of work flow and product quality, lowering of production costs, enhancement of production efficiency and cost-effectiveness and the improvement of ancillary facilities. The Group also makes use of its marketing network to collect the latest market information for its research and development centre which will liaise and work closely with the production department from time to time. The Group also engages experts of rare earth products and refractory materials every year to provide technical training to its staff.

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For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, the amount spent by the Group on research and development amounted to approximately HK\$1,407,000, HK\$1,327,000, HK\$1,054,000 and HK\$544,000 respectively.

Licensing requirement

According to PRC law and regulations, the Group has the right to engage in the business of manufacture and sale of rare earth products for a term of 30 years after it has obtained its business licence on 17th July, 1993. There is no other licensing requirement imposed by the PRC government in connection with such business. The municipal MOFTEC grants an “indicative export quota” to the Group every year based on the Group’s actual export sales of rare earth products in the previous year. The export quota is indicative only and in the event the actual export sales exceed the indicative export quota granted by the municipal MOFTEC, the Group may make an application to revise the quota. For the year 1999, an indicative export quota of 550 tonnes of rare earth products was granted to the Group.

Yixing Xinwei Leeshing Rare Earth Co., Ltd. has obtained (1) a business licence for the manufacture and sale of rare earth products; (2) a rare earth products import/export licence; and (3) all requisite approvals from the relevant rare earth administrative authorities of the State Council and the local Ministry of Foreign Trade and Economic Co-operation for its establishment.

Yixing Xinwei Leeshing Refractory Materials Co., Ltd. has obtained (1) a business licence for the manufacture and sale of refractory products; and (2) all requisite approvals for its establishment.

PRODUCTION FACILITIES

All of the Group’s products are manufactured at its self-constructed production facilities in Yixing, Jiangsu Province, the PRC. The Group has recently entered into two long term leases each of 30 years with the local authority in respect of the site on which the production facilities are constructed. The Directors consider that a long term lease would satisfy the requirements of the Group for the site is mainly used as its production plant. Information regarding the production facilities of the Group is set out below. Please refer to the section headed “Property Interests” for details of the long term leases mentioned above.

Rare Earth Division

The production facilities in Yixing occupy a total gross floor area of approximately 30,000 sq.m. and comprise a smelting workshop with 16 rare earth extraction lines, three thermal precipitation processors, 21 smelting furnaces, water purifying equipment, analysing and control system, electrolysis system, induction furnace, electronic vacuum furnace and fluorescent powder calciner. The rare earth division employs about 363 workers and the maximum annual production capacity of the facilities is about 3,550 tonnes (REO), which is currently operating at approximately 90% of its capacity.

Refractory Division

The production facilities in Yixing have a total gross floor area of approximately 28,000 sq.m. comprising high-temperature tunnel kilns, low temperature kilns, high tonnage brick pressors and pre-moulded production lines. The production facilities together have a maximum annual production capacity of approximately 30,000 tonnes.

BUSINESS OF THE GROUP

The refractory division employs about 337 workers. The Directors estimate that the production facilities are currently operating at approximately 98% of its capacity.

SAFETY AND ENVIRONMENTAL PROTECTION

The Group adopts various safety measures (including monthly inspections and annual overhauls) to ensure that its employees work in a safe working environment and that public safety will not be affected by the Group's operations.

For the three years ended 31st December, 1998 and the period up to the Latest Practicable Date, no major accident has occurred as far as the Group's operations are concerned, and the Group has made no claims in respect of any material accident.

In compliance with relevant provisions of the national environmental protection law, pollutants discharged during the production process are filtered and treated by the Group's waste treatment plant. For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, the amount spent by the Group on environmental protection amounted to approximately HK\$234,000, HK\$237,000, HK\$299,000 and HK\$103,000 respectively. The expenses mainly represented sewage treatment and disposal fee paid and payable to the local government. For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, the Group had not been fined for failure to comply with the relevant environmental laws.

YEAR 2000 (Y2K) COMPLIANCE

The Y2K compliance issue primarily results from using two digits to represent the four-digit calendar year in the early days of computer programming. The computer software using only two digits for the year identification will fail to differentiate the year 1900 from the year 2000. In this connection, the Company has already carried out a number of tests and inspections for the purpose of Y2K compliance. The results have indicated that the software and hardware used for the management information system are Y2K compliant. Accordingly, the Directors do not expect the Y2K problem to have any impact on the Group. For any computer systems to be acquired in future, the Group will take appropriate steps to ensure they are Y2K compliant.

INTELLECTUAL PROPERTY RIGHTS

The Group has registered trademarks in relation to its rare earth products and refractory materials in the PRC. The Group has also been granted exclusive licences to use certain patents in connection with its refractory materials business. For more details, please refer to the paragraph headed "Intellectual property rights of the Group" in Appendix VI to this prospectus.

COMPETITION

The growing recognition of the importance of rare earth and refractory products would attract new entrants. This unavoidably creates pressure on the pricing of these products. The Directors consider that the Group has a competitive edge over these new entrants given its market position and capability to produce quality products. The monetary crisis and the economic downturn in Southeast Asia since 1997 have resulted in sluggish growth in consumption and spending and also led to competitive price-reduction among rare earth and refractory producers in the PRC.

BUSINESS OF THE GROUP

The Directors are of the view that entry into the rare earth and refractory industries and the ability to compete on product quality and product reliability involve significant capital commitments. The Group believes that following the weeding out of small-scale and low-quality factories, the Group's status in China as well as in the world will be consolidated.

CONNECTED TRANSACTION

On 1st September, 1999, the Group entered into two lease agreements with Mr. Jiang whereby the Group agreed to lease from Mr. Jiang an office premises with an aggregate gross floor area of approximately 193.58 sq.m. at Rooms G and H, 8th Floor, Zhao Feng Universe Building, 1800 Zhong Shan Xi Road, Shanghai, for use as its sales and marketing headquarters, each for a term of three years commencing from 1st September, 1999 at an aggregate monthly rent of RMB18,000 (or about HK\$16,850).

Upon the listing of the Shares on the Stock Exchange, Mr. Jiang who is a Director will become a connected person of the Group. The lease of the office premises to the Group by Mr. Jiang will constitute a connected transaction for the Group. Vigers has confirmed that the rental payable under the two lease agreements is fair and reasonable as far as the Group is concerned. The transaction will fall under Rule 14.24(5) of the Listing Rules.

NON-COMPETITION UNDERTAKING

Immediately following listing of the Shares, the controlling shareholder of the Company, YY Holdings Limited and Mrs. Jiang do not own or control any interest in a business which competes or is likely to compete, either directly or indirectly, with the Group's business to the extent that there could be a conflict between the controlling shareholder's interests and those of the general body of shareholders of the Company. Pursuant to the share purchase agreement dated 29th September, 1999 entered into between Mrs. Jiang, Mr. Jiang, YY Holdings Limited and the Company (being the material contract (i) referred to in paragraph 9 of Appendix VI to this prospectus), each of Mr. Jiang, Mrs. Jiang and YY Holdings Limited has undertaken that at any time during which securities of the Company are listed on the Stock Exchange or any other stock exchange recognised under the Securities Ordinance (Chapter 333 of the Laws of Hong Kong) and for so long as each of Mr. Jiang, Mrs. Jiang and YY Holdings Limited and their associates (as defined in the Listing Rules) holds, whether individually or taken together, 35% or more of the issued shares in the Company or is otherwise regarded as a controlling shareholder of the Company under the Listing Rules or the rules of the relevant securities exchange, he/she/it will not and will procure that his/her/its associates (as defined in the Listing Rules) will not directly or indirectly carry on or be engaged or concerned or interested in: (a) Hong Kong and the PRC the business of manufacturing and sale of rare earth products and refractory material products; and/or (b) any other business in Hong Kong and the PRC that is similar to any member of the Group as described in this prospectus.

DIRECTORS, SENIOR MANAGEMENT AND STAFF

DIRECTORS

Executive Directors

Mr Jiang Quanlong, aged 47, is a founding member and the chairman of the Group. Mr Jiang has over 20 years of experience in the rare earth and refractory materials industry. Mr Jiang is responsible for the formulation of the Group's overall business development policies and oversees the daily operations of the Group. Prior to the founding of the Group, Mr Jiang had been a factory manager of a refractory materials production plant and a sales manager of a glass and ceramics manufacturing company. Mr Jiang is the husband of Ms Qian Yuanying, the deputy chairman of the Group.

Ms Qian Yuanying, aged 40, is a founding member and the deputy chairman of the Group. Mrs Jiang has over 10 years of experience in the rare earth and refractory materials industry. Mrs Jiang assists the chairman in the overall management of the Group and has particular responsibility for the marketing aspect of the Group's business. Prior to the founding of the Group, Mrs Jiang was a high school teacher. Mrs Jiang is the wife of Mr Jiang, the chairman of the Group.

Mr Fan Yajun, aged 32, joined the Group in 1988. Mr. Fan is the chief executive officer of the Group and is responsible for the overall administration of the Group and oversees the operations of rare earth business of the Group.

Mr Gu Aoxing, aged 47, is the deputy chief executive officer of the Group and is responsible for the overall financial matters of the Group. Mr Gu joined the Group in 1987. Mr Gu has over 20 years of experience in the accounting field.

Ms To Siu Mui, Annie, aged 36, is the deputy general manager of the Group's overseas office. She is responsible for the overall management of the Group's Hong Kong office. Ms. To joined the Group in 1999, prior to joining the Group, Ms To has over 15 years of experience in the sales of rare earth and metal products.

Independent Non-Executive Directors

Mr. Liu Yujiu, aged 66, is the head of the Rare-Earth Expert Group (), Applications and Development Section () under the State Planning Commission. Mr. Liu is also the executive of China Rare Earth Institute () and deputy editor-in-chief of China Rare Earth Journal (). He was appointed as chief engineer of China Rare Earth Development Co. Ltd. () for the period between December 1992 to December 1997.

Mr. Wong Yee Sui, Andrew, aged 50, is a partner of W.M. Sum & Co., Certified Public Accountants. He holds a degree of Master of Business Administration from Queen's University, Canada, and a bachelor degree of applied science in applied chemistry from the University of Adelaide, South Australia.

Directors' remuneration

Each of the above executive Directors has entered into a service contract with the Company for a term of three years from 1st September, 1999 under which, the aggregate annual salary is HK\$1,810,000, subject to an annual increment after 31st December, 2000 of not more than 15%. Details of the terms of the service contracts are set out in the paragraph headed "Particulars of Directors' service contracts" in the section headed "Further information about the Directors, management, staff and experts" in Appendix VI to this prospectus. The aggregate emoluments paid to the Directors for the year ended 31st December, 1998 were HK\$2,096,000.

DIRECTORS, SENIOR MANAGEMENT AND STAFF

Mrs Jiang, Ms To Siu Mui, Annie, Mr Jeffrey Cheng Man For, and 3 supporting staff will be present in Hong Kong. Given that none of the Company's suppliers and customers are located in Hong Kong and that the Group's production facilities are located in Dapu, Yixing, Jiangsu Province, the Directors believe that they have adequate management presence in Hong Kong in view of the business requirements of the Group.

Audit committee

The Company established an audit committee on 29th September, 1999 with written terms of reference in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules. The primary duties of the audit committee are to review and supervise the financial reporting process and internal control system of the Group. The audit committee has two members comprising the two independent non-executive Directors.

SENIOR MANAGEMENT

Mr Fang Zheng, aged 32, joined the Group in 1987. Mr Fang is the factory manager and engineer of the rare earth extraction workshop and is in charge of the daily production operations. Mr. Zheng has over 10 years of experience in management.

Mr Zhu Panjun, aged 38, joined the Group in 1989. Mr Zhu is the technician and deputy factory manager of the rare earth extraction workshop and is responsible for overseeing the daily production operations. Mr Zhu has over 10 years of experience in management.

Mr Zhou Minqiang, aged 62, joined the Group in 1995. Mr Zhou is the senior engineer and chief engineer of the rare earth extraction workshop and is responsible for overseeing the technical aspects of the operation. Prior to joining the Group, Mr Zhou has over 35 years of experience in the production of rare earth products.

Mr Shao Huashi, aged 51, joined the Group in 1994. Mr Shao is the engineer and factory manager of the refractory materials workshop and is responsible for overseeing the daily production operations. Mr Shao had over 30 years of experience in the production of refractory materials.

Mr Jiang Cainau, aged 40, joined the Group in 1987. Mr Jiang is the engineer and deputy factory manager (production) of the refractory materials workshop and is responsible for overseeing the daily operations. Mr Jiang has over 15 years of experience in refractory materials industry.

Mr Wang Zhizhong, aged 32, joined the Group in 1987. Mr Wang is the engineer and deputy factory manager (technology) of the refractory materials workshop and is responsible for overseeing the technical aspects of the operation. Mr. Wang has over 15 years of experience in refractory materials industry.

Mr Zhang Guanmin, aged 57, joined the Group in 1998. Mr Zhang is the senior engineer and chief engineer of the fluorescent powders and rare earth metals workshop and is responsible for overseeing the fluorescent powders production. Mr Zhang has over 30 years of experience in the manufacturing of fluorescent powders and rare earth products.

Ms Xu Panfeng, aged 34, joined the Group in 1987. Ms Xu is the assistant sales manager of rare earth products and is responsible for sales and marketing of rare earth products. Ms Xu has over 10 years of experience in management and marketing.

DIRECTORS, SENIOR MANAGEMENT AND STAFF

Ms Xu Xiangzhen, aged 29, joined the Group in 1989. Ms Xu is the assistant purchasing manager and is responsible for the Group's overall planning and purchasing of raw materials. Ms Xu has over 10 years in raw materials purchasing.

Company Secretary

Mr Cheng Man For, Jeffrey, aged 34, joined the Group in 1999. Mr. Cheng is the financial controller and company secretary of the Group. Mr Cheng is a member of the Association of Chartered Certified Accountants. He has over 10 years of experience in the accounting and finance field.

STAFF

Description

As at the Latest Practicable Date, the Group had a total of 700 full time employees and a breakdown of its staff by job nature is set out below:

	Total
Management and technical staff	210
Administration and marketing	30
Manufacturing operations	430
Technological research and development	<u>30</u>
Total:	<u><u>700</u></u>

LABOUR RELATIONS

The Group maintains good relations with its staff and has never encountered any major difficulties in its recruitment and retention of the experienced personnel. There has never been any interruption to its operations as a result of labour disputes. The Group provides free staff quarters to certain staff who come from other areas to work in Yixing. In addition, the Group provides social security scheme, namely pension and health insurance scheme to its employees.

For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, the Group did not have any formal staff retirement plans in place and the Group did not have any material liability arising from the relevant statutory retirement schemes.

SHARE OPTION SCHEME

The Company has conditionally adopted the share option scheme. Pursuant to the scheme, options to subscribe for Shares may be granted to full time employees of the Company and its subsidiaries (including executive Directors). The major terms of the scheme are summarised in the section headed "Share Option Scheme" in Appendix VI to this prospectus.

SUBSTANTIAL SHAREHOLDERS

Upon completion of the Share Offer and the Capitalisation Issue and assuming that the Over-Allotment Option is not exercised (taking no account of the Shares which may be taken up under the Share Offer), so far as the Directors are aware, the shareholder who will directly or indirectly own 10% or more of the voting right in any general meeting of the Company is as follows:

Name	Number of Shares	Percentage of the voting right
YY Holdings Limited	450,000,000 (Note 1)	75% (Note 2)

Notes:

1. The shares of YY Holdings Limited are held by the trustee of the Jiang family trust, the discretionary object of which is a company wholly owned by Mrs. Jiang.
2. On the basis that the Over-Allotment Option is exercised in full, YY Holdings Limited will hold 72.3% of the entire issued Shares.

SHARE CAPITAL

Authorised share capital

HK\$

<u>1,000,000,000</u>	Shares	<u>100,000,000</u>
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Issued and to be issued, fully paid or credited as fully paid:

2,000,000	Shares in issue as at the date of this prospectus	200,000
448,000,000	Shares to be issued under the Capitalisation Issue	44,800,000
<u>150,000,000</u>	New Shares to be issued pursuant to the Share Offer	<u>15,000,000</u>
<u>600,000,000</u>	Shares	<u>60,000,000</u>

Notes:

1. Assumptions

This table assumes that the Share Offer and the Capitalisation Issue become unconditional.

It takes no account of any Shares which may be issued upon the exercise of the Over-Allotment Option or pursuant to the exercise of options granted under the Share Option Scheme, or which may be allotted and issued under the general mandate (see note 4 below), or which may be repurchased by the Company pursuant to the share repurchase mandate (see note 5 below).

2. Ranking

The New Shares will rank pari passu with all Shares in issue or to be issued as mentioned in this prospectus save for the entitlement under the Capitalisation Issue, and will qualify for all dividends and other distributions declared, made or paid on the Shares after the date of this prospectus.

3. Share Option Scheme

The Company has conditionally adopted the Share Option Scheme. A summary of the main terms of the Share Option Scheme is set out in the section headed “Share Option Scheme” in Appendix VI to this prospectus.

Under the Share Option Scheme, full time employees (including executive Directors) of the Group may be granted options which entitle them to subscribe for Shares representing up to a maximum when aggregated with any securities subject to any other share option scheme(s) of the Company, of 10% of the issued capital of the Company from time to time (excluding Shares which may be issued upon the exercise of options granted under the Share Option Scheme).

4. General mandate to issue new Shares

The Directors have been granted a general mandate to allot and issue Shares in the share capital of the Company with a total nominal value of not more than the sum of:

- 20% of the total nominal amount of the share capital of the Company in issue immediately following the completion of Share Offer and the Capitalisation Issue (including Shares which may be issued upon the exercise of the Over-Allotment Option); and
- the total amount of the share capital of the Company repurchased by the Company under the mandate as mentioned in note 5 below.

The Directors may, in addition to the Shares which they are authorised to issue under the mandate, allot and issue Shares under a rights issue, scrip dividend scheme or similar arrangement, upon the exercise of the Over-Allotment Option or upon the exercise of options granted under the Share Option Scheme.

SHARE CAPITAL

This mandate will expire:

- at the end of the Company's next annual general meeting; or
- at the end of the period within which the Company is required by the Cayman Islands law or its articles of association to hold its next annual general meeting; or
- when varied or revoked by an ordinary resolution of the shareholders of the Company in general meeting;

whichever is the earliest.

Further information on this general mandate is contained in the section "Resolutions of the sole shareholder of the Company passed on 29th September, 1999" in Appendix VI to this prospectus.

5. General mandate to repurchase Shares

The Directors have been granted a general mandate to exercise all the powers of the Company to repurchase Shares with a total nominal value of not more than 10% of the total nominal amount of the share capital of the Company in issue immediately following the completion of Share Offer and the Capitalisation Issue (including the Shares which may be issued pursuant to the Over-Allotment Option).

This mandate only relates to repurchases made on the Stock Exchange or on any other stock exchange on which the Shares are listed (and which is recognised by the Securities and Futures Commission and the Stock Exchange for this purpose), and which are made in accordance with the Listing Rules. A summary of the relevant Listing Rules is set out in the section headed "Repurchase by the Company of its own securities" in Appendix VI to this prospectus.

This mandate will expire:

- at the end of the Company's next annual general meeting; or
- at the end of the period within which the Company is required by the Cayman Islands law or its articles of association to hold its next annual general meeting; or
- when varied or revoked by an ordinary resolution of the shareholders of the Company in general meeting;

whichever is the earliest.

FINANCIAL INFORMATION

INDEBTEDNESS

Borrowings

At the close of business on 31st July, 1999, being the latest practicable date for the purpose of this indebtedness statement prior to the printing of this prospectus, the Group had outstanding unsecured borrowings of approximately HK\$55,892,000 comprising short term revolving bank loans of approximately HK\$9,993,000, other short term borrowings of approximately HK\$619,000 and long term bank loans of approximately HK\$45,280,000. No guarantee or pledge of assets had been provided by any of Mr. Jiang and Mrs. Jiang in connection with the borrowings of the Group as at 31st July, 1999.

Disclaimer

Save as aforesaid and apart from intra-group liabilities, the Group did not have, at the close of business on 31st July, 1999, any outstanding, and authorised or otherwise created but unissued, loan capital or debentures, mortgages, charges, bank overdraft, liabilities under acceptances or other similar indebtedness or acceptance credits or hire purchase commitments, finance lease commitments, guarantees or other material contingent liabilities.

The Directors have confirmed that there has been no material change in the indebtedness or contingent liabilities of the Company since 31st July, 1999.

For the purpose of the indebtedness statement, foreign currency amounts (all in Renminbi) have been translated into HK dollars at the rates of exchange prevailing at the close of business on 31st July, 1999. The Directors have confirmed that as at 31st July, 1999, they were not aware of any circumstances which would give rise to a disclosure requirement under Practice Note 19 of the Listing Rules.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

Net current asset

As at 31st July, 1999, being the latest practicable date for the purpose of this statement, the Group had net current assets of approximately HK\$105,368,000. The current assets comprised cash on hand and at banks of approximately HK\$30,291,000, inventories of approximately HK\$58,744,000, accounts receivables, other receivables, prepayments and deposits of approximately HK\$110,437,000 and amount due from related companies of approximately HK\$499,000. The current liabilities of the Group comprised short term bank loans of approximately HK\$9,993,000, other short term borrowings of approximately HK\$619,000, accounts payable, other payables and accrued charges of approximately HK\$72,445,000, dividend payable of approximately HK\$2,732,000, amount due to directors of approximately HK\$844,000 and taxation payable of approximately HK\$7,970,000.

The net current assets of the Group increased from approximately HK\$81,371,000 as at 30th April, 1999 to approximately HK\$105,368,000 as at 31st July, 1999. This increase was mainly attributable to the decrease in accounts payable, other payables and accrued charges.

FINANCIAL INFORMATION

Borrowings and banking facilities

The Group generally finances its operation with internally-generated cashflow and banking facilities provided by its principal bankers in the PRC.

As at 31st July, 1999, the Group had total banking facilities of approximately HK\$55,273,000, all of which have been utilized.

As at 30th April, 1999, the authorized capital expenditure commitments of the Group amounted to approximately HK\$96,449,000, of which approximately HK\$31,511,000 was contracted while approximately HK\$64,938,000 was not contracted. Out of the contracted commitment, approximately HK\$8,115,000 was related to construction of factory buildings and related facilities and approximately HK\$23,396,000 was related to acquisition of machinery and equipment. In addition, approximately HK\$11,511,000 and HK\$20,000,000 of the contracted capital expenditures will be funded by internally generated funds and proceeds from the Share Offer.

Amounts denominated in Renminbi in this section have been translated into Hong Kong dollars at the rates of exchange prevailing as at the close of business on 31st July, 1999.

Working capital

Taking into account the financial resources available to the Group, including internally generated cashflow, the available banking facilities and the net proceeds of the Share Offer, the Directors are of the opinion that the Group has sufficient working capital for its present requirements.

FINANCIAL INFORMATION

TRADING RECORD

Summary of combined results of the Group

The following table, which summarises the combined audited results of the Group for the three years ended 31st December, 1998 and the four months ended 30th April, 1999, has been extracted from the accountants' report set out in Appendix I to this prospectus. The summary has been prepared as if the current structure of the Group had been in existence throughout the relevant period.

	Year ended 31st December,						Four months ended	
	1996		1997		1998		30th April, 1999	
	HK\$'000	%	HK\$'000	%	HK\$'000	%	HK\$'000	%
Turnover								
Rare earth products	219,762	69	261,890	69	288,081	69	96,716	67
Refractory materials	100,947	31	118,208	31	131,401	31	46,931	33
	<u>320,709</u>	<u>100</u>	<u>380,098</u>	<u>100</u>	<u>419,482</u>	<u>100</u>	<u>143,647</u>	<u>100</u>
Profits from operations	60,524		82,727		93,747		37,317	
Finance costs	<u>(8,201)</u>		<u>(6,536)</u>		<u>(6,264)</u>		<u>(1,558)</u>	
Profit before taxation	52,323		76,191		87,483		35,759	
Taxation	<u>(15,130)</u>		<u>(20,650)</u>		<u>(22,632)</u>		<u>(6,747)</u>	
Profit after taxation	37,193		55,541		64,851		29,012	
Minority interests	<u>(1,445)</u>		<u>(937)</u>		<u>(2,851)</u>		<u>(931)</u>	
Profit attributable to shareholders	<u>35,748</u>		<u>54,604</u>		<u>62,000</u>		<u>28,081</u>	
Dividends	<u>3,563</u>		<u>11,538</u>		<u>17,462</u>		<u>6,401</u>	

The 1997 financial year as compared to the 1996 financial year

Sales for the 1997 financial year were HK\$380 million, representing an increase of approximately 18.7% over that for the previous year. The increase in sales was mainly attributable to the enhancement of the Group's overall productivity and the increase in the demand for both rare earth and refractory materials. Sales of rare earth products increased by approximately 19.2% in 1997 over that for the previous year. Sales of refractory materials increased by approximately 17.1% in 1997 over that for the previous year.

The Group's profit before taxation increased from approximately HK\$52 million in 1996 to approximately HK\$76 million in 1997, representing an increase of approximately 45.6%. Gross profit for 1997 increased by approximately 27.2% when compared to that of the previous year while the gross profit margin rose from about 28.7% in 1996 to about 30.8% in 1997. Net profit margin of the

FINANCIAL INFORMATION

Group increased from approximately 11.1% for 1996 to approximately 14.4% for 1997. The increase was mainly due to improvement in production technologies and effective control of production cost, as well as the increase in average selling price of the Group's quality rare earth products despite the competitive price offered by newcomers to the rare earth business in the PRC.

For the 1996 and 1997 financial years, the Group declared dividends of approximately HK\$3.6 million and HK\$11.5 million respectively, which had been fully paid in cash.

The 1998 financial year as compared to the 1997 financial year

Sales for the 1998 financial year were approximately HK\$419 million, representing an increase of approximately 10.4% over the previous year. This was primarily due to the enhancement of the Group's productivity and the increase in demand for the Group's products. Sales for rare earth products and refractory materials increased by approximately 10.0% and 11.2% respectively in 1998 over that of the previous year.

Gross profit margin for the 1998 financial year slightly decreased from approximately 30.8% in 1997 to 28.0%. The slight decrease in gross profit margin was mainly attributable to the adverse impact brought by the Asian financial crisis on the market for rare earth products. Some of the overseas customers made use of this opportunity to request suppliers to lower the selling price. To maintain its competitiveness, the Group also lowered its price of rare earth materials which led to a slightly reduced gross profit margin in 1998 compared with that in 1997. Nevertheless, the Group was able to implement cost control measures which reduced production costs and to capture a larger market share with its quality products.

The Group's profit after taxation and before minority interest increased from approximately HK\$55 million in 1997 to approximately HK\$65 million in 1998, representing an increase of approximately 16.8%. Net profit margin increased from 14.4% for 1997 to 14.8% for 1998. This was mainly due to more effective cost controls. For 1998, the Group declared a dividend of approximately HK\$17.5 million, which has been fully settled in cash.

Four months ended 30th April 1999

Sales for the four months ended 30th April, 1999 were approximately HK\$144 million, representing approximately 34.2% of that for the whole 1998 financial year. Sales for the said period for rare earth products and refractory materials represented approximately 33.6% and 35.7% respectively of that for the whole 1998 financial year.

For the four months ended 30th April, 1999 the Group recorded a gross profit margin of approximately 34.6%. Such increase over that for the 1998 financial year was mainly attributable to the reduction in the costs of rare earth ore, raw materials for the rare earth business and the rapid growth in sales volume of the unshaped refractory products which has a relatively higher gross profit margin.

Net profit margin increased from approximately 14.8% in 1998 to 19.5% for the period. This was mainly due to the increase in sales of the unshaped refractory products during the period.

For the four months ended 30th April, 1999, the Group declared a dividend of approximately HK\$6.4 million.

FINANCIAL INFORMATION

TAXATION

For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, the Group's income was subject to PRC enterprise income tax. Provision for taxation of profits of the Group in the PRC has been calculated at the applicable rates of 33% or 24% on the assessable profits of companies within the PRC during each of the relevant period. The effective tax rate for the Group for the three years ended 31st December, 1998 and the four months ended 30th April, 1999 was approximately 28.9%, 27.1%, 25.9% and 18.9%, respectively.

Pursuant to relevant documents issued by the municipal branch of the ministry of finance and the municipal tax bureau of Yixing City of Jiangsu province, the PRC, the Group was granted financial refunds (the "Refunds") equal to a portion of the enterprise income tax paid by the Group. The Refunds were negotiated and determined jointly by the Group and the municipal tax bureau and the municipal ministry of finance. The variation of the effective tax rates over the track record period was mainly due to the increase in the Refunds. For detailed information, please refer to note (d) to section 3 of the accountants' report set out in Appendix I to this prospectus.

PROPERTY INTERESTS

Property occupied in the PRC

The Group's production facilities are located at its leased premises in Dapu, Yixing, Jiangsu Province. These facilities have a total gross floor area of approximately 117,480 sq.m. The Group has entered into two long term lease agreements with the Yixing City Land Administration Bureau each for a term of 30 years commencing from 1st September, 1999, being the date of issue of the State-owned Land Use Rights Certificates, pursuant to which the land use rights of the site were leased to the Group at an annual rental of RMB5 per sq.m. or RMB587,400 (about HK\$550,000) in aggregate. However, the land use rights of this property cannot be transferred, leased or mortgaged. Accordingly, this property has been valued as at 31st July, 1999 by Vigers as having no commercial value. Based on the calculation and analysis of Vigers, the depreciated replacement cost of the buildings of the premises was about RMB59 million as at 31st July, 1999. As disclosed in the accountants' report in Appendix I to this prospectus, for the purpose of entering into the long term lease agreements with the local land bureau, the Group has paid land resumption fees of HK\$792,000 to the local township government for the purposes of resumption of the agricultural land on which the Group's production facilities are constructed. The land resumption process was completed in August 1999. According to a general practice of the PRC government governing the use of agricultural land for industrial use, this cost can be treated as costs of land use rights and are amortized over 70 years. However, the Group has adopted a policy of amortizing the costs over 30 years, synchronized with the terms of the long term leases. The Directors consider that a long term lease would satisfy the requirements of the Group for the site is mainly used as its production plant.

Leased properties in the PRC

The Group's sales and marketing division in Shanghai is located at its leased premises. The Group leases an office premises with a gross floor area of about 193.58 sq.m. at Rooms G and H, 8th Floor, Zhao Feng Universe Building, 1800 Zhong Shan Xi Road, Shanghai. This property is leased from Mr. Jiang. Particulars of the leases are set out in the paragraph headed "Connected transaction" under the section headed "Business" of this prospectus.

FINANCIAL INFORMATION

Licensed/Leased property in Hong Kong

The Group's operations in Hong Kong is located at its licensed/leased premises at Room 1301, 13th Floor Ruttonjee House, Ruttonjee Centre, 11 Duddell Street, with a saleable floor area of about 136.29 sq.m. This property is licensed/leased from an independent third party. This property is licensed rent-free to Lee Shing Holdings Limited for a term commencing from 25th August 1999 to 14th May, 2000 and is leased to Lee Shing Holdings Limited for a term commencing from 15th May, 2000 to 14th January, 2002 at a monthly rent of HK\$39,384.

Property valuation

Vigers, the independent property valuer, valued the property interests of the Group as at 31st July, 1999. The text of its letter, the summary of values of the property interests and valuation certificate are set out in Appendix III to this prospectus.

PROFIT FORECAST, DIVIDENDS AND WORKING CAPITAL

Profit forecast

The Directors forecast that, in the absence of unforeseen circumstances and on the bases and assumptions set out in Appendix II to this prospectus, the combined profit after taxation and minority interests but before extraordinary items of the Group for the financial year ending 31st December, 1999 will amount to not less than HK\$80 million. The Directors are not aware of any extraordinary items which have arisen and are likely to arise during the financial year ending 31st December, 1999. The texts of the letters from Arthur Andersen & Co., the Group's reporting accountants, and from the Sponsors in respect of the profit forecast are set out in Appendix II to this prospectus.

On the basis of such profit forecast and the weighted average number of 485,753,425 Shares expected to be in issue during the year ending 31st December, 1999, the forecast earnings per Share is equivalent to 16.5 cents, representing a price-earnings multiple on a weighted average basis of 5.65 times based on the Issue Price. Assuming that the Share Offer and Capitalisation Issue are completed and that a total of 600,000,000 Shares are in issue, the forecast pro forma fully diluted earnings per Share will be 14.1 cents, representing a pro forma diluted price earnings ratio of 6.59 times based on the Issue Price of \$0.93 per Share. The above figures have not taken into account any Shares which may fall to be issued upon exercise of the Over-Allotment Option or Shares which may be allotted or issued upon the exercise of the options granted under the Share Option Scheme, or any shares which may fall to be allotted and issued or repurchased by the Company pursuant to the general mandates given to the Directors to allot and issue or repurchase shares under the section headed "Resolutions of the sole shareholder of the Company passed on 29th September, 1999" in Appendix VI to this prospectus.

Dividends

On the basis of the above profit forecast and in the absence of unforeseen circumstances, the Directors at present, intend to recommend a total dividend of 2 cents per Share in respect of the year ending 31st December, 1999, which will be payable in or about June 2000. Save as disclosed herein, the Directors do not intend to recommend any other dividend for the financial year ending 31st December, 1999. The dividend of 2 cents per Share would represent a pro forma dividend at the Issue Price of 5.4%. The Directors anticipate that future interim and final dividends will be paid in September and May of each year, respectively, with the interim dividend representing approximately one-third of the total dividends to be paid for the entire year. Based on this dividend policy and the final dividend of 2 cents

FINANCIAL INFORMATION

per Share in respect of the year ending 31st December, 1999, if the Company had been a listed company for the whole of the financial year ending 31st December, 1999, the Directors would expect to have declared for such year an interim dividend and a final dividend totalling 5 cents per Share, which represent a pro forma dividend yield of 5.4% based on the Issue Price.

Working capital

The Directors are of the opinion that taking into account the estimated net proceeds of the Share Offer (assuming that the Over-Allotment Option is not exercised), and the available banking facilities, the Group has sufficient working capital for its present requirements.

DISTRIBUTABLE RESERVES

As at 30th April, 1999, the Company had not been incorporated. There was accordingly no reserves available for distribution to the shareholders of the Company as at that date.

ADJUSTED NET TANGIBLE ASSETS

The following is a pro forma statement of the adjusted net tangible assets of the Group which is based on the audited combined net tangible assets of the Group as at 30th April, 1999 as shown in the accountants' report, the text of which is set out in Appendix I to this prospectus, adjusted as follows:

	<i>HK\$'000</i>
Audited combined net tangible assets of the Group as at 30th April, 1999	140,946
Unaudited combined profit attributable to shareholders of the Group for the three months ended 31st July, 1999	21,808
Estimated net proceeds of the Share Offer	<u>120,000</u>
Adjusted net tangible assets	<u>282,754</u>
Adjusted net tangible asset value per Share (<i>notes</i>)	<u>HK\$0.47</u>

Notes:

- (1) Based on the 600,000,000 Shares expected to be in issue immediately following the Share Offer and the Capitalisation Issue but taking no account of any Shares which may fall to be issued upon exercise of Over-Allotment Option or the exercise of any options granted under the Share Option Scheme or which may be issued or repurchased by the Company under the general mandates granted to the Directors to allot and issue or repurchase shares under the section headed "Resolutions of the sole shareholder of the Company passed on 29th September, 1999" in Appendix VI to this prospectus.
- (2) The net book value of the Group's leasehold land and buildings outside Hong Kong (namely the buildings occupied by the Group in the PRC) as at 30th April, 1999 was about HK\$54,844,000. Based on the calculation and analysis of Vigers, the depreciated replacement cost of the buildings of the property was about RMB59,000,000 (equivalent to approximately HK\$55,229,900) as at 31st July, 1999. Since this property cannot be transferred, leased or mortgaged, Vigers had valued this property as having no commercial value as at 31st July, 1999. No revaluation surplus has been included in the above pro forma statement of adjusted net tangible assets of the Group or will be included in the financial statements for the year ending 31st December, 1999.

NO MATERIAL CHANGE

Save as disclosed herein, the Directors are not aware of any material adverse change in the financial or trading position or prospects of the Group since 30th April, 1999, the date to which the latest audited financial statements of the Group were made up.

FUTURE PLANS

FUTURE PLANS AND PROSPECTS

The Directors believe that rare earth products are essential for the manufacture of a broad range of high technology products for enhancing performance, producing greater energy efficiency and environmental protection. As such, the Directors believe that sales to overseas customers of the rare earth products are likely to remain a stable source of return given the Group's long established business relationships with these customers. The Group also believes that the PRC, with its vast population and consumer spending power, is a large potential market. The Directors consider that both domestic and overseas demands for rare earth products will continue to grow given their diverse applications in such a wide range of modern technologies.

As regards the Group's sale of refractory materials, the Directors believe that the increasing popularity in the use of unshaped refractory products in the PRC domestic market will continue and demand for these products will increase.

It is the Group's strategy to achieve future business growth through the expansion of production facilities and the introduction of new rare earth products and refractory materials.

Rare earth business

In anticipation of the growing demand for rare earth products, the Group plans to expand its rare earth production facilities. Additional rare earth extraction lines have already been installed in mid July 1999 and the aggregate maximum production capacity of rare earth products have increased from 3,000 tonnes (REO) to 3,550 tonnes (REO) per annum. Furthermore, a plant of about 6,500 sq.m. which is now under construction at the Group's factory complex, and the proposed installation of five additional automated production lines will increase the Group's total production capacity to 4,900 tonnes (REO) by the second quarter of 2000.

The Directors intend to expand the Group's existing product range to include the production of permanent magnetic products in the near future by the installation of a new production line. The permanent magnetic products are characterised by its size, weight and performance advantage. The permanent magnetic products are an important component in most electric motors.

The Directors also believe that fluorescent powder, which uses rare earth as its principal raw material, is likely to continue to be in strong demand given the product's energy efficient feature. In anticipation of this demand, the Group intends to expand the existing production capacity of its fluorescent powder products by installing three additional production lines and it is expected that the new production facilities will commence production by the second quarter of 2000. As part of its long term development strategy, the Group aims to expand its business by actively identifying, developing and exploring other new rare earth products.

Refractory materials

For the three years ended 31st December, 1998 and the four months ended 30th April, 1999, sales of shaped refractory materials accounted for about 95%, 98%, 96%, and 97% and unshaped refractory materials products accounted for about 5%, 2%, 4% and 3% of the Group's total refractory materials sales respectively. Unshaped refractory materials offer more flexibility than shaped refractory materials in terms of application since unshaped refractory materials can be moulded into different forms. The Directors believe sales of the Group's unshaped refractory materials will continue to grow and the product will become increasingly important to the Group's business development.

FUTURE PLANS

Accordingly, the Group intends to invest approximately HK\$35 million for upgrading its existing production facilities by installing two additional furnaces thereby increasing production of unshaped refractory materials by the second quarter of 2000. The production of the unshaped refractory materials represents an expansion into upstream products from the Group's traditional refractory materials, and the Group believes that the production of unshaped refractory materials provides it with an important opportunity to diversify into increasingly higher margin businesses.

The Group also expects the export sales of refractory materials to the Group's existing Japanese customer will continue to increase in the coming years given its established relationship with the Group. The Group believes that the increased export sales will contribute to the profitability of the Group.

USE OF THE PROCEEDS

The net proceeds of the Share Offer, assuming that the Over-Allotment Option is not exercised and after deducting related expenses, are estimated to amount to HK\$120,000,000. On the basis that the Over-Allotment Option is exercised in full, the net proceeds will increase by approximately HK\$20 million. The Directors presently intend to apply the net proceeds as follows:

- as to approximately HK\$60,000,000 for the expansion of rare earth production facilities to increase the aggregate annual production capacity from 3,550 tonnes (REO) to about 4,900 tonnes (REO) of rare earth extracts, and related technical upgrading;
- as to approximately HK\$20,000,000 for the upgrading of the production facilities of fluorescent powders and the related technical upgrading;
- as to approximately HK\$35,000,000 for the upgrading of the existing production facilities for refractory materials and the installation of a new production line of unshaped refractory materials; and
- as to the balance as general working capital of the Group.

In the event that the net proceeds of the Share Offer are not immediately used for the above purposes, the Directors presently intend to place the net proceeds of the Share Offer on short term deposits with financial institutions in Hong Kong.

UNDERWRITING

UNDERWRITERS

The New Issue Underwriters

The New Issue Underwriters are China Everbright Securities (HK) Limited, Vickers, Shenyin Wanguo Capital (H.K.) Limited, Kim Eng Securities (Hong Kong) Limited and Kingsway SW Securities Limited.

The Placing Underwriters

The Placing Underwriters are China Everbright Securities (HK) Limited, Vickers, Shenyin Wanguo Capital (H.K.) Limited, Kim Eng Securities (Hong Kong) Limited and Kingsway SW Securities Limited.

UNDERWRITING ARRANGEMENTS AND EXPENSES

Underwriting agreement

Pursuant to the Underwriting Agreement (being the material contract (k) referred to in paragraph 9 of Appendix VI to this prospectus), the Company is offering the New Issue Shares for subscription on and subject to the terms and conditions of this prospectus and the Application Forms and the Placing Shares for subscription by way of Placing. Subject to, inter alia, the Listing Committee of the Stock Exchange granting listing of, and permission to deal in, the Shares in issue and to be issued as mentioned herein on or before 4th November, 1999 or such later date as China Everbright (on behalf of the Underwriters) may agree, (i) the New Issue Underwriters have severally agreed to subscribe, or procure subscribers to subscribe, on the terms and conditions of this prospectus and the Application Forms, for their respective applicable proportions of the New Issue Shares now being offered which are not taken up under the New Issue and (ii) the Placing Underwriters have severally agreed to subscribe, or procure subscribers to subscribe, for the Placing Shares.

Grounds for termination

The obligations of the Underwriters to subscribe, or procure subscribers to subscribe, for the New Shares are subject to termination if certain events, including force majeure, shall occur at any time prior to 5:30 p.m. on the third business day (not including a Saturday) following the close of the application lists under the New Issue.

The Underwriters are entitled to terminate their obligations under the Underwriting Agreement upon the occurrence of, but not limited to, any of the following events:

1. there shall develop, occur, exist or come into effect:
 - (A) any change in Hong Kong or the PRC, local, national or international financial, legal, political, economic, military, industrial, fiscal, regulatory, stock market or currency matters or conditions; or
 - (B) any new law or any material change in existing laws or any change in the interpretation or application thereof by any court or other competent authority in Hong Kong, the PRC, the Cayman Islands or any other jurisdiction relevant to the Group; or

UNDERWRITING

- (C) any change in the conditions of Hong Kong or international equity securities or other financial markets; or
- (D) the imposition of economic sanction or withdrawal of trading privileges, in whatever form, by the United States or by the European Union (or any member thereof) on Hong Kong or the PRC; or
- (E) a general moratorium on commercial banking activities in New York, London or Hong Kong declared by the relevant authorities; or
- (F) the imposition of any moratorium, suspension or material restriction on trading in securities generally on the New York Stock Exchange, the London Stock Exchange or the Stock Exchange; or
- (G) any change or development involving a prospective change in taxation or exchange control (or the implementation of any exchange control) in Hong Kong or the PRC or the Cayman Islands or elsewhere; or
- (H) any event of force majeure including, without limiting the generality thereof, any act of God, war, riot, public disorder, civil commotion, fire, flood, explosion, epidemic, terrorism, strike or lock-out;

which, in the sole opinion of China Everbright:

- (A) is or will be, or is likely to be, adverse, in any material respect, to the business, financial or other condition or prospects of the Company and its subsidiaries taken as a whole; or
 - (B) has or will have or is likely to have adverse and material effect on the success of the New Issue and the Placing or the full subscription of all of the New Issue Shares and the Placing Shares; or
 - (C) for any other reason makes it impracticable, inadvisable or inexpedient to proceed with the New Issue and the Placing;
2. there comes to the notice of China Everbright any matter or event showing any of the representations, warranties or undertakings contained in this Agreement to be untrue or inaccurate in any respect; or
 3. there has been a breach of any other provisions of this Agreement which, in any such cases, is considered by China Everbright to be material in the overall context of the Share Offer,

then China Everbright may, upon giving notice to the Company and the other Underwriters which may be given at any time prior to 5:30 p.m. on the fourth business day following the closing of the application lists, terminate the Underwriting Agreement with immediate effect.

Undertakings

Each of the Covenantors has jointly and severally undertaken to the Company and each of the Underwriters, inter alia, that (i) neither he/she/it nor any of his/her/its associates (as defined in the Listing Rules) nor any company controlled by him/her/it nor any nominee or trustee holding in trust for him/her/it will sell, transfer or otherwise dispose of (other than by way of security for a bona fide commercial loan or pursuant to a stock lending arrangement with China Everbright in respect of which a waiver has been applied to the Stock Exchange from strict compliance with Rule 10.07 of the Listing

UNDERWRITING

Rules) any of the Shares or any interests therein (which for this purpose shall include any interest in any company which holds any Shares (whether directly or through another company)) (a) within six months from the date of commencement of dealings of the Shares on the Stock Exchange (the “Period”), and (b) within the period of six months after the expiry of the Period if, immediately following such sale, transfer or disposal, such person or company will cease to be a controlling shareholder (as defined in the Listing Rules) of the Company, (ii) on any sale, transfer or disposal of such Shares during the six month period after the expiry of the Period, any such sale, transfer or disposal will be effected in such a manner so as not to create a disorderly or false market for the Shares and (iii) he/she/it will, and will procure that his/her/its associates (as defined in the Listing Rules) will, comply with all the restrictions and requirements under the Listing Rules on the sale, transfer or disposal by him/her/it or by the registered holder of any Shares or other securities of the Company in respect of which he/she/it is, or is shown in this prospectus to be, the beneficial owner.

Each of the Covenantors has, in addition, jointly and severally undertaken to the Company, the Stock Exchange and the Underwriters that within the period of 12 calendar months from the date on which dealings in the Shares commence on the Stock Exchange, he/she/it shall: (i) if and when he/she/it pledges or charges any securities in the Company beneficially owned by him/her/it, immediately inform the Company in writing of such pledge or charge together with the number of such securities so pledged or charged; and (ii) if and when he/she/it receives indications, either verbal or written, from any pledgee or chargee that any securities in the Company pledged or charged by him/her/it will be disposed of, immediately inform the Company in writing of such indications. Upon receiving such information in writing from the relevant Covenantor, the Company will, as soon as reasonably practicable, notify the Stock Exchange and make a public disclosure by way of press announcement in accordance with the Listing Rules.

The Company has undertaken to each of the Underwriters that, save as mentioned in this prospectus and pursuant to the grant of options under the Share Option Scheme, the exercise of the options granted under the Share Option Scheme or the exercise of the Over-Allotment Option, or pursuant to any scrip dividend or other similar scheme under the general mandate granted to the Directors as set out in Appendix VI to this prospectus, the Company will not issue or agree to issue any Shares or other securities of the Company or grant or agree to grant options to subscribe for Shares or other securities of the Company during the period of six months from the date when dealings of the Shares first commence on the Stock Exchange without the prior written consent of China Everbright on behalf of the Underwriters.

Commission

The New Issue Underwriter will receive an underwriting commission of 2.5% of the aggregate Issue Price of the New Issue Shares, out of which they will pay any sub-underwriting commissions. The Placing Underwriters will receive an underwriting commission of 2.5% of the aggregate Issue Price of the Placing Shares, out of which they will pay any sub-underwriting commissions. Each of China Everbright and Vickers will also receive a documentation fee.

The underwriting commissions, documentation fee, Stock Exchange listing fees and transaction levy, legal and other professional fees and other expenses relating to the Share Offer are estimated to amount to approximately HK\$20 million in total and are payable by the Company.

Underwriters’ interest in the Company

Save for its obligations under the Underwriting Agreement, none of the Underwriters or any of their respective holding companies, or any of their respective subsidiaries has any interests in the Group or has the right to subscribe for and/or purchase or to nominate persons to subscribe for and/or purchase securities in any companies of the Group.

STRUCTURE OF THE SHARE OFFER

PRICE PAYABLE ON APPLICATION

The Issue Price is HK\$0.93 plus 1% brokerage and a 0.011% Stock Exchange transaction levy, constituting a total of HK\$1,878.80 for every 2,000 Shares.

CONDITIONS OF THE SHARE OFFER

Acceptance of applications for the New Shares is conditional upon:

Listing

- (a) the Listing Committee of the Stock Exchange granting listing of, and permission to deal in, the Shares in issue and to be issued as mentioned in this prospectus (subject only to allotment), including any Shares which may be issued pursuant to the exercise of options granted under the Share Option Scheme or the exercise of the Over-Allotment Option; and

Underwriting Agreement

- (b) the obligations of the Underwriters under the Underwriting Agreement becoming unconditional (including, if relevant, as a result of the waiver of any condition(s) by China Everbright on behalf of the Underwriters) and the Underwriting Agreement not being terminated in accordance with its terms or otherwise by giving notice on or before the fourth business day following the date on which the application lists close (expected to be 14th October, 1999). Details of the Underwriting Agreement, their conditions and grounds for termination, are set out in the section headed “Underwriting” of this prospectus.

If the conditions referred to above are not fulfilled on or before 4th November, 1999, your application money will be returned to you, without interest. The terms on which your money will be returned to you are set out under the heading “Refund of your money” on the notes attached to the Application Forms.

In the meantime, your money will be held in one or more separate bank accounts with the receiving banker or other bank or banks in Hong Kong.

Subject to the granting of the listing of, and permission to deal in, the Shares on the Stock Exchange as well as the compliance with the stock admission requirements of Hongkong Clearing, the Shares will be accepted as eligible securities by Hongkong Clearing for deposit, clearance and settlement in CCASS with effect from the commencement date of dealings in the Shares or such other date as determined by Hongkong Clearing.

OFFER MECHANISM — BASIS OF ALLOCATION OF THE OFFER SHARES

Share Offer

The Share Offer comprises the New Issue and the Placing. The New Shares initially offered in the Share Offer, totalling 150,000,000 Shares, will represent 25%, of the share capital of the Company immediately following completion of the Shares Offer and the Capitalisation Issue. In addition, the Company has granted the Over-Allotment Option exercisable by China Everbright on behalf of the Placing Underwriters at any time within 30 days from the date of this prospectus, to require the Company to issue up to an aggregate of 22,500,000 additional shares, representing 15% of the New

STRUCTURE OF THE SHARE OFFER

Shares initially offered in the Share Offer, on the same terms as those applicable to the New Issue and the Placing, as the case may be, to cover over-allocations in the Placing. China Everbright may also at its option cover any over-allocations under the Placing through stock borrowing arrangements and the purchase of Shares in the secondary market or otherwise as may be permitted under applicable laws. If the Over-Allotment Option is exercised in full, the New Shares (including the Shares to be allotted and issued pursuant to the exercise of the Over-Allotment Option) will represent approximately 27.7% of the share capital of the Company immediately after completion of the Share Offer, the Capitalisation Issue and the exercise of the Over-Allotment Option. The results of application and basis of allotment of the New Issue Shares will be announced in the South China Morning Post and Hong Kong Economic Times on or before 12th October, 1999.

The net proceeds of the Share Offer, assuming that the Over-Allotment Option is not exercised, and after deducting related expenses, are estimated to be approximately HK\$120 million. If the Over-Allotment Option is exercised in full, the Company will receive additional net proceeds of approximately HK\$20 million, after deducting brokerage, commission and expenses attributable to the exercise of the Over-Allotment Option.

The New Issue

The Company is initially offering 15,000,000 new Shares (subject to reallocation) for public subscription under the New Issue, representing 10% of the Shares being offered in the Share Offer. For allocation purposes only, the New Issue Shares will be divided equally into two pools: pool A and pool B. The New Issue Shares in pool A will be allocated on an equitable basis to applicants who have applied for Shares in the value of HK\$5 million (excluding the brokerage and the Stock Exchange transaction levy payable thereon) or less. The New Issue Shares in pool B will be allocated on an equitable basis to applicants who have applied for Shares in the value of more than HK\$5 million (excluding the brokerage and the Stock Exchange transaction levy payable thereon) and up to the total value of pool B. Applicants should be aware that applications in the same pool, as well as applications in different pools, are likely to receive different allocation ratios. If one (but not both) of the pools is undersubscribed, the surplus New Issue Shares will be transferred to the other pool to satisfy demand and shall be allocated accordingly. Applicants can only apply for or receive an allocation of New Issue Shares from any one pool but not from both pools. No applications will be accepted from applicants applying for more than the total number of Shares initially allocated to each pool.

The allocation of the New Shares between the New Issue and the Placing is subject to adjustment. In the event that the number of Shares validly applied for under the New Issue represents 15 times or more but less than 50 times the number of Shares initially available for subscription, the number of Shares available for subscription under the New Issue will be increased to 45,000,000 Shares, representing 30% of the entire Share Offer (without taking account of any Shares allotted and issued upon exercise of the Over-Allotment Option). In the event that the number of Shares validly applied for under the New Issue represents 50 times or more but less than 100 times the number of Shares initially available for subscription, the number of Shares available for subscription under the New Issue will be increased to 60,000,000 Shares, representing 40% of the entire Share Offer (without taking account of any Shares allotted and issued upon exercise of the Over-Allotment Option). In the event that the number of Shares validly applied for under the New Issue represents 100 times or more the number of Shares initially available for subscription, the number of Shares available for subscription under the New Issue will be increased to 75,000,000 Shares, representing 50% of the

STRUCTURE OF THE SHARE OFFER

entire Share Offer (without taking account of any Shares allotted and issued upon exercise of the Over-Allotment Option). In all cases, the additional Shares reallocated to the New Issue will be allocated equally between pool A and pool B and the number of New Shares allocated to the Placing will be correspondingly reduced.

The New Issue is subject to the conditions as stated in the section headed “Conditions of the Share Offer” of this prospectus.

The Placing

The Company is initially offering 135,000,000 Placing Shares (subject to adjustment), representing 90% of the Shares being offered in the Share Offer, for subscription by way of placing at the Issue Price.

Pursuant to the Placing, it is expected that the Placing Underwriters, on behalf of the Company, will conditionally place the Placing Shares at the Issue Price payable by the investors subscribing for the Placing Shares plus 1% brokerage and 0.011% Stock Exchange transaction levy. The Placing Shares are to be placed with selected professional and institutional investors in Hong Kong. Professional and institutional investors generally include brokers, dealers, companies, including fund managers, whose ordinary business involves dealing in shares and other securities and corporate entities which regularly invest in shares and other securities. The Placing Shares are unlikely to be allocated to individual retail investors, who are expected to subscribe for New Shares under the New Issue and individual investors applying through banks and other institutions.

Applications under the New Issue from investors receiving Shares under the Placing will be identified and rejected and investors receiving Shares under the New Issue will not be offered Placing Shares under the Placing.

The Placing is subject to the conditions as stated in the section headed “Conditions of the Share Offer” of this prospectus.

OVER-SUBSCRIPTION

Allocation of the New Issue Shares to investors under the New Issue will be based solely on the level of valid applications received. The basis of allocation may vary, depending on the number of New Issue Shares validly applied for by each applicant, but will otherwise be made on a strictly pro-rata basis. However, this may involve balloting, which would mean that some applicants may be allotted more New Issue Shares than others who have applied for the same number of New Issue Shares and that applicants who are not successful in the ballot may not receive any New Issue Shares.

The allocation of the Placing Shares will be based on a number of factors, including the level and timing of demand and whether or not it is expected that the investor is likely to acquire further Shares, and/or hold or sell its Shares, after the listing of the Shares on the Stock Exchange. Such allocation is intended to result in a distribution of the Placing Shares which would lead to the establishment of a solid professional and institutional shareholder base for the benefit of the Company and its shareholders as a whole. Investors to whom Placing Shares are offered will be required to undertake not to apply for Shares under the New Issue.

HOW TO APPLY FOR NEW ISSUE SHARES

WHICH APPLICATION FORM TO USE

Use a **WHITE** Application Form if you want the New Issue Shares issued in your own name.

Use a **YELLOW** Application Form if you want the New Issue Shares issued in the name of HKSCC Nominees Limited and deposited directly into CCASS for credit to your investor participant stock account or the stock account of your designated CCASS participant maintained in CCASS.

Note: The New Shares are not available to any Director or chief executive of the Company or existing beneficial shareholder of the Company or their respective associates, as defined in the Listing Rules.

WHERE TO COLLECT THE APPLICATION FORMS

You can collect a **WHITE** Application Form and a prospectus from:

Any member of the Stock Exchange

or

**China Everbright Capital Limited
40th Floor, Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong**

or

**Vickers Ballas Capital Limited
19th Floor, Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong**

or

**China Everbright Securities (HK) Limited
36th Floor, Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong**

or

**Shenyin Wanguo Capital (H.K.) Limited
28th Floor, Citibank Tower
Citibank Plaza
3 Garden Road
Hong Kong**

**Kim Eng Securities (Hong Kong) Limited
8th Floor, Alexandra House
16-20 Chater Road
Central
Hong Kong**

or

**Kingsway SW Securities Limited
10 Ice House Street
12th Floor, 121 New Henry House
Central
Hong Kong**

HOW TO APPLY FOR NEW ISSUE SHARES

or any of the following branches of **Standard Chartered Bank**:

Hong Kong Island:	The Landmark Branch	The Landmark, 15 Queen's Road Central
	Des Voeux Road Branch	Standard Chartered Bank Building, 4-4a Des Voeux Road Central
	Exchange Square Branch	Shop 101, One Exchange Square, 8 Connaught Place, Central
	CIG Building Branch	Shop B, G/F, CIG Building, 141 Des Voeux Road Central
	Causeway Bay Branch	1 Sugar Street, Causeway Bay
	Taikoo Place Branch	G/F, 969 King's Road, Quarry Bay
Kowloon:	Kwun Tong Branch	88-90 Fu Yan Street, Kwun Tong
	Mongkok Bank Centre Branch	Bank Centre, 630-636 Nathan Road, Mongkok
	Tsimshatsui Branch	10 Granville Road, Tsimshatsui
	Cheung Sha Wan Branch	828 Cheung Sha Wan Road, Cheung Sha Wan
New Territories:	Tsuen Wan Branch	Basement 1/F, Emperor Plaza, 263 Sha Tsui Road, Tsuen Wan

You can collect a **YELLOW** Application Form and a prospectus from:

**Hongkong Clearing
Service Counter
2nd Floor, Vicwood Plaza
199 Des Voeux Road Central
Hong Kong**

or

**Hongkong Clearing
Investor Service Centre
Room 1901, Chinachem Exchange Square
1 Hoi Wan Street, Quarry Bay
Hong Kong**

or your stockbroker may have forms available.

HOW TO COMPLETE THE APPLICATION FORM

There are detailed instructions on each Application Form. You should read those instructions carefully. If you do not follow the instructions your application may be rejected.

If your application is made through a duly authorised attorney, the Company and China Everbright (on behalf of the New Issue Underwriters) as agent for the Company may accept it at their discretion, and subject to any conditions they think fit, including evidence of the authority of your attorney. China Everbright in its capacity as agent for the Company has full discretion to reject or accept any application, in full or in part, without assigning any reason.

HOW TO APPLY FOR NEW ISSUE SHARES

NUMBER OF APPLICATIONS YOU MAY MAKE

You may make more than one application for New Issue Shares if you are a nominee. You may lodge more than one application in your own name on behalf of different owners. In the box on the Application Form marked “For nominees”, you must include (i) an account number; or (ii) some other identification code for **each** beneficial owner. If you do not include this information, the application will be treated as being made for your benefit. *Otherwise, multiple applications are not allowed and rejected.*

It will be a term and condition of all applications that by completing and delivering an Application Form, you give a warranty to the following effect that:

- no other application is made for your benefit by you or by anyone applying as your agent or by any other person, if the application is made for your benefit;
- if the application is made by you as agent for the benefit of another person, no other application is being made by you as agent for or for the benefit of that person or by that person or by other person as agent for that person; and you have due authority to sign the application as agent for the person who is to benefit from the application.

All of your applications will be rejected as multiple applications if you, or you and joint applicants together:

- make more than one application on a **WHITE** or **YELLOW** Application Form (save in case of applications being made by nominees in accordance with the terms herein); or
- apply on one **WHITE** or **YELLOW** Application Form for more than 100% of the New Issue Shares being offered for public subscription initially available in either pool A or pool B as referred to in the paragraph headed “The New Issue” in the section headed “Structure of the Share Offer”.

All of your applications will also be rejected as multiple applications if more than one application is made for **your benefit**. If an application is made by an unlisted company and

- the only business of that company is dealing in securities; and
- you exercise statutory control over that company,

then the application will be treated as being for your benefit.

Unlisted company means a company with no equity securities listed on the Stock Exchange.

Statutory control means you:

- control the composition of the board of directors of the company; or
- control more than one half of the voting power of the company; or
- hold more than one half of the issued share capital of the company (not counting any part of it which carries no right to participate beyond a specified amount in a distribution of either profits or capital).

HOW TO APPLY FOR NEW ISSUE SHARES

HOW MUCH ARE THE NEW ISSUE SHARES

The Issue Price of the New Issue Shares is HK\$0.93 each. You must also pay the brokerage of 1% and a Stock Exchange transaction levy of 0.011% on application. This means that for every 2,000 New Issue Shares you want to apply for, you have to pay HK\$1,878.80. The Application Forms contain tables showing the exact amount payable for certain multiples of Shares.

You must pay the Issue Price, brokerage and the Stock Exchange transaction levy in full when you apply for the New Issue Shares.

If your application is successful, brokerage is paid to members of the Stock Exchange, and the transaction levy is paid to the Stock Exchange.

TIME FOR APPLICATION OF NEW ISSUE SHARES

Completed **WHITE** or **YELLOW** Application Forms, with payment in Hong Kong dollars for the full amount payable on application attached, must be lodged **by 12 noon on Friday, 8th October, 1999**, or, if the application lists are not open on that day, then by 12 noon on the day the lists are open.

Your completed Application Form, with payment in Hong Kong dollars for the full amount payable on application attached, should be deposited in the special collection boxes provided at any of the branches of Standard Chartered Bank listed on page 68 of this prospectus at the following times:

Tuesday, 5th October, 1999 — 9 a.m. to 4 p.m.
Wednesday, 6th October, 1999 — 9 a.m. to 4 p.m.
Thursday, 7th October, 1999 — 9 a.m. to 4 p.m.
Friday, 8th October, 1999 — 9 a.m. to 12 noon

The application lists will be open **from 11:45 a.m. to 12 noon on Friday, 8th October, 1999**.

EFFECT OF BAD WEATHER ON THE OPENING OF THE APPLICATION LISTS

The application lists will not open if there is:

- a tropical cyclone warning signal number 8 or above, or
- a “black” rainstorm warning signal

in force in Hong Kong at any time between 9 a.m. and 12 noon on Friday, 8th October, 1999. Instead they will open between 11:45 a.m. and 12 noon on the next business day which does not have either of those warnings in force at any time between 9 a.m. and 12 noon.

Business day means a day that is not a Saturday, Sunday or public holiday in Hong Kong.

HOW TO APPLY FOR NEW ISSUE SHARES

CIRCUMSTANCES IN WHICH YOU WILL NOT BE ALLOTTED NEW ISSUE SHARES

Full details of the circumstances in which you will not be allotted New Issue Shares are set out in the notes attached to the Application Forms, and you should read them carefully. You should note in particular the following two situations in which the New Issue Shares will not be allotted to you.

- **If your application is revoked:**

By completing an Application Form you agree that you cannot revoke your application before 4th November, 1999. This agreement will take effect as a collateral contract with the Company, and will become binding when you lodge your Application Form. This collateral contract will be in consideration of the Company agreeing that, it will not offer any New Issue Shares to any person before 4th November, 1999 except by means of one of the procedures referred to in this prospectus.

You cannot revoke your application before 4th November, 1999 (excluding for this purpose any day which is a Saturday, Sunday or public holiday in Hong Kong) unless a person responsible for this prospectus under section 40 of the Companies Ordinance gives a public notice under that section which excludes or limits the responsibility of that person for this prospectus.

If your application has been accepted, it cannot be revoked. Acceptance of application will be constituted by notification to the press of the basis of allocation and, where such basis of allocation is subject to certain conditions or provides for allocation by ballot, such acceptance will be subject to satisfaction of such conditions or the results of such ballot, respectively.

- **If the allotment of New Issue Shares is void:**

Your allotment of New Issue Shares will be void if the Listing Committee of the Stock Exchange does not grant permission to list the Shares either:

- within three weeks from the closing of the application lists; or
- within a longer period of up to six weeks if the Listing Committee of the Stock Exchange notifies the Company of that longer period within three weeks of the closing of the application lists.

COMMENCEMENT OF DEALINGS IN THE NEW SHARES

Dealings in the Shares are expected to commence on Friday, 15th October, 1999.

Shares will be traded in board lots of 2,000 each.

IF YOUR APPLICATION FOR NEW ISSUE IS SUCCESSFUL (IN WHOLE OR IN PART)

The Company will not issue temporary documents of title. No receipt will be issued for application money paid.

HOW TO APPLY FOR NEW ISSUE SHARES

COLLECTION/POSTING OF SHARE CERTIFICATE(S)/REFUND CHEQUE AND DEPOSIT OF SHARE CERTIFICATES INTO CCASS

WHITE application form:

If you have applied for 200,000 New Issue Shares or more and have indicated on your application form that you will collect your share certificate(s) and/or refund cheque, you may collect it/them in person from:

Central Registration Hong Kong Limited
Shops 1712-1716
17th Floor, Hopewell Centre,
183 Queen's Road East
Hong Kong

Share certificate(s) and refund cheque will be available for collection between 9 a.m. and 1 p.m. on 13th October, 1999.

You must show your identification document to collect your share certificate(s) and/or refund cheque which must correspond to the information in the Application Form and produce other satisfactory evidence of your identity for collection of your share certificate(s) and/or refund cheque.

If you do not collect your share certificate(s) and/or refund cheque in person within the time specifying the collection, if any, they will be sent to the address on your application form after 13th October, 1999 by ordinary post and at your own risk.

If you have applied for 200,000 New Issue Shares or above and have not indicated on your application form that you will collect your share certificate(s) and/or refund cheque in person, or if you have applied for less than 200,000 New Issue Shares, then your share certificate(s) and/or refund cheque, if any, will be sent to the address on your application form by ordinary post and at your own risk on 13th October, 1999, respectively.

YELLOW application form:

Your share certificate(s) will be issued in the name of HKSCC Nominees Limited and deposited into CCASS for credit to your investor participant stock account or the stock account of your designated CCASS participant as instructed by you at the close of business on 13th October, 1999, or any other date as shall be determined by Hongkong Clearing or HKSCC Nominees Limited.

If you are applying through a designated CCASS participant (other than an investor participant):

- for New Issue Shares credited to the stock account of your designated CCASS participant (other than an investor participant), you can check the number of New Issue Shares allotted to you with that CCASS participant.

If you are applying as an investor participant:

- the Company will publish the results of investor participants' applications together with the results of the Share Offer in the newspapers on 12th October, 1999. You should check against the announcement published by the Company and report any discrepancies to

HOW TO APPLY FOR NEW ISSUE SHARES

Hongkong Clearing before 12 noon on Wednesday, 13th October, 1999 or such other date as shall be determined by Hongkong Clearing or HKSCC Nominees Limited. On 14th October, 1999 (the next day following the credit of the New Issue Shares to your stock account) you can check your new account balance via the CCASS Phone System (under the procedures contained in Hongkong Clearing's "An Operating Guide for Investor Participants" in effect from time to time). Hongkong Clearing will also mail to you an Activity Statement showing the number of New Issue Shares credited to your stock account.

If you have applied for 200,000 New Issue Shares or above and have indicated on your application form that you will collect your refund cheque(s) in person, please follow the instructions set out under the sub-paragraph headed "White application form" above.

SHARES WILL BE ELIGIBLE FOR CCASS

If the Stock Exchange grants the listing of and permission to deal in the Shares and the Company complies with the stock admission requirements of Hongkong Clearing, the Shares will be accepted as eligible securities by Hongkong Clearing for deposit, clearance and settlement in CCASS with effect from the commencement date of dealings in the Shares on the Stock Exchange or on any other date as determined by Hongkong Clearing. Settlement of transactions between members of the Stock Exchange is required to take place in CCASS on the second business day after any trading day.

All necessary arrangements have been made for the Shares to be admitted into CCASS.

All activities under CCASS are subject to the General Rules of CCASS and CCASS Operational Procedures in effect from time to time.

The following is the text of a report, prepared for the purpose of incorporation in this prospectus, received from the auditors and reporting accountants of the Company, Arthur Andersen & Co., Certified Public Accountants, Hong Kong.



Arthur Andersen & Co.
Certified Public Accountants

21st Floor, Edinburgh Tower
The Landmark
15 Queen's Road Central
Hong Kong

5th October, 1999

The Directors

Yixing Xinwei Holdings Limited
China Everbright Capital Limited
Vickers Ballas Capital Limited

Dear Sirs,

We set out below our report on the financial information relating to Yixing Xinwei Holdings Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") for inclusion in the prospectus of the Company dated 5th October, 1999 (the "Prospectus").

The Company was incorporated in the Cayman Islands on 27th July, 1999 as an exempted company under the Companies Law (1998 Revision) of the Cayman Islands. The Company has not carried on any business since its incorporation. Pursuant to a group reorganization (the "Reorganization") as described more fully in the paragraph headed "Group reorganization" in Appendix VI to the Prospectus, the Company became the ultimate holding company of its directly and indirectly owned subsidiaries (all these companies being private limited companies or, if incorporated/established outside Hong Kong, have substantially similar characteristics to a private company incorporated in Hong Kong). As of the date of this report, the details of the Company and its subsidiaries are set out as below:

Name	Place and date of incorporation	Issued and fully paid share capital/ Registered capital	Percentage of equity interest/ voting capital attributable to the Group	Principal activities
Lee Shing Holdings Limited ("Lee Shing Holdings")	British Virgin Islands 3rd December, 1998	US\$20 (HK\$155)	100%	Investment holding

Name	Place and date of incorporation	Issued and fully paid share capital/ Registered capital	Percentage of equity interest/ voting capital attributable to the Group	Principal activities
Yixing Xinwei Leeshing Refractory Materials Co. Ltd. ("Xinwei Leeshing Refractory Materials") (<i>Note 1</i>)	The People's Republic of China ("the PRC") 30th July, 1999	US\$4,000,000 (HK\$30,992,000)	100%	Manufacturing and selling of refractory materials
Xinwei Rare Earth Group (Hong Kong) Limited ("Xinwei HK")	Hong Kong 23rd October, 1998	(i) HK\$10,000,000 non-voting deferred shares (<i>Note 3</i>) (ii) HK\$2 ordinary shares	100%	Trading
Yixing Xinwei Leeshing Rare Earth Co. Ltd. ("Xinwei Leeshing Rare Earth") (<i>Note 2</i>)	The PRC 17th July, 1993	US\$15,660,000 (HK\$121,334,000)	95%	Extraction and selling of rare earth products

Note 1: Xinwei Leeshing Refractory Materials is a wholly foreign-owned enterprise with an operating period of 30 years commencing 30th July, 1999. It was established to own the refractory materials operations of the Group.

Note 2: Xinwei Leeshing Rare Earth is a Sino-foreign equity joint venture established by Yixing Rare Earth Separating Factory ("Xinwei Separating Factory") with an operating period of 30 years commencing 17th July, 1993 and the equity interests were then transferred to Yixing Xinwei Group Limited ("Xinwei Group Limited") when it was established. Xinwei Leeshing Rare Earth had been dormant since incorporation. Pursuant to the Reorganization, 95% of the equity interests in Xinwei Leeshing Rare Earth were transferred to Lee Shing Holdings with the Xinwei Group Limited retaining the remaining 5% interest. It was activated to own the rare earth products operations of the Group.

Note 3: The non-voting deferred shares have not been paid up. The rights and restrictions attaching to such non-voting deferred shares are set out in the paragraph headed "Rights and restrictions of the non-voting deferred shares" in Appendix VI to the Prospectus.

No financial statements have been prepared by any of the companies now comprising the Group for each of the three years ended 31st December, 1998 and the four months ended 30th April, 1999 (the "Relevant Period") as these companies were either newly incorporated or established or have been dormant since their establishment and have not been involved in any business transactions other than the Reorganization referred to herein. We have, however, reviewed all relevant transactions of these companies since their incorporation or establishment and carried out such procedures as we considered necessary for inclusion of the financial information relating to these companies in this report.

Ms. Qian Yuan Ying ("Mrs. Jiang"), a director and the beneficial owner of the discretionary object of the Jiang family trust, the trust assets of which include the shares of YY Holding Limited (the substantial shareholder of the Company), together with Mr. Jiang Quan Long ("Mr. Jiang"), the husband of Mrs. Jiang and a director of the Company, established the Xinwei Separating Factory in 1987 in the People's Republic of China ("the PRC"). The equity interests held by Mrs. Jiang and Mr.

Jiang in Xinwei Separating Factory were 95% and 5% respectively. In 1994, Xinwei Group Limited was set up and took over all the assets and liabilities of Xinwei Separating Factory following which Xinwei Separating Factory was dissolved. The subsidiary companies of Xinwei Group Limited and other companies directly owned by Mrs. Jiang and Mr. Jiang, all in the ratio of 95% and 5% (collectively referred to as the "Xinwei Group") are all registered in the PRC. They were principally engaged in the extraction and production of rare earth products and the manufacturing of refractory materials for sale within and outside the PRC. Details of the companies comprising the Xinwei Group are as follows:

Name	Date of Incorporation/ Establishment	Percentage of equity interest/ voting rights directly or indirectly held by Mrs. Jiang before 30th April, 1999	Principal activities
Xinwei Separating Factory/Xinwei Group Limited	12th November, 1987	95%	Investment holding, extraction and selling of rare earth products
Yixing Rare Earth Refinery Factory ("Rare Earth Refinery")	27th December, 1988	95%	Extraction and selling of rare earth metals
Yixing Yimei Fluorescent Materials Co. Ltd. ("Yimei Fluorescent Materials")	30th November, 1991	95%	Manufacturing and selling of fluorescent rare earth materials
Yixing Xinwei Refractory Materials Factory ("Xinwei Refractory Materials")	20th September, 1993	95%	Manufacturing and selling of refractory materials
Yixing Xinwei Materials Trading Company ("Xinwei Trading")	28th March, 1994	95%	Dormant
Yixing Wellfire Refractory Materials Co. Ltd. ("Wellfire")	23rd September, 1991	48.45%	Manufacturing and selling of refractory materials
Xinwei Leeshing Rare Earth (Note 1)	17th July, 1993	28.5%	Dormant
Yixing Shengyi Ytterbium Co. Ltd. ("Shengyi Co.")	18th September, 1996	11.12%	Extraction and selling of rare earth products

Note:

1. Refer to Note 2 of the details of the Company and its subsidiaries in the preceding paragraphs.

Pursuant to the Reorganization of the Xinwei Group on and subsequent to 30th April, 1999 to prepare for a listing on The Stock Exchange of Hong Kong Limited, Mrs. Jiang, Mr. Jiang and Xinwei Group Limited undertook the following arrangements:

Wellfire was a Sino-foreign equity joint venture which was 51% owned by the Xinwei Group and 49% owned by a Japanese corporation (the "Japanese Corporation"). The joint venture period is 11 years commencing 23rd September, 1991. On 30th April, 1999, 49% of the equity interest in Wellfire held by the Japanese Corporation was acquired by Mrs. Jiang for a cash consideration of US\$490,000 (HK\$3,797,000). Mrs. Jiang and Mr. Jiang then acquired 46% and 5% of the remaining equity interest in Wellfire from the Xinwei Group respectively.

Shengyi Co. was a limited liability company incorporated in the PRC in which the Xinwei Group owned an 11.7% equity interest with the remaining interests owned by several other individuals (the "Individuals") including a brother of Mrs. Jiang. As part of the Reorganization, Mrs. Jiang, Mr. Jiang and Xinwei Group Limited acquired the remaining equity interests in Shengyi Co. from the Individuals on 30th April, 1999. As a result of this acquisition, Mrs. Jiang and Mr. Jiang effectively held and controlled equity interests of Shengyi Co. in the ratio of 95% to 5%. With effect on the same date, the Xinwei Group also entered into an agreement with Shengyi Co. whereby the Xinwei Group took over all the operating assets and liabilities of Shengyi Co., following which it was dissolved.

Yixing Longwei Special Refractory Materials Factory ("Longwei Factory") was incorporated in the PRC with Mr. Jiang and his father owning 27% and 73% equity interests, respectively. Pursuant to the Reorganization, Mr. Jiang's father, Mr. Jiang and Mrs. Jiang entered into an agreement whereby Mrs. Jiang acquired a 95% equity interest in Longwei Factory on 30th April, 1999 with Mr. Jiang retaining the remaining 5% equity interest. With effect on the same date, the Xinwei Group also entered into a merger agreement with Longwei Factory whereby the Xinwei Group took over all the operating assets and liabilities of Longwei Factory, following which it was dissolved.

With effect from 30th April, 1999:

- all the assets and liabilities of Xinwei Group's refractory materials operations were transferred to the Group in return for which shares in Lee Shing Holdings were allotted and issued to Mrs. Jiang and cash consideration in the aggregate amount of RMB1,924,149.98 was paid to Mr. Jiang;
- (i) 95% of the assets and liabilities of Xinwei Group's rare earth products operations were transferred to the Group in return for which shares in Lee Shing Holdings were allotted and issued, credited as fully paid, to Mrs. Jiang and (ii) the remaining assets and liabilities of the rare earth products operations of Xinwei Group were contributed by Xinwei Group into Xinwei Leeshing Rare Earth as its 5% share of its registered capital.

Following such transfers, all the other companies of the Xinwei Group were dissolved or became dormant.

The management or audited accounts of all the companies within the Xinwei Group were prepared in accordance with the relevant accounting principles and financial regulations in the PRC. With the exception of Wellfire, no audited financial statements have been prepared for the companies within the Xinwei Group as there were no statutory requirements for preparation of audited accounts. The

financial statements of Wellfire as of and for the two years ended 31st December, 1996 and 1997 were audited by Jiangsu Yixing Certified Public Accountants () and the financial statements as of and for the year ended 31st December, 1998 were audited by Jiangsu Yixing Surui Certified Public Accountants (). Both certified public accountants were registered in the PRC.

For the purpose of this report, we have undertaken an independent audit of the management accounts of the companies in the Xinwei Group for the Relevant Period or since their respective dates of incorporation where this is a shorter period in accordance with Auditing Standards issued by the Hong Kong Society of Accountants (“HKSA”). In addition we have carried out such additional procedures as we consider necessary in accordance with the Auditing Guideline “Prospectuses and the Reporting Accountant” issued by the HKSA. Adjustments have been made to the management accounts of the companies within the Xinwei Group to comply with Statements of Standard Accounting Practice (“SSAPs”) issued by the HKSA.

The summaries of the combined results of the Group for the Relevant Period and of the combined net tangible assets of the Group as of 30th April, 1999 (the “Summaries”) set out in this report have been prepared from the audited or management accounts of the companies within the Xinwei Group as well as the management accounts of the companies now comprising the Group on the basis set out in Section 1 below, after making such adjustments as we consider appropriate.

In our opinion, the Summaries, together with the notes thereon, give, for the purpose of this report, a true and fair view of the combined results of the Group for each of the three years ended 31st December, 1998 and the four months ended 30th April, 1999 and of the combined net tangible assets of the Group as of 30th April, 1999.

1. BASIS OF PRESENTATION

- a. The accompanying combined financial statements are prepared in accordance with SSAPs issued by the HKSA.
- b. The summary of the combined results includes the results of the companies within the Xinwei Group and the companies now comprising the Group, as if the current group structure had been in existence throughout the Relevant Period or since their respective dates of incorporation or acquisition where this is a shorter period. The summary of the combined net tangible assets of the Group as of 30th April, 1999 has been prepared to present the assets and liabilities of the Group as if the current group structure had been in existence as of 30th April, 1999.
- c. The acquisitions of the remaining 49% equity interests in Wellfire and the remaining equity interests in Shengyi Co. held by the Japanese Corporation and the Individuals, respectively; and the acquisition of Mr. Jiang’s 5% equity interest in the refractory business of the Xinwei Group by the Group were accounted for using the acquisition method of accounting.
- d. Significant transactions and balances between companies now comprising the Group have been eliminated on combination.

2. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted by the Group in arriving at the financial information set out in this report, which conform with SSAPs issued by the HKSA, are as follows:

a. Subsidiary

A subsidiary is a company in which another company holds, directly or indirectly, more than 50% of its issued voting share capital or registered capital as a long term investment.

b. Joint venture

The Group's investment in a joint venture in the PRC is in the form of a Sino-foreign equity joint venture in respect of which the partners' profit-sharing ratios and share of net assets upon the expiration of the joint venture period are in proportion to their equity interests as defined in the joint venture contract.

Investments in joint ventures are accounted for as subsidiaries where the Group controls the board of directors or equivalent governing body and/or is in a position to exercise control over the financial and operating policies of the joint ventures.

c. Turnover and revenue recognition

Turnover represents the net invoiced value of goods sold after allowances for returns and discounts.

Revenue from the sale of goods is recognized when the goods are shipped and title has passed. Deposits or advances received from customers prior to the passage of title of the goods are recorded as deposits from customers. Interest income is recognized on a time-proportion basis on the principal outstanding and at the rates applicable.

d. Fixed assets and depreciation

Fixed assets are stated at cost less accumulated depreciation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the fixed assets have been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the profit and loss account in the period in which it is incurred.

Depreciation is provided on the straight-line basis to write off the cost of each asset over its estimated useful life. Leasehold land is depreciated over the remaining period of the respective lease. The annual rates of depreciation are as follows:

Leasehold land	Over the remaining period of the lease
Buildings	5%
Machinery and equipment	10%
Office equipment and fixtures	20%
Motor vehicles	20%

Gains and losses on disposals of fixed assets are recognized in the profit and loss account based on the net disposal proceeds less the carrying amount of the assets at the date of disposal.

e. Construction in progress

Construction in progress represents factory and office buildings under construction and machinery and equipment pending installation. Cost includes the costs of construction, the costs of plant and machinery and interest charges arising from borrowings utilized to finance these assets during the period of construction or installation. Construction in progress is transferred to fixed assets when it is completed.

f. Inventories

Inventories are carried at the lower of cost and net realizable value.

Cost includes costs of materials determined based on the first-in first-out method and comprises all costs of purchase, costs of conversion including direct labor and an appropriate proportion of production overheads and other costs incurred in bringing the inventories to their present location and condition.

Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of the inventories is recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories are recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of write-down of inventories, arising from an increase in net realizable value, is recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs.

g. Foreign currencies

The reporting currency of the Group is the Hong Kong dollar. Companies within the Group maintain their books and records in Hong Kong dollars or renminbi. Foreign currency transactions denominated in other currencies during the Relevant Period are translated into Hong Kong dollars or renminbi as applicable at the applicable rates of exchange ruling at the time of the transactions. Monetary assets and liabilities denominated in other currencies are translated into Hong Kong dollars or renminbi as applicable at the rates of exchange in effect at the balance sheet dates; non-monetary assets and liabilities denominated in other currencies are translated at historical rates. Exchange differences arising from the above translation policy are dealt with in the profit and loss accounts.

For combination purposes, the financial statements of subsidiaries in the PRC are translated into Hong Kong dollars using the closing rate method. Under the closing rate method, assets and liabilities of the PRC subsidiaries are translated at the rates of exchange ruling at the balance sheet dates, the profit and loss accounts are translated at the average rates of exchange prevailing in each relevant year/period and registered capital and reserves are translated at historical exchange rates. Exchange differences arising from translation of the financial statements are taken directly to the cumulative translation reserve.

h. Borrowing costs

Interest is expensed as incurred, except for the interest directly attributable to the construction or acquisition of buildings and machinery and equipment. Interest is capitalized at the weighted average cost of the related borrowings up to the date of completion of construction or when the machinery and equipment are ready for their intended use.

i. Taxation**(i) Income taxes**

Companies within the Group provide for income taxes on the basis of their profit for financial reporting purposes, adjusted for income and expense items which are not assessable or deductible for income tax purposes.

(ii) Value-added tax ("VAT")

In accordance with the relevant PRC tax laws, all the companies of the Group established in the PRC are subject to VAT. This principal indirect tax is levied on the sales of goods and provision of certain specified services (known as "Output VAT"). Output VAT is recovered from customers with sales proceeds and is calculated at 17% of the selling price. The VAT payable by the subsidiaries of the Group established in the PRC represents Output VAT minus the VAT paid on its purchases (known as "Input VAT").

(iii) Deferred taxation

Deferred taxation is provided under the liability method in respect of significant timing differences between profit as computed for taxation purposes and profit as stated in the financial statements, except when it is considered that no liability will arise in the foreseeable future. Deferred tax assets are not recognized unless the related benefits are expected to crystallize in the foreseeable future.

j. Research and development costs

Research and development costs represent all costs directly attributable to the improvement of production processes and products. Research costs are written off as incurred. Development costs incurred on specific projects are carried forward when recoverability can be foreseen with reasonable assurance. The costs are amortized based on the sales from such projects. The directors believe this accounting treatment results in a proper matching of costs and revenue. All other development costs are written off as incurred.

k. Operating leases

Leases where substantially all the rewards and risks of ownership remain with the leasing company are accounted for as operating leases. Rental payments under operating leases are charged to the profit and loss account on a straight-line basis over the period of the relevant leases.

3. RESULTS

The following is a summary of the combined results of the Group for each of the three years ended 31st December, 1998 and for the four months ended 30th April, 1999, prepared on the basis set out in Section 1 above:

		Year ended 31st December,			Four months ended
	Notes	1996	1997	1998	30th April, 1999
		HK\$'000	HK\$'000	HK\$'000	HK\$'000
Turnover	(a)	<u>320,709</u>	<u>380,098</u>	<u>419,482</u>	<u>143,647</u>
Profit from operations	(b)	60,524	82,727	93,747	37,317
Finance costs		<u>(8,201)</u>	<u>(6,536)</u>	<u>(6,264)</u>	<u>(1,558)</u>
Profit before taxation	(c)	52,323	76,191	87,483	35,759
Taxation	(d)	<u>(15,130)</u>	<u>(20,650)</u>	<u>(22,632)</u>	<u>(6,747)</u>
Profit after taxation		37,193	55,541	64,851	29,012
Minority interests		<u>(1,445)</u>	<u>(937)</u>	<u>(2,851)</u>	<u>(931)</u>
Profit attributable to shareholders		<u>35,748</u>	<u>54,604</u>	<u>62,000</u>	<u>28,081</u>
Dividends	(e)	<u>3,563</u>	<u>11,538</u>	<u>17,462</u>	<u>6,401</u>

Notes:

a. Turnover

Analysis of turnover by major product lines is as follows:

	Year ended 31st December,			Four months ended
	1996	1997	1998	30th April, 1999
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Sales of rare earth products	219,762	261,890	288,081	96,716
Sales of refractory materials	<u>100,947</u>	<u>118,208</u>	<u>131,401</u>	<u>46,931</u>
Total turnover	<u>320,709</u>	<u>380,098</u>	<u>419,482</u>	<u>143,647</u>

b. Profit from operations

Additional disclosure information on components of the results of operations of the Group in accordance with SSAP 1, Presentation of Financial Statements, issued by the HKSA are as follows:

	Year ended 31st December,			Four months ended
	1996	1997	1998	30th April, 1999
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Turnover	320,709	380,098	419,482	143,647
Cost of sales	<u>(228,720)</u>	<u>(263,049)</u>	<u>(301,920)</u>	<u>(94,016)</u>
Gross profit	91,989	117,049	117,562	49,631
Distribution and selling costs	(10,100)	(11,888)	(9,295)	(4,255)
Administrative expenses	(21,952)	(22,922)	(14,861)	(8,635)
Other operating income, net	<u>587</u>	<u>488</u>	<u>341</u>	<u>576</u>
Profit from operations	<u><u>60,524</u></u>	<u><u>82,727</u></u>	<u><u>93,747</u></u>	<u><u>37,317</u></u>

c. Profit before taxation

Profit before taxation was stated after charging and crediting the following:

	Year ended 31st December,			Four months ended
	1996	1997	1998	30th April, 1999
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
After charging -				
Depreciation of fixed assets	4,898	7,719	8,667	3,035
Interest expenses on bank borrowings wholly repayable within five years	8,285	6,698	6,898	1,712
Less: amount capitalized in construction in progress	(53)	(151)	(596)	(128)
Provision for bad and doubtful debts	2,455	5,803	871	936
Staff costs	7,436	7,572	7,894	3,249
Provision for obsolescence and net realizable value	1,988	—	—	—
Auditors' remuneration	7	7	7	505
Net exchange loss	—	—	53	—
Research and development costs written off	<u>1,407</u>	<u>1,327</u>	<u>1,054</u>	<u>544</u>
After crediting -				
Interest income from bank deposits	31	11	38	26
Write-back of provision for obsolescence and net realizable value	<u>—</u>	<u>414</u>	<u>902</u>	<u>205</u>

d. Taxation

Taxation charges comprised:

	Year ended 31st December,			Four months ended
	1996	1997	1998	30th April, 1999
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
PRC enterprise income tax (<i>Note ii</i>)				
— Current	17,267	25,143	28,869	11,800
— Financial refund	<u>(2,137)</u>	<u>(4,493)</u>	<u>(6,237)</u>	<u>(5,053)</u>
	<u>15,130</u>	<u>20,650</u>	<u>22,632</u>	<u>6,747</u>

Notes:

- i) No provision for Hong Kong profits tax has been made in the accounts as the Group had no assessable profits in Hong Kong during the Relevant Period.
- ii) The PRC enterprise income tax during the Relevant Period represented the tax charges on the assessable profit of the Xinwei Group. The details of applicable enterprise income tax rates are as follows:
 - Except for Wellfire, all companies within the Xinwei Group were subject to enterprise income tax at a rate of 33% on assessable profits. Wellfire was a foreign invested enterprise located in the coastal open area of Yixing and was engaged in production activities with an operating period of more than 10 years. Therefore, the applicable tax rate was 24% for State enterprise income tax. It was also entitled to full exemption from enterprise income tax for two years starting from its first profit-making year, after offsetting all losses brought forward, followed by a 50% reduction for the next three years thereafter ("tax holiday"). Wellfire was in the 3rd to 5th years of its tax holiday during the three years ended 31st December, 1998.
 - Pursuant to relevant documents issued by the municipal ministry of finance and the municipal tax bureau of Yixing City of Jiangsu province, the PRC, the Xinwei Group was granted financial refunds equal to a portion of the enterprise income tax paid by the Xinwei Group.

There is no assurance that the Group will continue to enjoy the benefits of such financial refunds in the future.
- iii) Pursuant to the approvals of the municipal tax bureau of Yixing City dated 10th August, 1999, the two foreign invested enterprises of the Group, Xinwei Leeshing Refractory Materials and Xinwei Leeshing Rare Earth are entitled to the tax holiday from their first profit-making year after offsetting all previous losses brought forward.
- iv) There was no material unprovided deferred taxation for each of the three years ended 31st December, 1998 and the four months ended 30th April, 1999.

e. Dividends

No dividend has been paid or declared by the Company since its incorporation.

The following dividends were paid and payable by the companies within the Xinwei Group to their then shareholders during each of the three years ended 31st December, 1998 and for the four months ended 30th April, 1999:

	Year ended 31st December,			Four months ended
	1996	1997	1998	30th April, 1999
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Ms. Qian Yuan Ying ("Mrs. Jiang")	<u>3,385</u>	<u>10,962</u>	<u>16,589</u>	<u>6,081</u>
Mr. Jiang Quan Long ("Mr. Jiang")	<u>178</u>	<u>576</u>	<u>873</u>	<u>320</u>

f. Related party transactions

Particulars of significant transactions between the companies now comprising the Group or companies within the Xinwei Group and related companies during the Relevant Period covered by this report are summarized below:

Name of related party	Nature of transactions	Year ended 31st December,			Four months ended
		1996	1997	1998	30th April, 1999
		HK\$'000	HK\$'000	HK\$'000	HK\$'000
* Mei Zhi Refractory Factory	Purchases from the Group	1,360	555	120	—
	Sales to the Group	—	407	—	—
* Yixing Gao Wen Refractory Factory	Purchases from the Group	1,456	—	65	—
* Pan Jia Ba Marble Stone Factory	Purchases from the Group	—	63	—	—
	Sales to the Group	—	289	—	—

* Direct translation of the name of the companies in Chinese.

The above-named companies are related parties by virtue of the fact that close relatives of Mr. Jiang and Mrs. Jiang have beneficial interests in such companies.

In the opinion of the directors of the Company, the above related party transactions were carried out in the usual course of business of the Group and on normal commercial terms.

g. Directors' and senior executives' emoluments

i) Details of emoluments paid to the directors were as follows:

	Year ended 31st December,			Four months ended
	1996	1997	1998	30th April, 1999
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Fees	—	—	—	—
Other emoluments				
— Basic salaries and allowances	2,092	2,112	2,096	699
	<u>2,092</u>	<u>2,112</u>	<u>2,096</u>	<u>699</u>

The number of directors whose emoluments fall within the following bands are as follows:

	Year ended 31st December,			Four months ended
	1996	1997	1998	30th April, 1999
Nil — HK\$1,000,000	3	3	3	4
HK\$1,000,001 — HK\$1,500,000	<u>1</u>	<u>1</u>	<u>1</u>	<u>—</u>

ii) Details of emoluments paid to the five highest paid individuals (including directors and other employees) were:

	Year ended 31st December,			Four months ended
	1996	1997	1998	30th April, 1999
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Basic salaries and allowances				
— directors	2,073	2,094	2,092	691
— employees	<u>69</u>	<u>36</u>	<u>41</u>	<u>20</u>
	<u>2,142</u>	<u>2,130</u>	<u>2,133</u>	<u>711</u>
Number of directors	3	3	3	3
Number of employees	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>
	<u>5</u>	<u>5</u>	<u>5</u>	<u>5</u>

During the Relevant Period, no emoluments were paid to the five highest paid individuals (including directors and other employees) as inducement to join or upon joining the Group or as compensation for loss of office.

The remuneration of all the highest paid individuals, other than one director, falls within the band of nil to HK\$1,000,000 during each of the three years ended 31st December, 1998 and for the four months ended 30th April, 1999.

h. Transfer to and from reserves and recognized gains

- i) The movements in reserves during each of the three years ended 31st December, 1998 and for the four months ended 30th April, 1999 were as follows:

	Year ended 31st December,			Four months ended
	1996	1997	1998	30th April, 1999
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Capitalization of retained profits as registered capital	—	38,498	35,297	13,277
Exchange fluctuation arising from translation of financial statements of subsidiaries in the PRC	<u>40</u>	<u>226</u>	<u>17</u>	<u>73</u>
Transfers from profit after taxation to:				
— Statutory surplus reserve	<u>706</u>	<u>5,277</u>	<u>6,161</u>	<u>2,756</u>
— Statutory public welfare reserve	<u>353</u>	<u>2,638</u>	<u>3,080</u>	<u>1,378</u>

In accordance with relevant financial regulations of the PRC and articles of association of the companies within the Xinwei Group, the companies are required to appropriate 10% and 5% of their statutory net income (after offsetting any prior year losses) to the statutory surplus reserve and the statutory public welfare reserve respectively. The appropriations to statutory surplus reserve can cease when the balances of the reserve reach 50% of the paid up capital or registered capital of the relevant companies. These reserves cannot be used for purposes other than those for which they are created and are not distributable as cash dividends.

Pursuant to resolutions passed by the board of directors of the Xinwei Group's subsidiaries, the statutory public welfare reserve will be utilized to acquire capital assets in the name of the relevant company which will be used for the benefit of workers and will not be used to pay for staff welfare expenses.

Pursuant to an approval of the relevant PRC government authorities on 4th May, 1997, the combined registered capital of the Xinwei Group was increased to RMB119,466,600. The increase was fulfilled by capitalization of retained profits of the Xinwei Group.

- ii) An analysis of the recognized gains for the three years ended 31st December, 1996, 1997 and 1998 and the four months ended 30th April, 1999 is as follows:

	Year ended 31st December,			Four months ended
	1996	1997	1998	30th April, 1999
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Gain from exchange fluctuations arising from translation of financial statements of subsidiaries in the PRC not recognized in the income statements	40	226	17	73
Net profit for the year/period	<u>35,748</u>	<u>54,604</u>	<u>62,000</u>	<u>28,081</u>
Total recognized gains	<u>35,788</u>	<u>54,830</u>	<u>62,017</u>	<u>28,154</u>

There were no unrecognised gains/losses during the Relevant Period.

i. **Earnings per Share ("EPS") information**

No EPS information is presented as companies/entities within the Xinwei Group were not limited by shares and they did not have share capital, only registered capital.

j. **Staff retirement benefits plans**

The Group did not have any formal staff retirement plans in place during the track record period.

4. NET TANGIBLE ASSETS

The following is a summary of the combined net tangible assets of the Group as of 30th April, 1999 prepared on the basis set out in Section 1 above.

	<i>Notes</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Fixed assets	(a)		86,365
Construction in progress	(a)		25,387
Current assets:			
Inventories	(b)	55,373	
Accounts receivable and other receivables	(c)	98,251	
Prepayments, deposits and other current assets		19,040	
Due from a related company	(d)	819	
Cash and bank balances		<u>24,678</u>	
Total current assets		<u>198,161</u>	
Current liabilities:			
Short term bank loans	(e)	12,338	
Accounts payable		33,417	
Accruals and other payables		57,351	
Dividend payable		3,745	
Due to directors	(d)	843	
Due to related companies	(d)	1,938	
Taxation payable	(f)	<u>7,158</u>	
Total current liabilities		<u>116,790</u>	
Net current assets			<u>81,371</u>
Total assets less current liabilities			193,123
Non-current liabilities:			
Long term bank loans	(e)		45,216
Minority interests			<u>6,961</u>
Net tangible assets			<u><u>140,946</u></u>

Notes:

a. **Fixed assets and construction in progress**

Fixed assets comprised:

	Cost <i>HK\$'000</i>	Accumulated depreciation <i>HK\$'000</i>	Net book value <i>HK\$'000</i>
Leasehold land and buildings	67,625	12,781	54,844
Machinery and equipment	50,696	21,536	29,160
Office equipment and fixtures	1,678	1,144	534
Motor vehicles	<u>4,287</u>	<u>2,460</u>	<u>1,827</u>
	<u>124,286</u>	<u>37,921</u>	<u>86,365</u>
Construction in progress	<u>25,387</u>	<u>—</u>	<u>25,387</u>

All of the Group's leasehold land and buildings are located in the PRC and the land use rights of the land where the Group's buildings are situated are for a period of 30 years expiring in the year 2029.

b. **Inventories**

Inventories comprised:

	<i>HK\$'000</i>
Raw materials	19,283
Work-in-progress	10,946
Finished goods	27,671
Provision for obsolescence and net realizable value	<u>(2,527)</u>
	<u>55,373</u>

c. **Accounts receivable and other receivables**

Accounts receivable and other receivables comprised:

	<i>HK\$'000</i>
Accounts receivable	102,662
Other receivables	5,638
Provision for bad and doubtful debts	<u>(10,049)</u>
	<u>98,251</u>

d. Due from(to) directors and related companies

i) Amount due from(to) directors:

Name of directors	Outstanding balance at 1st January, 1999 HK\$'000	Outstanding balance at 30th April, 1999 HK\$'000	Maximum balance due from director during the four months ended 30th April, 1999 HK\$'000
Mr. Jiang Quan Long ("Mr. Jiang")	—	(843)	—
Ms. Qian Yuan Ying ("Mrs. Jiang")	63	—	63

The outstanding balances due from (to) directors were unsecured, non-interest bearing and without pre-determined repayment terms.

ii) Amount due from(to) related companies

Particulars of the amounts due from(to) related companies were as follows:

Name of related company	Outstanding balance at 1st January, 1999 HK\$'000	Outstanding balance at 30th April, 1999 HK\$'000	Maximum balance due from related company during the four months ended 30th April, 1999 HK\$'000
* Pan Jia Ba Marble Stone Factory (Note 1)	<u>819</u>	<u>819</u>	819
* Mei Zhi Refractory Factory (Note 1)	(852)	(1,236)	—
* Shanghai Xinwei Rare Earth Company Limited ("Shanghai Xinwei") (Note 2)	<u>270</u>	<u>(702)</u>	270
	<u>(582)</u>	<u>(1,938)</u>	

* Direct translation of the name of the companies in Chinese.

The amounts were unsecured, interest free and have been fully settled in cash subsequent to 30th April, 1999.

Notes:

- The close relatives of Mr. Jiang and Mrs. Jiang have beneficial interests in these companies. See Note (f) of Section 3.
- Shanghai Xinwei is 90% and 8.91% owned by Mr. Jiang and Mrs. Jiang, respectively.

e. **Bank loans**

Details of bank loans were as follows:

	<i>HK\$'000</i>
Short term revolving bank loans	<u>12,338</u>
Long term bank loans, analyzed by amounts repayable within a period:	
— not exceeding one year	—
— more than one year but not exceeding two years	—
— more than two years but not exceeding five years	<u>45,216</u>
	<u>45,216</u>

All the loans are unsecured and bear interest at commercial borrowing rates.

Refer to Section 6 for details of the Group's banking facilities.

f. **Taxation payable**

Taxation payable comprised:

	<i>HK\$'000</i>
PRC enterprise income tax payable	35
PRC value-added tax payable	<u>7,123</u>
	<u>7,158</u>

There were no material unprovided deferred taxation as of 30th April, 1999.

g. **Net tangible assets of the Company**

The Company was incorporated on 27th July, 1999. On the basis set out in Section 1 above, the net tangible assets of the Company as of 30th April, 1999 amounted to approximately HK\$141 million, representing investment in subsidiaries.

h. **Distributable reserves**

As part of the Reorganization in preparation for the listing of the shares of the Company on The Stock Exchange of Hong Kong Limited, mentioned in Section 7(a) below, the distributable reserves of the companies within the Xinwei Group were capitalized as share capital and capital reserves of the Company and the Group. In addition, the Company has not been incorporated on 30th April, 1999, accordingly, the Company had no reserves available for distribution as of 30th April, 1999.

5. COMMITMENTS

The Group had the following significant commitments which were not provided for in the summary of the combined net tangible assets of the Group as of 30th April, 1999 set out in Section 4 above:

a. Capital commitments

As of 30th April, 1999, the capital expenditure commitments of the Group for acquisition of fixed assets were as follows:

	<i>HK\$'000</i>
Authorized and contracted for	31,511
Authorized but not contracted for	<u>64,938</u>
	<u>96,449</u>

b. Operating lease commitments

Subsequent to 30th April, 1999, the Group entered into five non-cancellable operating lease agreements in relation to leasing of office premises in Hong Kong and the PRC as well as the land on which the Group's production and administrative facilities are located. These leases extend to year 2029 and the total commitment as at 30th April, 1999 was approximately HK\$18,241,000. The amount of commitment payable within the next twelve months is analyzed as follows:

	<i>HK\$'000</i>
Leases expiring within a period	
— not exceeding one year	—
— more than one year but not exceeding five years	442
— exceeding five years	<u>390</u>
	<u>832</u>

6. BANKING FACILITIES

As of 30th April, 1999, the Group had aggregate banking facilities of approximately HK\$58 million for short term revolving and long term loans. All the facilities were utilized as of that date. These facilities are unsecured and bear interest at commercial rates.

7. SUBSEQUENT EVENTS

The following transactions took place subsequent to 30th April, 1999:

- a. the Group completed the Reorganization in preparation for the listing of the shares of the Company on The Stock Exchange of Hong Kong Limited, details of the Reorganization are set out in the paragraph headed "Group reorganization" in Appendix VI to the Prospectus;
- b. the Group entered into five non-cancellable operating leases as mentioned in Section 5 note (b).

8. DIRECTORS' REMUNERATION

Save as disclosed in Section 3 note (g), no remuneration has been paid or is payable in respect of the Relevant Period by the Company or any of its subsidiaries to directors of the Company. Under the arrangements currently in force, it is estimated that an aggregate sum of approximately HK\$2,565,000 will be paid to directors as remuneration and benefits in kind by the Group in respect of the year ending 31st December, 1999, before discretionary bonuses and share options, if any, which are subject to the approval of the Board of Directors.

9. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements have been prepared by the Company or any of the companies now comprising the Group in respect of any period subsequent to 30th April, 1999. In addition, no dividend has been declared, made or paid by the Company or any of the companies now comprising the Group in respect of any period subsequent to 30th April, 1999.

Yours faithfully,
ARTHUR ANDERSEN & CO.
Hong Kong

The forecast of the combined profit after taxation and minority interests but before extraordinary items of the Group for the year ending 31st December, 1999 is set out in the section headed “Profit forecast, dividends and working capital” in this prospectus.

1. BASES AND ASSUMPTIONS

The Directors have prepared the forecast of the combined profit after taxation and minority interests but before extraordinary items of the Group for the year ending 31st December, 1999 based on the audited results of the Group for the four months ended 30th April, 1999, the unaudited combined results based on management accounts of the Group for the three months ended 31st July, 1999 and a forecast of the results for the remaining five months ending 31st December, 1999 (the “forecasted period”). The Directors are not aware of any extraordinary items which have arisen or are likely to arise during the year ending 31st December, 1999. The forecast has been prepared on the basis of the accounting policies consistent in all material respects with those normally adopted by the Group as summarized in the accountants’ report, the text of which is set out in Appendix I of this prospectus.

The Directors have adopted the following assumptions in the preparation of the profit forecast:

- (i) there will be no material changes in the existing political, legal, fiscal or economic conditions in Hong Kong, the People’s Republic of China (“PRC”), Japan, the United States of America or any other countries where the Group operates or to which the Group sells its products;
- (ii) there will be no material changes in legislation or regulations or rules, whether in the PRC, Hong Kong or any other countries, where any of the Group’s members or companies are incorporated or operate;
- (iii) there will be no circumstances beyond managements control that will adversely affect the operation; and
- (iv) there will be no material changes in the interest rates and exchange rates from those currently prevailing.

2. LETTERS

Set out below are texts of the letters received (i) by the Directors and the Sponsors from Arthur Andersen & Co., the auditors and reporting accountants of the Company, and (ii) by the Directors from the Sponsors, prepared for the purpose of incorporation in this prospectus, in connection with the profit forecast of the Group for the year ending 31st December, 1999.



Arthur Andersen & Co.
Certified Public Accountants

21st Floor, Edinburgh Tower
The Landmark
15 Queen's Road Central
Hong Kong

5th October, 1999

The Directors
Yixing Xinwei Holdings Limited
China Everbright Capital Limited
Vickers Ballas Capital Limited

Dear Sirs,

We have reviewed the accounting policies and calculations adopted in arriving at the forecast of the combined profit after taxation and minority interests but before extraordinary items of Yixing Xinwei Holdings Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") for the year ending 31st December, 1999 (the "Forecast"), for which the directors of the Company are solely responsible, as set out in the section headed "Profit forecast, dividends and working capital" in the prospectus of the Company dated 5th October, 1999 (the "Prospectus").

The Forecast has been prepared by the directors of the Company based on the audited combined results of the Group for the four months ended 30th April, 1999, the unaudited combined results based on management accounts of the Group for the three months ended 31st July, 1999 and a forecast of the combined results of the Group for the remaining five months ending 31st December, 1999 on the basis that the Group had been in existence throughout the entire financial year ending 31st December, 1999.

In our opinion, so far as the accounting policies and calculations are concerned, the Forecast has been properly compiled in accordance with the bases and assumptions made by the directors of the Company as set out in Appendix II to the Prospectus, and is presented on a basis consistent in all material respects with the accounting policies normally adopted by the Group as set out in our accountants' report dated 5th October, 1999, the text of which is set out in Appendix I to the Prospectus.

Yours faithfully,
Arthur Andersen & Co.
Hong Kong

China Everbright Capital Limited

40th Floor, Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong

Vickers Ballas Capital Limited

43rd Floor, Far East Finance Centre
16 Harcourt Road
Admiralty
Hong Kong

5th October, 1999

The Directors

Yixing Xinwei Holdings Limited
Room 1301, 13th Floor
Ruttonjee House
Ruttonjee Centre
11 Duddell Street
Central
Hong Kong

Dear Sirs,

We refer to the forecast of the combined profit after taxation and minority interests but before extraordinary items of Yixing Xinwei Holdings Limited (the “Company”) and its subsidiaries (hereinafter collectively referred to as the “Group”) for the year ending 31st December, 1999 (the “Forecast”) as set out in the prospectus of the Company dated 5th October, 1999.

We have discussed with you the bases and assumptions upon which the Forecast has been made. We have also considered the letter dated 5th October, 1999 addressed to yourselves and ourselves from Arthur Andersen & Co. regarding the accounting policies and calculations upon which the Forecast has been made.

On the basis of the foregoing, the bases and assumptions made by you and on the accounting policies and calculations reviewed by Arthur Andersen & Co., we have formed the opinion that the Forecast, for which you as directors of the Company are solely responsible, has been made after due and careful enquiry.

Yours faithfully,
For and on behalf of
China Everbright Capital Limited
Ying Yuming
Director

Yours faithfully,
For and on behalf of
Vickers Ballas Capital Limited
Alex Lau
Director

**Vigers Hong Kong Ltd.
International Property Consultants**

Suite 801-6
Miramar Tower
1 Kimberley Road
Tsimshatsui
Kowloon
Hong Kong



5th October, 1999

The Directors
Yixing Xinwei Holdings Limited
Room 1301 on 13th Floor
Ruttonjee House
Ruttonjee Centre
11 Duddell Street
Central, Hong Kong

Dear Sirs,

In accordance with your instructions for us to value the property interests of Yixing Xinwei Holdings Limited (the “Company”) and its subsidiary companies (together referred to as the “Group”) in Hong Kong and the People’s Republic of China (the “PRC”), we confirm that we have carried out inspections, made relevant enquiries and obtained such further information as we consider necessary for the purpose of providing you with our opinion of the open market value of such property interests as at 31st July, 1999.

Our valuation is our opinion of the open market value and here we would define open market value as intended to mean — “the best price at which the sale of an interest in a property might reasonably be expected to have been completed unconditionally for cash consideration on the date of valuation assuming:—

- (a) a willing seller;
- (b) that, prior to the date of valuation, there had been a reasonable period (having regard to the nature of the property and the state of the market) for the proper marketing of the interest, for the agreement of price and terms and for the completion of the sale;
- (c) that the state of the market, level of values and other circumstances were, on any earlier assumed date of exchange of contracts, the same as on the date of valuation; and
- (d) that no account is taken of any additional bid by a special purchaser with a special interest.”

The properties in Group I, II and III have no commercial value due to the short term nature of the property interests or the restrictions imposed upon the tenants under the tenancy agreements or lack of substantial profit rent or cannot be freely transferred in the open market.

Our valuation has been made on the assumption that the owner sells the property interests on the open market in its existing state without the benefit of a deferred terms contract, leaseback, joint venture, management agreement or any similar arrangement which would serve to increase the value of the property interests.

We have been provided with extracts from title documents relating to such property interests. We have not, however, searched the original documents to verify ownership or to verify the existence of any lease amendment which do not appear on the copies handed to us. All documents and leases have been used for reference only. All dimensions, measurements and areas are approximations.

In undertaking our valuation of property No. 1, we have relied on the legal opinion provided by the Group’s PRC legal adviser (“the PRC Legal Opinion”).

From the PRC Legal Opinion, we understand the current status of titles, grant of major approvals, licences and documents of property No. 1 are as follows:—

(a) State-owned Land Use Rights Certificate	Yes
(b) State-owned Land Use Rights Grant/Transfer Contract	N/A
(c) State-owned Land Use Rights Lease Contract	Yes
(d) Red Line Drawing	Yes
(e) Building Ownership Certificate	Yes
(f) Business Licence	Yes

Key: N/A means not applicable

We have inspected the exterior of the properties. However, we have not carried out a structural survey nor have we inspected woodwork or other parts of the structures which are covered, unexposed or inaccessible and we are therefore unable to report that any such parts of the property interests are free from defect.

We have not undertaken a survey to determine whether the mechanical and electrical systems within the subject properties (or the building or development in which it is located) will be adversely affected on or after the year 2000 by the Year 2000 issue and as such have assumed that the subject properties will be unaffected.

We have relied to a considerable extent on information provided by you and have accepted advice given to us by you on such matters as planning approvals or statutory notices, easements, tenure, occupation, lettings, site and floor areas and in the identification of those property interests in which the Group has a valid interest.

No allowance has been made in our valuation for any charges, mortgages or amounts owing on any property interests nor for any expenses or taxation which may be incurred in effecting a sale. Unless otherwise stated, it is assumed that the property interests are free from encumbrances, restrictions and outgoings of an onerous nature which could affect their value.

We have prepared our valuation in accordance with the Practice Note No. 12 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited on the valuation of property assets.

We enclose herewith our summary of valuation and our valuation certificate.

Yours faithfully,
For and on behalf of
VIGERS HONG KONG LTD.
Raymond Ho Kai Kwong
Registered Professional Surveyor
ARICS AHKIS ASVA
Director

Re: Raymond H.K. Ho, Chartered Surveyor, ARICS, AHKIS, ASVA has 12 years' experience in undertaking valuations of properties in Hong Kong and Macau and has over six year's experience in the valuation of properties in the PRC.

SUMMARY OF VALUATION

Property	Capital Value in Existing State as at 31st July, 1999
Group I — Property occupied by the Group in the PRC	
1. Factory complex in Yang An Village, Dapu Town, Yixing, Jiangsu Province, The PRC.	No commercial value
Group II — Property rented by the Group in the PRC	
2. Rooms G and H on 8th Floor, Zhao Feng Universe Building, No. 1800 Zhong Shan Xi Road, Xu Hui district, Shanghai, The PRC.	No commercial value
Group III — Property rented by the Group in Hong Kong	
3. Room 1301 on 13th Floor, Ruttonjee House, Ruttonjee Centre, 11 Duddell Street, Central, Hong Kong.	No commercial value
	<hr/>
Total:	<u><u>No commercial value</u></u>

VALUATION CERTIFICATE

Group I — Property occupied by the Group in PRC

Property	Description and Tenure	Particulars of Occupancy	Capital Value in Existing State as at 31st July, 1999
1. Factory complex in Yang An Village, Dapu Town, Yixing, Jiangsu Province, The PRC.	<p>The property comprises (i) 66 items of buildings and structures (already completed) erected on a site (comprising six lots) with an area of approximately 117,480.4 sq.m. and it was completed within the period from 1982 to 1996 and (ii) number of items of buildings and structures are now being erected on the subject site.</p> <p>The total gross floor area of the completed portion of the property is approximately 55,547.25 sq.m.</p>	The property is occupied by the Group as workshops and office.	No commercial value

Notes:

- Pursuant to a State-owned Land Use Rights Lease Contract No. (1999) 3 dated 12th August, 1999, the subject three lots of the subject property with a total site area of approximately 67,287 sq.m. was leased by Yi Xing City State-owned Land Administrative Bureau to Yixing Xinwei Leeshing Rare Earth Co., Ltd. for a term of 30 years at a rent of RMB336,435 per annum and the permitted usage is for industrial.
- Pursuant to a State-owned Land Use Rights Lease Contract No. (1999) 2 dated 12th August, 1999, the subject three lots of the subject property with a total site area of approximately 50,193 sq.m. was leased by Yi Xing City State-owned Land Administrative Bureau to Yixing Xinwei Leeshing Refractory Materials Co., Ltd. for a term of 30 years at a rent of RMB250,965 per annum and the permitted usage is for industrial.
- Pursuant to three Land Use Rights Certificates Nos. (1999) 000133-000135 issued by Yi Xing City State-owned Land Administrative Bureau on 1st September, 1999, the land use rights of the subject three lots of the property with a total site of approximately 67,287.8 sq.m. has been leased to the Yixing Xinwei Leeshing Rare Earth Co., Ltd. for a term of 30 years and the permitted usage is for industrial.
- Pursuant to three Land Use Rights Certificates Nos. (1999) 000136-000138 issued by Yi Xing City State-owned Land Administrative Bureau on 1st September, 1999, the land use rights of the subject three lots of the property with a total site area of approximately 50,192.6 sq.m. has been leased to Yixing Xinwei Leeshing Refractory Materials Co., Ltd. for a term of 30 years and the permitted usage is for industrial.
- Pursuant to the Building Ownership Certificate No. BE 200224-BE200262, the property is held by Yixing Xinwei Leeshing Rare Earth Co., Ltd..
- Pursuant to the Building Ownership Certificate No. BE 200263-BE200288, the property is held by Yixing Xinwei Leeshing Refractory Materials Co., Ltd..
- From the PRC Legal Opinion, we understand the current status of titles, grant of major approvals, licences and documents of property are as follows:—
 - State-owned Land Use Rights Certificate Yes
 - State-owned Land Use Rights Grant/Transfer Contract N/A
 - State-owned Land Use Rights Lease Contract Yes
 - Red Line Drawing Yes
 - Building Ownership Certificate Yes
 - Business Licence Yes

* N/A: Not Applicable

8. The opinion of the Group's legal adviser on PRC law states that:—
 - (i) As the subject site is let by Yi Xing City State-owned Land Administrative Bureau to Yixing Xinwei Leeshing Rare Earth Co., Ltd and Yixing Xinwei Leeshing Refractory Materials Co., Ltd., the subject site cannot be freely transferred or sub-leased without prior approval granted by Yi Xing City State-owned Land Administrative Bureau.
 - (ii) The buildings and structures of the property cannot be freely transferred and leased without prior approval granted by Yi Xing City State-owned Land Administrative Bureau.
9. As we understand that the property cannot be freely transferred or sub-leased, we have attributed no commercial value to the property.
10. Based on our calculation and analysis, the depreciated replacement cost of the building of the property was approximately RMB59,000,000 as at 31st July, 1999.
11. As advised by the Group, the amount incurred for construction in progress items as at 31st July, 1999 was RMB17,460,000.

Group II — Property rented by the Group in the PRC

	Property	Description and Tenure	Particulars of Occupancy	Capital Value in Existing State as at 31st July, 1999
2.	Rooms G and H on 8th Floor, Zhao Feng Universe Building, No. 1800 Zhong Shan Xi Road, Xu Hui district, Shanghai, The PRC.	<p>The property comprises two office units on level 8 of a 23-storey commercial building completed in or about 1998.</p> <p>The property has a gross floor area of approximately 193.58 sq.m..</p>	<p>The property is occupied by the Group as an office.</p> <p>The property is let to the Group for a term of three years from 1st September, 1999 to 30th August, 2002 at a monthly rent of RMB18,000.</p>	No commercial value

Group III — Property licenced/rented by the Group in Hong Kong

	Property	Description and Tenure	Particulars of Occupancy	Capital Value in Existing State as at 31st July, 1999
3.	Room 1301 on 13th Floor, Ruttonjee House, Ruttonjee Centre 11 Duddell Street, Central, Hong Kong.	<p>The property comprises an office unit on the 13th Floor of a 28-storey commercial building completed in or about 1986.</p> <p>The property has a saleable floor area of approximately 136.20 sq.m..</p>	<p>The property is occupied by the Group as an office. The property is licenced to the Group for a term commencing from 25th August, 1999 to 14th May, 2000 and is let to the Group for a term commencing from 15th May, 2000 to 14th January, 2002 at a monthly rent of HK\$39,384.00.</p>	No commercial value

Set out below is a summary of certain provisions of the memorandum and articles of association of the Company and of certain aspects of Cayman Islands company law.

1. MEMORANDUM OF ASSOCIATION

The memorandum of association provides that the company's objects are unrestricted. The objects of the Company are set out in Clause 3 of the memorandum of association which is available for inspection at the address and during the period specified in the paragraph headed "Documents available for inspection" in Appendix VII. As an exempted company, the Company will not trade in the Cayman Islands with any person, firm or corporation except in furtherance of the business of the Company carried on outside the Cayman Islands.

2. ARTICLES OF ASSOCIATION

The articles of association of the Company (the "Articles") were adopted on 29th September, 1999. The following is a summary of certain provisions of the Articles.

(a) Directors

(i) *Power to allot and issue shares*

Without prejudice to any special rights or restrictions for the time being attaching to any shares or any class of shares, any share may be issued upon such terms and conditions and with such preferred, deferred or other special rights, or such restrictions, whether as regards dividend, voting, return of capital or otherwise, as the Company may from time to time by ordinary resolution determine (or, in the absence of any such determination or so far as the same may not make specific provision, as the Directors may determine) and any preference shares may be issued on terms that they are liable to be redeemed upon the happening of a specified event or upon a given date and either at the option of the Company or at the option of the holder. The Directors may issue warrants to subscribe for any class of shares or securities of the Company on such terms as they may from time to time determine.

All unissued shares in the Company shall be at the disposal of the Directors, who may offer, allot, grant options over or otherwise dispose of them to such persons, at such times, for such consideration and generally on such terms they shall in their absolute discretion think fit, but so that no shares shall be issued at a discount.

(ii) *Power to dispose of the assets of the Company or any subsidiary*

There are no specific provisions in the Articles relating to the disposal of the assets of the Company or any of its subsidiaries although the Directors may exercise all powers and do all acts and things which may be exercised or done or approved by the Company and which are not required by the Articles or relevant statutes of the Cayman Islands to be exercised or done by the Company in general meeting.

(iii) *Compensation or payments for loss of office*

Payments to any Director or past Director of any sum by way of compensation for loss of office or as consideration for or in connection with his retirement from office (not being a payment to which the Director is contractually entitled) must be approved by the Company in general meeting.

(iv) *Loans and the giving of security for loans to Directors*

Where the shares of the Company remain listed on the Stock Exchange or on a stock exchange in such other territory as the Directors may from time to time decide, the Company may not make, without the approval of, or ratification by, the Company in general meeting, any loans to, or provide any guarantee, indemnity or security in respect of any loan to a Director or any of his associates, provided that the Articles do not prohibit the granting of any loan or the provision of any guarantee, indemnity or security (i) to be applied for, or in respect of a liability incurred, for any business of the Company, (ii) for the purchase by a Director (or the repayment of a loan for his purchase) of a residence where the amount of the loan, the liability under the guarantee or indemnity or the value of the security does not exceed 80% of the fair market value of such residence nor 5% of the consolidated net asset value of the Company as shown in its latest audited accounts; provided that any such loan is on normal commercial terms and is secured by a legal charge over the residence or (iii) of any amount to, or in respect of a liability of, a company in which the Company has an equity interest, and the amount of such loan, or the liability assumed by the Company under such guarantee, indemnity or security, does not exceed its proportional interest in such company.

(v) *Financial assistance to purchase shares of the Company or its holdings company*

There are no provisions in the Articles relating to the giving by the Company of financial assistance for the purchase, subscription or other acquisition of shares of the Company or of its holding company. The law on this area is summarised in paragraph 4(b) below.

(vi) *Disclosure of interests in contracts with the Company or any of its subsidiaries*

A Director may hold any other office or place of profit with the Company (except that of an auditor) in conjunction with his office of Director for such period and upon such terms as the Directors may determine, and may be paid such extra remuneration therefor (whether by way of salary, commission, participation in profits or otherwise) as the Directors may determine. A Director may be or become a director or other officer of, or be otherwise interested in, any company promoted by the Company or any other company in which the Company may be interested, and shall not be liable to account to the Company or the members for any remuneration, profit or other benefit received by him as a director or officer of or from his interest in such other company. The Directors may also cause the voting power conferred by the shares in any other company held or owned by the Company to be exercised in such manner in all respects as they think fit, including the exercise thereof in favour of any resolution appointing the Directors or any of them to be directors or officers of such other company, or voting or providing for the payment of remuneration to the directors or officers of such other company. A Director shall not vote or be counted in the quorum on any resolution of the Directors concerning his own appointment as the holder of any office or place of profit with the Company or any other company in which the Company is interested (including the arrangement or variation of the terms thereof, or the termination thereof).

Subject to the provisions of the Articles, no Director or proposed or intended Director shall be disqualified by his office from contracting with the Company, either with regard to his tenure of any office or place of profit or as vendor, purchaser or in any other manner whatsoever, nor will any contract with regard thereto or any other contract or arrangement in which any Director is in any way interested be liable to be avoided, nor shall any Director so contracting or being so interested be liable to account to the Company or the members for any remuneration, profit or other benefits realised by any such contract or arrangement by reason of such Director holding that office or the fiduciary relationship thereby established. A Director who to his knowledge is in any way, whether directly or indirectly, interested in a contract or arrangement or proposed contract or arrangement with the Company must declare the nature of his interest at the meeting of the Directors at which the question of entering into the contract or arrangement is first taken into consideration, if he knows his interest then exists, or in any other case at the first meeting of the Directors after he knows that he is or has become so interested.

Save as otherwise provided by the Articles, a Director may not vote (nor be counted in the quorum for the voting) on any resolution of the Directors in respect of any contract or arrangement in which he is to his knowledge materially interested, and if he does so his vote will not be counted, but this prohibition will not apply to any of the following matters, namely:

- (aa) any contract or arrangement for the giving to the Director of any security or indemnity in respect of money lent by him or obligations undertaken by him for the benefit of the Company;
- (bb) any contract or arrangement for the giving by the Company of any security to a third party in respect of a debt or obligation of the Company which the Director has himself guaranteed or secured in whole or in part;
- (cc) any contract or arrangement by a Director to subscribe for shares or debentures or other securities of the Company to be issued pursuant to any offer or invitation to the members or debenture or other securities holders or to the public which does not provide the Director any privilege not accorded to any other members or debenture or other securities holders or to the public;
- (dd) any contract or arrangement concerning an offer of the shares, debentures or other securities of or by the Company for subscription or purchase where the Director is or is to be interested as a participant in the underwriting or sub-underwriting of the offer and/or for the purposes of making any representations, the giving of any covenants, undertakings or warranties or assuming any other obligations in connection with such offer;
- (ee) any contract or arrangement in which the Director is interested by virtue only of his interest in shares or debentures or other securities of the Company;
- (ff) any contract or arrangement concerning any company in which he is interested directly or indirectly whether as a director and/or an employee and/or a member, other than a company in which the Director together with any of his associates owns five per cent. or more of the voting equity capital or voting rights of any class of shares of such company (or of any third company through which his interest is derived), excluding shares which carry no voting rights at general meetings and no or nugatory dividend and return of capital rights, and excluding shares held directly or indirectly through the Company;
- (gg) any proposal or arrangement for the benefit of employees of the Company or its subsidiaries including a pension fund or retirement, death or disability benefit scheme or personal pension plan under which a Director may benefit and which has been approved by or is subject to and conditional on approval by the relevant tax authorities for taxation purposes or relates both to Directors and employees of the Company or any of its subsidiaries and does not give the Director any privilege not accorded to the relevant class of officers of which the Director is a member and to whom such scheme or fund relates;
- (hh) any proposal concerning the adoption, modification or operation of any share scheme involving the issue or grant of options over shares or other securities by the Company to, or for the benefit of, the employees of the Company or its subsidiaries under which the Director may benefit; and
- (ii) any contract, agreement, transaction or proposal concerning the purchase and/or maintenance of any insurance policy for the benefit of any Director, officer or employee pursuant to the Articles.

(vii) *Remuneration*

The Directors shall be entitled to receive by way of ordinary remuneration for their services such sum as is from time to time determined by the Company in general meeting, such sum (unless otherwise directed by the resolution by which it is voted) to be divided amongst the Directors in such proportions and in such manner as they may agree, or failing agreement, equally, except that in such event any Director holding office for less than the whole of the relevant period in respect of which the remuneration is paid shall only rank in such division in proportion to the time during such period for which he has held office. The foregoing provisions shall not apply to a Director who holds any salaried employment or office in the Company except in the case of sums paid in respect of Directors' fees. The Directors shall also be entitled to be repaid all travelling, hotel and other expenses reasonably incurred by them respectively in or about the performance of their duties as Directors, including their expenses of travelling to and from Directors' meetings, committee meetings or general meetings, or otherwise incurred whilst engaged on the business of the Company or in the discharge of their duties as Directors.

The Directors may grant special remuneration to any Director who performs any special or extra services to or at the request of the Company. Such special remuneration may be made payable to such Director in addition to or in substitution for his ordinary remuneration as a Director, and may be made payable by way of salary, commission or participation in profits or otherwise as may be arranged. Notwithstanding the foregoing the remuneration of chairman, deputy chairman, managing director, joint managing director, deputy managing director or an executive Director or a Director appointed to any other office in the management of the Company may be fixed from time to time by the Directors and may be by way of salary, commission or participation in profits or otherwise or by all or any of those modes and with such other benefits (including pension and/or gratuity and/or other benefits on retirement) and allowances as the Directors may from time to time decide. Such remuneration is in addition to his ordinary remuneration as a Director.

The Directors also have power to establish and maintain or procure the establishment and maintenance of any contributory or non-contributory pension or superannuation funds for the benefit of, or to give or procure the giving of donations, gratuities, pensions, allowances or emoluments to, any persons who are or were at any time in the employment or service of the Company, or of any company which is a subsidiary of the Company, or is allied or associated with the Company or with any such subsidiary company, or who are or were at any time directors or officers of the Company or of any such other company as aforesaid, and holding or who have held any salaried employment or office in the Company or such other company, and the spouses, widows, widowers, families and dependants of any such persons and may make payments for or towards the insurance of any such persons. Any Director holding any such employment or office is entitled to participate in and retain for his own benefit any such donation, gratuity, pension, allowance or emolument.

(viii) *Retirement, appointment and removal*

At each annual general meeting one-third of the Directors for the time being (or if their number is not three or a multiple of three, then the number nearest but not exceeding one third) will retire from office save for any chairman, deputy chairman and managing director. The Directors to retire in every year will be those who have been longest in office since their last election but as between persons who became Directors on the same day those to retire shall (unless they otherwise agree between themselves) be determined by lot.

A Director is not required to retire upon reaching any particular age.

The Directors are entitled to attend and speak at all general meetings.

The number of Directors shall not be fewer than one. A Director may be removed by a special resolution of the Company before the expiration of his period of office (but without prejudice to any claim which such Director may have for damages for breach of any contract of service between him and the Company). The Company may from time to time in general meeting by ordinary resolution elect any person to be a Director either to fill a casual vacancy or as an additional Director. Any Director so appointed shall hold office only until the next following annual general meeting of the Company and shall then be eligible for re-election at the meeting.

The Directors may from time to time entrust to and confer upon the chairman, deputy chairman, managing director, joint managing director, deputy managing director or executive director of the Company all or any of the powers of the Directors that they may think fit, provided that the exercise of all powers by such Director shall be subject to such regulations and restrictions as the Directors may from time to time make and impose. The Directors may delegate any of their powers to committees consisting of such member or members of their body and such other persons as they think fit, and they may from time to time revoke such delegation or revoke the appointment of and discharge any such committees either wholly or in part, and either as to persons or purposes, but every committee so formed shall in the exercise of the powers so delegated conform to any regulations that may from time to time be imposed upon it by the Directors.

(ix) *Borrowing powers*

The Directors may from time to time at their discretion exercise all the powers of the Company to raise or borrow or to secure the payment of any sum or sums of money for the purposes of the Company and to mortgage or charge its undertaking, property and uncalled capital or any part thereof. The Directors may raise or secure the payment or repayment of such sum or sums in such manner and upon such terms and conditions in all respects as they think fit and in particular, but subject to the provisions of the Companies Law, by the issue of debentures, debenture stock, bonds or other securities of the Company, whether outright or as collateral security for any debt, liability or obligation of the Company or of any third party.

Note: The provisions summarised above, in common with the Articles in general, may be varied with the sanction of a special resolution of the Company.

(x) *Qualification shares*

Directors of the Company are not required under the Articles to hold any qualification shares.

(xi) *Indemnity to Directors*

The Articles contain provisions that provide indemnity to, among other persons, the Directors from and against all actions, costs, charges, losses, damages and expenses which they or any of them may incur or sustain by reason of any act done, concurred in or omitted in or about the execution of their duty or supposed duty in their respective offices or trusts, except such (if any) as they shall incur or sustain through their own fraud or dishonesty.

(b) Alterations to constitutive documents

The memorandum of association of the Company may be altered by the Company in general meeting. The Articles may also be altered by the Company in general meeting. As more fully described in paragraph 3 below, the Articles provide that, subject to certain exceptions, a special resolution is required to alter the memorandum of association, to approve any alteration to the Articles and to change the name of the Company.

(c) Alterations of capital

The Company may from time to time by ordinary resolution:

- (i) increase its share capital;
- (ii) consolidate or divide all or any of its share capital into shares of larger or smaller amount than its existing shares; on any consolidation of fully paid shares into shares of larger amount, the Board may settle any difficulty which may arise as it thinks expedient and in particular (but without prejudice to the generality of the foregoing) may, as between the holders of the shares to be consolidated, determine which particular shares are to be consolidated into a consolidated share, and if it shall happen that any person shall become entitled to fractions of a consolidated share or shares, such fractions may be sold by some person appointed by the Directors for that purpose and the person so appointed may transfer the shares so sold to the

purchaser thereof and the validity of such transfer shall not be questioned, and so that the net proceeds of such sale (after deduction of the expenses of such sale) may either be distributed among the persons who would otherwise be entitled to a fraction or fractions of a consolidated share or shares rateably in accordance with their rights and interests or may be paid to the Company for the Company's benefit;

- (iii) divide its shares into several classes and attach thereto respectively any preferential, deferred, qualified or special rights, privileges or conditions;
- (iv) cancel any shares which at the date of the passing of the resolution have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled;
- (v) sub-divide its shares or any of them into shares of smaller amount than is fixed by the memorandum of association, subject nevertheless to the Companies Law, and so that the resolution whereby any shares are sub-divided may determine that, as between the holders of the shares resulting from such sub-division, one or more of the shares may have any such preferred or other special rights over, or may have such deferred rights or be subject to any such restrictions as compared with the others as the Company has power to attach to unissued or new shares;
- (vi) change the currency of denomination of its share capital;
- (vii) make provision for the issue and allotment of shares which do not carry any voting rights; and
- (viii) reduce its share premium account in any manner authorised, and subject to any conditions prescribed by law.

The Company may by special resolution reduce its authorised or issued share capital, any capital redemption reserve fund or other undistributable reserve in any manner authorised and subject to any conditions prescribed by law.

(d) Variation of rights of existing shares or classes of shares

If at any time the capital is divided into different classes of shares, all or any of the special rights (unless otherwise provided for by the terms of issue of that class) attached to any class may, subject to the provisions of the Companies Law, be varied or abrogated either with the consent in writing of the holders of not less than three-fourths in nominal value of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the shares of that class. To every such separate general meeting the provisions of the Articles relating to general meetings will mutatis mutandis apply, save as to the provisions regarding the quorum of meetings, as to which see paragraph 2(s) below.

(e) Special resolutions - majority required

For so long as any part of the issued capital of the Company remains listed on the Stock Exchange, a special resolution of the Company must be passed by a majority of not less than three-fourths of the votes cast by such members as, being entitled so to do, vote in person or, in the case of such members as are corporations, by their respective duly authorised representatives, or by proxy, at a general meeting of which not less than 21 days' notice, specifying the intention to propose the resolution as a special resolution, has been duly given. However, at all times while any part of the issued capital of the Company is listed on the Stock Exchange, except in the case of an annual general meeting, if it is so agreed by a majority in number of the members having a right to attend and vote at such meeting, being a majority together holding not less than 95% in nominal value of the shares giving that right, (or, in the case of an annual general meeting, by all members) a resolution may be proposed and passed as a special resolution at a meeting of which less than 21 days' notice has been given.

f) Voting rights and right to demand a poll

Subject to any special rights, privileges or restrictions as to voting for the time being attached to any class or classes of shares, at any general meeting on a show of hands every member who is present in person (or, in the case of a member being a corporation, by its duly authorised representative) or by proxy shall have one vote and on a poll every member present in person (or, in the case of a member being a corporation, by its duly authorised representative) or by proxy shall have one vote for every share of which he is the holder which is fully paid or credited as fully paid (but so that no amount paid or credited as paid on a share in advance of calls or instalments is treated for the foregoing purposes as paid on the share). Notwithstanding anything contained in the Articles, where more than one proxy is appointed by a shareholder which is a clearing house (or its nominee), each such proxy shall have one vote on a show of hands. On a poll, a member entitled to more than one vote need not use all his votes or cast all his votes in the same way.

At any general meeting a resolution put to the vote of the meeting shall be decided on a show of hands unless a poll is (before or on the declaration of the result of the show of hands or on the withdrawal of any other demand for a poll) demanded by (i) the Chairman of the meeting; or (ii) by at least three members present in person or by proxy (or, in the case of a member being a corporation, by its duly authorised representative) for the time being entitled to vote at the meeting; or (iii) by any member or members present in person or by proxy (or, in the case of a member being a corporation, by its duly authorised representative) and representing not less than one-tenth of the total voting rights of all the members having the right to vote at the meeting; or (iv) by a member or members present in person or by proxy (or, in the case of a member being a corporation, by its duly authorised representative) and holding shares in the Company conferring a right to vote at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

Where a shareholder is a clearing house (as defined in the Articles) or a nominee of a clearing house, it may authorise such persons as it thinks fit to act as its representatives at any meeting of the Company or at any meeting of any class of shareholders provided that the authorisation shall specify the number and class of shares in respect of which each such representative is so authorised. Each person so authorised under the provisions of the Articles shall be entitled to exercise the same rights and powers as if such person was the registered holder of the shares of the Company held by the clearing house (or its nominee) in respect of the number and class of shares specified in the relevant authorisation.

(g) Requirements for annual general meetings

For so long as any part of the issued capital of the Company remains listed on the Stock Exchange, an annual general meeting must be held once in every year and within not more than 15 months after the last preceding annual general meeting or such longer period as is permissible or not prohibited under the rules of the Stock Exchange on which any securities of the Company are listed with the permission of the Company.

(h) Accounts and audit

The Directors shall cause true accounts to be kept of the sums of money received and expended by the Company, and the matters in respect of which such receipts and expenditure take place, and of the property, assets, credits and liabilities of the Company and of all other matters required by law or are necessary to give a true and fair view of the state of the Company's affairs and to show and explain its transactions.

The books of accounts are to be kept at the principal office of the Company or at such other place as the Directors think fit and shall always be open to the inspection of the Directors. No member (not being a Director) or other person has any right to inspect any account or book or document of the Company except as conferred by law or ordered by a court of competent jurisdiction or authorised by the Directors or by the Company in general meeting. The Directors shall from time to time cause to be prepared and laid before the Company at its annual general meeting such profit and loss accounts, balance sheets, group accounts (if any) and reports and so long as any shares in the Company are listed on the Stock Exchange, the accounts of the Company shall be prepared and audited based on the generally accepted accounting principles of Hong Kong or the International Accounting Standards or such other standards as the Stock Exchange may permit. Every balance sheet of the Company shall be signed on behalf of the Directors by two Directors and a copy of every balance sheet (including every document required by law to be comprised therein or attached or annexed thereto) and profit and loss account which is to be laid before the Company at its annual general meeting, together with a copy of the Directors' report and a copy of the auditors' report, shall not less than 21 days before the date of the meeting,

be sent to every member of, and every holder of debentures of, the Company and every other person entitled to receive notices of general meetings of the Company under the Companies Law or of the Articles. If all or any of the shares or debentures of the Company are for the time being (with the consent of the Company) listed or dealt in on any stock exchange, there shall be forwarded to such stock exchange such number of copies of such documents as may for the time being be required under its regulations or practice.

Auditors shall be appointed and their duties regulated in accordance with the Articles. Save as otherwise provided by such provisions the remuneration of the auditors shall be fixed by or on the authority of the Company at each annual general meeting, but in respect of any particular year, the Company in general meeting may delegate the fixing of such remuneration to the Directors.

(i) Notices of meetings and business to be conducted thereat

For so long as any part of the issued capital remains listed on the Stock Exchange, an annual general meeting and any extraordinary general meeting at which it is proposed to pass a special resolution must be called by giving at least 21 days' notice in writing and any other extraordinary general meeting shall be called by giving at least 14 days' notice in writing (in each case exclusive of the day on which the notice is served or deemed to be served and of the day for which it is given). The notice must specify the place, the day and the hour of meeting and, in the case of special business, the general nature of that business.

(j) Transfer of shares

All transfers of shares must be effected by transfer in writing in the usual or common form or in any other form acceptable to the Board and may be under hand only or, if the transferor or transferee is a clearing house or its nominee(s), by hand, by machine imprinted signature or by such other means of execution as the Directors may approve from time to time; and an instrument of transfer must be executed by or on behalf of the transferor and by or on behalf of the transferee and the transferor shall be deemed to remain the holder of the share until the name of the transferee is entered in the register of members in respect thereof, provided that the Directors may in their absolute discretion dispense with the requirement for the production of a transfer in writing before registering a transfer of a share, and may accept mechanically executed transfers in any case.

The Directors may, in their absolute discretion, at any time and from time to time transfer or agree to transfer any share upon the principal register to any branch register or any share on any branch register to the principal register or any other branch register.

Unless the Directors otherwise agree, no shares on the principal register shall be transferred to any branch register nor shall shares on any branch register be transferred to the principal register or any other register. All transfers and other documents of title must be lodged for registration and registered, in the case of shares on a branch register, at the relevant registration office and, in the case of shares on the principal register, at the transfer office for that register.

The Directors may in their absolute discretion and without assigning any reason therefor, refuse to register any transfer of any shares (not being fully paid shares) to a person of whom they do not approve and they may refuse to register the transfer of any shares (not being fully paid shares) on which the Company has a lien. The Directors may also refuse to register a transfer of shares (whether fully paid or not) in favour of more than four persons jointly or any share issued under any share option scheme for employees upon which a restriction on transfer imposed thereby shall subsist, or where the transfer is to an infant or a person of unsound mind or under other legal disability. If the Directors refuse to register a transfer, they must within two months after the date on which the transfer was lodged with the Company send to the transferor and transferee notice of the refusal and (if the shares concerned are fully paid shares) the reasons(s) for such refusal.

The Directors may, if applicable, decline to recognise an instrument of transfer unless the instrument of transfer is properly stamped, is in respect of only one class of share and is lodged at the relevant registration or transfer office accompanied by the relevant share certificate(s) and such other evidence as they may reasonably require to show the right of the transferor to make the transfer (and if the instrument of transfer is executed by some other person on his behalf, the authority of that person so to do).

The registration of transfers may, on giving notice by advertisement in one English and one Chinese newspaper circulating in Hong Kong, be suspended at such times and for such periods as the Directors may from time to time determine and either generally or in respect of any class of shares. The register of members shall not be closed for periods exceeding in the whole 30 days in any year.

(k) Power for the Company to purchase its own shares

The Articles provide that the power of the Company to purchase or otherwise acquire its shares is exercisable by the Directors upon such terms and conditions as they think fit subject to the conditions prescribed by the Companies Law.

(l) Power of any subsidiary to own securities in the Company

There are no provisions in the Articles relating to ownership of securities in the Company by a subsidiary.

(m) Dividends and other methods of distribution

The Company in general meeting may declare dividends in any currency but no dividend may exceed the amount recommended by the Directors. The Company may also make a distribution out of share premium account subject to the provisions of the Companies Law.

Unless and to the extent that the rights attached to any shares or the terms of issue thereof otherwise provide, all dividends will be apportioned and paid pro rata according to the amounts paid or credited as paid on the shares during any portion or portions of the period in respect of which the dividend is paid. No amount paid on a share in advance of calls will for this purpose be treated as paid on the shares. The Directors may retain any dividends or other moneys payable on or in respect of a share upon which the Company has a lien, and may apply the same in or towards satisfaction of the debts, liabilities or engagements in respect of which the lien exists. The Directors may deduct from any dividend or bonus payable to any member all sums of money (if any) presently payable by him to the Company on account of calls, instalments or otherwise.

Whenever the Directors or the Company in general meeting have resolved that a dividend be paid or declared on the share capital of the Company, the Directors may further resolve either (a) that such dividend be satisfied wholly or in part in the form of an allotment of shares credited as fully paid, provided that the members entitled thereto will be entitled to elect to receive such dividend (or part thereof) in cash in lieu of such allotment, or (b) that the members entitled to such dividend will be entitled to elect to receive an allotment of shares credited as fully paid in lieu of the whole or such part of the dividend as the Directors may think fit.

The Company may also upon the recommendation of the Directors by an ordinary resolution resolve in respect of any particular dividend of the Company that it may be satisfied wholly in the form of an allotment of shares credited as fully paid without offering any right to members to elect to receive such dividend in cash in lieu of such allotment.

Whenever the Directors or the Company in general meeting have resolved that a dividend be paid or declared the Directors may further resolve that such dividend be satisfied wholly or in part by the distribution of specific assets of any kind.

All dividends, bonuses or other distributions or the proceeds of the realisation of any of the foregoing unclaimed for one year after having been declared may be invested or otherwise made use of by the Directors for the benefit of the Company until claimed and the Company shall not be constituted a trustee in respect thereof. All dividends, bonuses or other distributions or proceeds as aforesaid unclaimed for six years after having been declared or remitted may be forfeited by the Directors and, upon such forfeiture, shall revert to the Company and, in the case where any of the same are securities in the Company, may be re-allotted or re-issued for such consideration as the Directors think fit.

(n) Proxies

Any member of the Company entitled to attend and vote at a meeting of the Company or a meeting of the holders of any class of shares in the Company is entitled to appoint another person as his proxy to attend and vote instead of him. A member who is the holder of two or more shares may appoint more than one proxy to represent him to vote on his behalf at a general meeting of the Company or at a class meeting. At any general meeting where voting is by a show of hands or by poll, votes may be given either personally (or, in the case of a member being a corporation, by its duly authorised representative) or by proxy. Proxies need not be members of the Company.

A proxy shall be entitled to exercise the same powers on behalf of a member who is an individual and for whom he acts as proxy as such member could exercise. In addition, a proxy shall be entitled to exercise the same powers on behalf of a member which is a corporation and for which he acts as proxy as such member could exercise as if it were an individual member.

(o) Corporate representatives

A corporate member of the Company entitled to attend and vote at a meeting of the Company is entitled to appoint any person or persons as its representative to attend and vote on its behalf. A corporate member represented by its representative is deemed to be present in person at the relevant meeting and its representative may vote on a show of hands and on a poll on any resolution put at such meeting.

(p) Calls on shares and forfeiture of shares

The Directors may from time to time make such calls as it may think fit upon the members in respect of any monies unpaid on the shares held by them respectively (whether on account of the nominal value of the shares or by way of premium) and not by the conditions of allotment thereof made payable at fixed times. A call may be made payable either in one sum or by instalments. If the sum payable in respect of any call or instalment is not paid on or before the day appointed for payment thereof, the person or persons from whom the sum is due shall pay interest on the same at such rate not exceeding 20% per annum as the Directors shall fix from the day appointed for the payment thereof to the time of actual payment, but the Directors may waive payment of such interest wholly or in part. The Directors may, if they think fit, receive from any member willing to advance the same, either in money or money's worth, all or any part of the money uncalled and unpaid or instalments payable upon any shares held by him, and in respect of all or any of the monies so advanced the Company may pay interest at such rate (if any) not exceeding 20% per annum as the Directors may decide.

If a member fails to pay any call or instalment of a call on the day appointed for payment thereof, the Directors may, at any time thereafter during such time as any part of the call or instalment remains unpaid, serve a notice on him requiring payment of so much of the call or instalment as is unpaid, together with any interest which may have accrued and which may still accrue up to the date of actual payment. The notice will name a further day (not earlier than the expiration of fourteen days from the date of the notice) on or before which the payment required by the notice is to be made, and it will also name the place where payment is to be made. The notice shall also state that, in the event of non-payment at or before the time appointed, the shares in respect of which the call was made will be liable to be forfeited.

If the requirements of any such notice are not complied with, any share in respect of which the notice has been given may at any time thereafter, before the payment required by the notice has been made, be forfeited by a resolution of the Directors to that effect. Such forfeiture will include all dividends and bonuses declared in respect of the forfeited share and not actually paid before the forfeiture.

A person whose shares have been forfeited shall cease to be a member in respect of the forfeited shares but shall, notwithstanding, remain liable to pay to the Company all moneys which, at the date of forfeiture, were payable by him to the Company in respect of the shares together with (if the Directors shall in their discretion so require) interest thereon from the date of forfeiture until payment at such rate not exceeding 20% per annum as the Board may prescribe.

(q) Inspection of register of members

For so long as any part of the share capital is listed on the Stock Exchange, any member may inspect the principal or branch register of the Company maintained in Hong Kong without charge and require the provision to him of copies or extracts thereof in all respect as if the Company were incorporated under and is subject to the Companies Ordinance (Cap. 32) of the laws of Hong Kong.

(r) Inspection of register of Directors

There are no provisions in the Articles relating to the inspection of the register of Directors and Officers of the Company, since the register is not open to inspection. (as to which see paragraph 4(k) below).

(s) Quorum for meetings and separate class meetings

For all purposes the quorum for a general meeting shall be two members present in person and entitled to vote (or, in the case of a member being a corporation, by its duly authorised representative) or by proxy and entitled to vote. In respect of a separate class meeting convened to sanction the modification of class rights, the necessary quorum shall not be less than two persons holding or representing by proxy one-third in nominal value of the issued shares of that class and, where such meeting is adjourned for want of quorum, the quorum for the adjourned meeting shall be any two members present in person and entitled to vote or by proxy (whatever the number of shares held by them).

(t) Rights of the minorities in relation to fraud or oppression

There are no provisions in the Articles relating to rights of minority members in relation to fraud or oppression. However, certain remedies are available to members of the Company under Cayman Islands company law as summarised in paragraph 4(e) below.

(u) Procedures on liquidation

A resolution for a court or voluntary winding up of the Company must be passed by way of a special resolution.

If the Company shall be wound up, the surplus assets remaining after payment to all creditors are to be divided among the members in proportion to the capital paid up on the shares held by them respectively, and if such surplus assets shall be insufficient to repay the whole of the paid up capital, they are to be distributed so that, as nearly as may be, the losses shall be borne by the members in proportion to the capital paid up on the shares held by them respectively, all subject to the rights of any shares issued on special terms and conditions.

If the Company shall be wound up (whether the liquidation is voluntary or by the court), the liquidator may, with the sanction of a special resolution, divide among the members in specie or kind the whole or any part of the assets of the Company and whether the assets consist of property of one kind or properties of different kinds and the liquidator may, for such purposes, set such value as he deems fair upon any one or more class or classes of property to be divided as aforesaid and may determine how such division is to be carried out as between the members or different classes of members and the members within each class. The liquidator may, with the like sanction, vest any one or more class or classes of property and may determine how such division shall be carried out as between the members or different classes of members. The liquidator may, with the like sanction, vest any part of the assets in trustees upon such trusts for the benefit of members as the liquidator, with the like sanction, shall think fit, but so that no member shall be compelled to accept any shares or other assets upon which there is a liability.

(v) Untraceable members

The Company may sell the shares of any member if: (i) dividends or other distributions have been declared by the Company on at least three occasions during a period of 12 years and these dividends or distributions have been unclaimed on such shares; (ii) the Company has published an advertisement of its intention to sell such shares in English and in

Chinese in one leading English and (unless unavailable) one leading Chinese newspaper circulating in the territory of the stock exchange on which the ordinary share capital of the Company is listed and a period of three months has elapsed since the date of the first publication of such notice; (iii) the Company has not at any time during the said periods of 12 years and three months received any indication of the existence of the member who is the holder of such shares or of a person entitled to such shares by death, bankruptcy or operations of law; and (iv) the Company has notified the stock exchange on which the ordinary share capital of the Company is listed of its intention to sell such shares. The net proceeds of any such sale will belong to the Company and upon the receipt of such net proceeds by the Company, the Company will become indebted to the former holder of such shares for an amount equal to the amount of such net proceeds.

(w) Stock

The Company may by ordinary resolution convert any fully paid shares into stock, and may from time to time by like resolution reconvert any stock into fully paid shares of any denominations. The holders of stock may transfer the same or any part thereof in the same manner, and subject to the same regulations as and subject to which the shares from which the stock arose might prior to conversion have been transferred or as near thereto as circumstances admit, but the Directors may from time to time, if they think fit, fix the minimum amount of stock transferable and restrict or prohibit the transfer of fractions of that minimum, but so that such minimum shall not exceed the nominal amount of the shares from which the stock arose. No warrants to bearer shall be issued in respect of any stock. The holders of stock shall, according to the amount of the stock held by them, have the same rights, privileges and advantages as regards dividends, participation in assets on a winding-up, voting at meetings, and other matters, as if they held the shares from which the stock arose, but no such privilege of the Company shall be conferred by an amount of stock which would not, if existing in shares, have conferred such privilege or advantage. All such of the provisions of the Articles as are applicable to paid up shares shall apply to stock, and the words “share” and “shareholder” therein shall include “stock” and “stockholder”.

(x) Other provisions

The Articles provide that, to the extent that it is not prohibited by and is in compliance with Cayman Islands law, if any rights attaching to any warrants which the Company may issue after the date of this prospectus shall remain exercisable and the Company does any act which would result in the subscription price under such warrants being reduced below the par value of a Share, a subscription right reserve shall be established and applied in paying up the shortfall between the subscription price and the par value of a Share on any exercise of the warrants.

3. VARIATION OF MEMORANDUM AND ARTICLES OF ASSOCIATION

Subject to the rights of the Company set out in paragraph 2(c) above to amend its capital by ordinary resolution, the memorandum of association of the Company may only be altered by special resolution of the Company. The Articles may also be amended by special resolution of the Company. The Articles state that a special resolution shall be required to alter the provisions of the memorandum of association (subject as provided above) or the Articles or to change the name of the Company. For these purposes, a resolution is a special resolution if it has been passed by a majority of not less than three-fourths of the votes cast by such members of the Company as, being entitled to do so, vote in person or, in the case of such members as are corporations, by their respective duly authorised representatives or, where proxies are allowed, by proxy at a general meeting of which not less than 21 clear days’ notice specifying the intention to propose the resolution as a special resolution has been duly given. Except in the case of an annual general meeting, the requirement of 21 clear days’ notice may be waived by a majority in number of the members having the right to attend and vote at the relevant meeting, being a majority together holding not less than 95% in nominal value of the shares giving that right.

4. CAYMAN ISLANDS COMPANY LAW

The Company is incorporated in the Cayman Islands and, therefore, operates subject to Cayman Islands law. Set out below is a summary of certain provisions of the Cayman Islands company law, although this does not purport to contain all applicable qualifications and exceptions or to be a complete review of all matters of Cayman Islands company law and taxation, which may differ from equivalent provisions in jurisdictions with which interested parties may be more familiar.

(a) Share capital

The Companies Law provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account, to be called the “share premium account”. The share premium account may be applied by a company subject to the provisions of its memorandum and articles of association in such manner as the company may from time to time determine including, but without limitation:

- (i) in paying distributions or dividends to members;
- (ii) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;
- (iii) in redeeming or purchasing its shares as provided in the Companies Law;
- (iv) in writing off
 - (aa) the preliminary expenses of the company; or
 - (bb) the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or
- (v) in providing for the premium payable on redemption of any shares or of any debentures of the company.

No dividend or distribution may be paid to members out of the share premium account unless immediately following the date of the proposed payment, the company is able to pay its debts as they fall due in the ordinary course of business.

A company may issue preference shares and redeemable preference shares.

The Companies Law does not contain any express provisions dealing with the variation of rights of holders of different classes of shares.

(b) Financial assistance to purchase shares of a company or its holding company

There is no statutory restriction in the Cayman Islands against the provision of financial assistance for the purchase, subscription or other acquisition of its shares, though on English common law principles, the directors have a duty to act in good faith for a proper purpose in the best interests of the company, and moreover, there are restrictions on any act which amounts to a reduction of capital. Accordingly, it may, depending on the circumstances, be legitimate for the directors to authorise the provision by a company of financial assistance for the purchase, subscription or other acquisition of its own shares, or the shares of its holding company.

(c) Redemption and Purchase of shares and warrants by a company and its subsidiaries

A company may, if authorised by its articles of association issue redeemable shares and purchase its own shares, including any redeemable shares. Purchases and redemptions may only be effected out of the profits of the company or out of the proceeds of a fresh issue of shares made for the purpose, or, if so authorised by its articles of association and subject to the provisions of the Companies Law, out of capital. Any premium payable on a redemption or purchase over the par value of the shares to be purchased must be provided for out of profits of the company or out of the company's share premium account, or, if so authorised by its articles of association and subject to the provisions of the Companies Law, out of capital. Any purchase by a company of its own shares may be authorised by its directors or otherwise by or in accordance with the provisions of its articles. A payment out of capital for a redemption or purchase of a company's own shares is not lawful unless immediately following the date of the proposed payment the company is able to pay its debts as they fall due in the ordinary course of business. The shares so purchased or redeemed will be treated as cancelled and the company's issued, but not its authorised, capital will be diminished accordingly.

A company is not prohibited from purchasing and may purchase its own subscription warrants subject to and in accordance with the terms and conditions of the relevant warrant instrument or certificate. There is no requirement under Cayman Islands law that a company's memorandum or articles of association contain a specific provision enabling such purchases.

Under Cayman Islands law, a subsidiary may hold shares in its holding company and in certain circumstances, may acquire such shares. A company, whether a subsidiary or a holding company, may purchase its own shares if it is authorised to do so in its articles of association.

(d) Dividends and distributions

A company may not pay a dividend, or make a distribution out of share premium account unless immediately following the date on which the payment is proposed to be made, the company is able to pay its debts as they fall due in the ordinary course of business.

(e) Protection of minorities

The Cayman Islands courts ordinarily would be expected to follow English case law precedents which permit a minority shareholder to commence a class action against or derivative actions in the name of a company to challenge (a) an act which is ultra vires the company or illegal (b) an act which constitutes a fraud against the minority and the wrong doers are themselves in control of the company, and (c) an irregularity in the passing of a resolution which requires a qualified (or special) majority.

In the case of company (not being a bank) having a share capital divided into shares, the court may, on the application of members holding not less than one-fifth of the shares of the company in issue, appoint an inspector to examine into the affairs of the company and to report thereon in such manner as the court shall direct.

Any shareholder of a company may petition the court which may make a winding up order if the court is of the opinion that is just and equitable that the company shall be wound up.

Generally, claims against a company by its shareholders must be based on the general laws of contract or tort applicable in the Cayman Islands or their individual rights as shareholders as established by the memorandum and articles of association of the company.

(f) Management

The Companies Law contains no specific restrictions on the power of directors to dispose of assets of a company although it specifically requires that every officer of a company, which includes a director, managing director and secretary is required, in exercising his powers and discharging his duties must do so honestly and in good faith with a view to the best interests of the company and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

(g) Accounting and auditing requirements

The Companies Law requires a company to cause proper records of accounts to be kept with respect to (i) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place; (ii) all sales and purchases of goods by the company and (iii) the assets and liabilities of the company. A company is required to keep such books of account as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.

(h) Exchange control

There are no exchange control regulations or currency restrictions in the Cayman Islands.

(i) Taxation

There are no income, corporation, capital gains or other taxes in effect in the Cayman Islands on the basis of the present legislation. As an exempted company, the Company has received from the Governor-in-Counsel of the Cayman Islands pursuant to the Tax Concessions Law (1995 Revision) of the Cayman Islands, an undertaking that in the event of any change to the foregoing, the Company, for a period of twenty years from the date of the grant of the undertaking, will not be chargeable to tax in the Cayman Islands on its income or its capital gains arising in the Cayman Islands or elsewhere and that dividends of the Company will be payable without deductions of Cayman Islands tax. No capital or stamp duties are levied in the Cayman Islands on the issue, transfer or redemption of Shares.

(j) Stamp duty

Certain documents (which do not include contract, notes for the sale and purchase of, or instruments of transfer of, shares in Cayman Islands companies) are subject to stamp duty which is generally calculated on an ad valorem basis.

(k) Inspection of corporate records

Neither the members of a company nor the general public have the right to inspect the register of directors and officers, the minutes, accounts or, in the case of an exempted company, the register of members. The register of mortgages and charges must be kept at the registered office of the company and must be open to inspection by any creditor or member at all reasonable times.

Members of the public have no right to inspect the constitutive documents of a company but the memorandum and articles of association must be forwarded to any member of the company upon request. If no articles of association have been registered with the Registrar of Companies, each member has the right to receive copies of special resolutions of members upon request upon payment of a nominal fee.

The location of the registered office of a company is available to the general public upon request to the Registrar of Companies.

(l) Winding up

A company may be wound up by the Cayman Islands court on application presented by the company itself, its creditors or its contributors. The Cayman Islands court also has authority to order winding up in a number of specified circumstances including where it is, in the opinion of the Cayman Islands court, just and equitable that such company be wound up.

A company may be wound up voluntarily when the members so resolve in general meeting, or, in the case of a limited duration company, when the period fixed for the duration of the company by its memorandum of association expires, or the event occurs on the occurrence of which the memorandum of association provides that the company is to be dissolved. In the case of a voluntary winding up, such company is obliged to cease to carry on its business from the time of passing the resolution for voluntary winding up or upon the expiry of the period or the occurrence of the event referred to above. Upon the appointment of a liquidator, the responsibility for the company's affairs rests entirely in his hands and no future executive action may be carried out without his approval.

Where a resolution has been passed for the voluntary winding up of a company, the court may make an order that the winding up should continue subject to the supervision of the court with such liberty to creditors, contributors or others to apply to the court as the court may think fit.

In the case of a members' voluntary winding up of a company, the company in general meeting must appoint one or more liquidators for the purposes of winding up the affairs of the company and distributing its assets. If the liquidator at any time forms the opinion that such company will not be able to pay its debts in full, he is obliged to summon a meeting of creditors.

As soon as the affairs of the company are fully wound up, the liquidator must make up an account of the winding up, showing how the winding up has been conducted and the property of the company has been disposed of, and thereupon call a general meeting of the company for the purposes of laying before it the account and giving an explanation thereof. This final general meeting requires at least one month's notice called by Public Notice in the Cayman Islands or otherwise as the Registrar of Companies may direct.

5. GENERAL

Conyers Dill & Pearman, Cayman, the Company's legal advisers on Cayman Islands law, have sent to the Company a letter of advice summarising certain aspects of Cayman Islands company law. This letter, together with a copy of the Companies Law, is available for inspection as referred to in the paragraph headed "Documents available for inspection" in Appendix VII. Any person wishing to have a detailed summary of Cayman Islands company law or advice on the differences between it and the laws of any jurisdiction with which he is more familiar is recommended to seek independent legal advice.

APPENDIX V SUMMARY OF THE RELEVANT PRC LAWS AND REGULATIONS

This Appendix sets out summaries of certain aspects of the PRC legal and judicial system, its arbitration system and its laws and regulations on manufacture and production of rare earth products joint ventures, foreign exchange control and taxation.

1. PRC legal system

The PRC legal system is based on the PRC Constitution and is made up of written laws, regulations and directives. Decided court cases do not constitute binding precedents.

The National People's Congress of the PRC ("NPC") and the Standing Committee of the NPC are empowered by the PRC Constitution to exercise the legislative power of the state. The NPC has the power to amend the PRC Constitution and to enact and amend primary laws governing the state organs, civil and criminal matters. The Standing Committee of the NPC is empowered to interpret, enact and amend laws other than those required to be enacted by the NPC.

The State Council of the PRC is the highest organ of state administration and has the power to enact administrative rules and regulations. Ministries and commissions under the State Council of the PRC are also vested with the power to issue orders, directives and regulations within the jurisdiction of their respective departments. Administrative rules, regulations, directives and orders promulgated by the State Council and its ministries and commissions must not be in conflict with the PRC Constitution or the national laws and, in the event that any conflict arises, the Standing Committee of the NPC has the power to annul such administrative rules, regulations, directives and orders.

At the regional level, the people's congresses of provinces and municipalities and their standing committees may enact local rules and regulations and the people's government may promulgate administrative rules and directives applicable to their own administrative area. These local laws and regulations may not be in conflict with the PRC Constitution, any national laws or any administrative rules and regulations promulgated by the State Council.

Rules, regulations or directives may be enacted or issued at the provincial or municipal level or by the State Council of the PRC or its ministries and commissions in the first instance for experimental purposes. After sufficient experience has been gained, the State Council may submit legislative proposals to be considered by the NPC or the Standing Committee of the NPC for enactment at the national level.

The power to interpret laws is vested by the PRC Constitution in the Standing Committee of the NPC. According to the Decision of the Standing Committee of the NPC Regarding the Strengthening of Interpretation of Laws () passed on 10th June, 1981, the Supreme People's Court has the power to give general interpretation on application of laws in judicial proceedings apart from its power to issue specific interpretation in specific cases. The State Council and its ministries and commissions are also vested with the power to give interpretation of the rules and regulations which they promulgated. At the regional level, the power to give interpretation of regional laws is vested in the regional legislative and administration organs which promulgate such laws. All such interpretations carry legal effect.

2. Judicial system

The People's Courts are the judicial organs of the PRC. Under the PRC Constitution and the Law of Organisation of the People's Courts of the People's Republic of China (), the People's Courts comprise the Supreme People's Courts, the local people's courts, military courts

APPENDIX V SUMMARY OF THE RELEVANT PRC LAWS AND REGULATIONS

and other special people's courts. The local people's courts are divided into three levels, namely, the basic people's courts, intermediate people's courts and higher people's courts. The basic people's courts are divided into civil, criminal and economic divisions. The intermediate people's courts have divisions similar to those of the basic people's courts and, where the circumstances so warrant, may have other special divisions (such as intellectual property divisions). The judicial functions of people's courts at lower levels are subject to supervision of people's courts at higher levels. The people's procuratorates also have the right to exercise legal supervision over the civil proceedings of people's courts of the same and lower levels. The Supreme People's Court is the highest judicial organ of the PRC. It supervises the administration of justice by the people's courts of all levels.

The people's courts adopt a two-tier final appeal system. A party may before the taking effect of a judgment or order appeal against the judgment or order of the first instance of a local people's court to the people's court at the next higher level. Judgments or orders of the second instance of the same level and at the next higher level are final and binding. Judgments or orders of the first instance of the Supreme People's Court are also final and binding. If, however, the Supreme People's Court or a people's court at a higher level finds an error in a final and binding judgment which has taken effect in any people's court at a lower level, or the presiding judge of a people's court finds an error in a final and binding judgment which has taken effect in the court over which he presides, a retrial of the case may be conducted according to the judicial supervision procedures.

The PRC civil procedures are governed by the Civil Procedure Law of the People's Republic of China (中华人民共和国民事诉讼法) (the "Civil Procedure Law") adopted on 9th April, 1991. The Civil Procedure Law contains regulations on the institution of a civil action, the jurisdiction of the people's courts, the procedures in conducting a civil action, trial procedures and procedures for the enforcement of a civil judgment or order. All parties to a civil action conducted within the territory of the PRC must comply with the Civil Procedure Law. A civil case is generally heard by a court located in the defendant's place of domicile. The jurisdiction may also be selected by express agreement by the parties to a contract provided that the jurisdiction of the people's court selected has some actual connection with the dispute, that is to say, the plaintiff or the defendant is located or domiciled, or the contract was executed or implemented in the jurisdiction selected, or the subject-matter of the proceedings is located in the jurisdiction selected. A foreign national or foreign enterprise is accorded the same litigation rights and obligations as a citizen or legal person of the PRC. If any party to a civil action refuses to comply with a judgment or order made by a people's court or an award made by an arbitration body in the PRC, the aggrieved party may apply to the people's court to enforce the judgment, order or award. There are time limits on the right to apply for such enforcement. Where at least one of the parties to the dispute is an individual, the time limit is one year. If both parties to the dispute are legal persons or other entities, the time limit is six months.

A party seeking to enforce a judgment or order of a people's court against a party who or whose property is not within the PRC may apply to a foreign court with jurisdiction over the case for recognition and enforcement of such judgment or order. A foreign judgment or ruling may also be recognised and enforced according to PRC enforcement procedures by the people's courts in accordance with the principle of reciprocity or if there exists an international or bilateral treaty with or acceded to by the foreign country that provides for such recognition and enforcement, unless the people's court considers that the recognition or enforcement of the judgment or ruling will violate fundamental legal principles of the PRC or its sovereignty, security or social or public interest.

APPENDIX V SUMMARY OF THE RELEVANT PRC LAWS AND REGULATIONS

3. Arbitration and enforcement of arbitral awards

The Arbitration Law of the PRC () (the “Arbitration Law”) was promulgated by the Standing Committee of the NPC on 31st August, 1994 and came into effect on 1st September, 1995. It is applicable to, among other matters, trade disputes involving foreign parties where the parties have entered into a written agreement to refer the matter to arbitration before an arbitration committee constituted in accordance with the Arbitration Law. Under the Arbitration Law, an arbitration committee may, before the promulgation by the PRC Arbitration Association of arbitration regulations, formulate interim arbitration rules in accordance with the Arbitration Law and the PRC Civil Procedure Law. Where the parties have by an agreement provided arbitration as a method for dispute resolution, the parties are not permitted to institute legal proceedings in a people’s court.

Under the Arbitration Law, an arbitral award is final and binding on the parties and if a party fails to comply with an award, the other party to the award may apply to the people’s court for enforcement. A people’s court may refuse to enforce an arbitral award made by an arbitration committee if there were mistakes, an absence of material evidence or irregularities over the arbitration proceedings, or the jurisdiction or constitution of the arbitration committee.

A party seeking to enforce an arbitral award of a foreign affairs arbitration body of the PRC against a party who or whose property is not within the PRC may apply to a foreign court with jurisdiction over the case for enforcement. Similarly, an arbitral award made by a foreign arbitration body may be recognised and enforced by the PRC courts in accordance with the principles of reciprocity or any international treaty concluded or acceded to by the PRC.

In respect of contractual and non-contractual commercial-law-related disputes which are recognised as such for the purposes of PRC law, the PRC has acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Award (“New York Convention”) adopted on 10th June, 1958 pursuant to a resolution of the Standing Committee of the NPC passed on 2nd December, 1986. The New York Convention provides that all arbitral awards made by a state which is a party to the New York Convention shall be recognised and enforced by other parties to the New York Convention subject to their right to refuse enforcement under certain circumstances including where the enforcement of the arbitral award is against the public policy of the state to which the application for enforcement is made. It was declared by the Standing Committee of the NPC at the time of the accession of the PRC that (1) the PRC would only recognise and enforce foreign arbitral awards on the principle of reciprocity and (2) the PRC would only apply the New York Convention in disputes considered under PRC laws to be arising from contractual and non-contractual mercantile legal relations.

4. Foreign exchange control

Major reforms have been introduced on the foreign exchange control system of the PRC since 1993.

The People’s Bank of China, with the authorisation of the State Council, issued on 28th December, 1993 the Notice on the Further Reform of the Foreign Exchange Control System () and on 24th April, 1994 the Provisional Regulations on the Settlement, Sale and Payment of Foreign Exchange () which came into effect on 1st January, 1994 and 1st April, 1994 respectively. On 29th January, 1996, the State Council promulgated the PRC Foreign Exchange Administration Regulations () which took effect on 1st April, 1996. On 20th June, 1996, the PBOC issued the Administration Regulations on the Sale, Purchase and Payment of Foreign Exchange

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(), which took effect on 1st July, 1996. On 25th October, 1998, the People's Bank of China and the State Administration for Foreign Exchange issued a Joint Announcement on Abolishment of Foreign Exchange Swap Business which stated that from 1st December, 1998, all foreign exchange transactions for FIEs may only be conducted through authorised banks.

These regulations contain detailed provisions regulating the holding, sale and purchase of foreign exchange by individuals, enterprises, economic bodies and social organisations in the PRC.

Under the new regulations, the previous dual exchange rate system for Renminbi was abolished and a unified floating exchange rate system based largely on supply and demand was introduced. The People's Bank of China, having regard to the trading prices between Renminbi and major foreign currencies on the inter-bank foreign exchange market, publishes on each bank business day the Renminbi exchange rates against major foreign currencies. In general, all organisations and individuals within the PRC, including foreign investment enterprises, are required to remit their foreign exchange earnings to the PRC. In relation to PRC enterprises, their recurrent foreign exchange earnings are generally required to be sold to designated banks unless specifically approved otherwise. Foreign investment enterprises (including sino-foreign equity joint ventures and sino-foreign co-operative enterprises), on the other hand, are permitted to retain certain percentage of their recurrent foreign exchange earnings and the sums retained may be deposited into foreign exchange bank accounts maintained with designated banks. Capital foreign exchange earnings must be deposited into foreign exchange bank accounts maintained with designated banks and can generally be retained in such accounts.

At present, control on the purchase of foreign exchange is being relaxed. Enterprises which require foreign exchange for their current activities such as trading activities and payment of staff remuneration may purchase foreign exchange from designated banks, subject to the production of relevant supporting documents without the need for any prior approvals of the State Administration of Exchange Control.

In addition, where an enterprise requires any foreign exchange for the payment of dividends that are payable in foreign currencies under applicable regulations, such as the distribution of profits by a foreign investment enterprise to its foreign investment party, then, subject to the due payment of tax on such dividends the amount required may be withdrawn from funds in foreign exchange accounts maintained with designated banks, and where the amount of the funds in foreign exchange is insufficient, the enterprise may purchase additional foreign exchange from designated banks upon the presentation of the resolutions of the directors on the profit distribution plan of that enterprise. Despite the relaxation of foreign exchange control over current account transaction, the approval of the foreign exchange administration authority is still required before a PRC enterprise may borrow a loan in foreign currency or provide any foreign exchange guarantee or make any investment outside of the PRC or to enter into any other capital account transaction involving the purchase of foreign exchange.

When conducting actual foreign exchange transactions, the designated banks may, based on the exchange rate published by the People's Bank of China and subject to certain limits, freely determine the applicable exchange rate.

The China Foreign Exchange Trading Centre ("CFETC") was formally established and came into operation on 1st January, 1994. CFETC has set up a computerised network with sub-centres in several major cities, thereby forming an interbank market in which designated PRC banks can trade in foreign exchange and settle their foreign currency obligations. Prior to 1st December, 1998, enterprises with

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foreign investment may at their own choice enter into exchange transactions through Swap Centre or through designated PRC banks. From 1st December, 1998 onwards, exchange transactions will have to be conducted through designated banks. Swap Centres became restricted to conducting foreign exchange transactions between authorised banks and inter-bank lending between PRC banks.

5. Taxation

(a) *Income tax on joint ventures*

Under the Income Tax Law of the PRC on Foreign Investment Enterprises and Foreign Enterprises () (the “Foreign Enterprises Tax Law”) adopted by the NPC on 4th April, 1991 and the Implementing Rules of the Foreign Enterprises Tax Law () promulgated by the State Council, which came into effect on 1st July, 1994, foreign investment enterprises (including sino-foreign equity joint ventures, sino-foreign co-operative joint ventures and wholly foreign owned enterprises established in the territory of the PRC) is required to pay a national income tax at a rate of 30% of their taxable income and a local income tax at a rate of three per cent. of their taxable income.

A joint venture engaged in production having a period of operation of not less than ten years shall be exempted from income tax for the first two profit-making years and a 50% reduction in the income tax payable for the next three years. The income tax concession for foreign investment enterprises engaged in the exploitation of resources such as petroleum, natural gas, rare metals and precious metals are regulated separately by the State Council.

Foreign investment enterprises established in special economic zones, foreign enterprises having an establishment in special economic zones engaged in production or business operations and foreign investment enterprises engaged in production in economic and technological zones may pay income tax at a reduced rate of 15%. Foreign investment enterprises engaged in production established in coastal economic open zones or in the old urban districts of cities where the special economic zones or the economic and technological development zones are located may pay income taxes at a reduced rate of 24%. A reduced income tax rate of 15 per cent. may apply to an enterprise located in such regions which is engaged in energy, communication, harbour, wharf or other projects encouraged by the State.

Losses incurred in a tax year may be carried forward for not more than five years.

The people’s governments of provinces, autonomous regions and centrally supervised municipalities may grant exemptions from or reduced local income tax for a foreign investment enterprise engaged in an industry or a project encouraged by the State.

(b) *Value added tax*

The Provisional Regulations of the People’s Republic of China Concerning Value Added Tax () promulgated by the State Council came into effect on 1st January, 1994. Under these regulations and the Implementing Rules of the Provisional Regulations of the People’s Republic of China Concerning Value Added Tax (), value added tax is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC.

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Value added tax payable in the PRC is charged on an aggregated basis at a rate of 13 or 17% (depending on the type of goods involved) on the full price collected for the goods sold or, in the case of taxable services provided, at a rate of 17% on the charges for the taxable services provided but excluding, in respect of both goods and services, any amount paid in respect of value added tax included in the price or charges, and less any deductible value added tax already paid by the taxpayer on purchases of goods and services in the same financial year.

(c) *Business tax*

With effect from 1st January, 1994, business that provide services (except entertainment business), assign intangible assets or sell immovable property became liable to business tax at a rate ranging from three to five per cent. of the charges of the services provided, intangible assets assigned or immovable property sold, as the case may be.

(d) *Tax on dividends from a PRC enterprise with foreign investment*

Under the Foreign Enterprises Tax Law, income such as dividends and profits distribution from the PRC derived from a foreign enterprise which has no establishment in the PRC is subject to a 20% withholding tax, subject to reduction as provided by any applicable double taxation treaty, unless the relevant income is specifically exempted from tax under the Foreign Enterprises Tax Law. The profit derived by a foreign investor from a PRC enterprise with foreign investment is exempted from PRC tax under the Foreign Enterprises Tax Law.

6. Joint ventures

Joint ventures in the PRC between domestic and foreign entities may take two forms: equity joint ventures and cooperative joint ventures. Equity joint ventures are governed by the Sino-foreign Equity Joint Venture Law of the PRC () (the “Equity Joint Venture Law”) adopted on 1st July, 1979 by the NPC and the Implementing Regulations of the Sino-foreign Equity Joint Venture Law of the PRC () promulgated on 20th September, 1983 by the State Council. Cooperative joint ventures are governed by the Sino-foreign Cooperative Joint Venture Law of the PRC () (the “Cooperative Joint Venture Law”) promulgated on 13th April, 1988 and the Implementing Rules of the Sino-foreign Cooperative Joint Venture Law of the PRC () promulgated by the Ministry of Foreign Trade and Economic Cooperation (“MOFTEC”) on 4th September, 1995.

(a) *Procedures for establishment of a joint venture*

The establishment of a joint venture requires the approval of MOFTEC (or its delegated authorities). Certain documents including a feasibility study report, joint venture contract and articles of association of the joint venture are required to be submitted to MOFTEC or its delegated authorities for approval. Within 30 days after the issue of the approval certificate by MOFTEC, an applicant is required to apply to the State Administration Bureau for Industry and Commerce (“SAIC”) (or its local bureau) for the issue of a business licence. A joint venture entity is formally established on the date its business licence is issued.

(b) *Sino-foreign equity joint ventures*

Under the Equity Joint Venture Law and its implementing regulations, an equity joint venture takes the form of a limited liability company. It is an independent legal person which may

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independently assume civil obligations, enjoy civil rights and own, use and dispose of its assets. The liability of the joint venture partners is limited to the amount of the registered capital they have respectively agreed to contribute under the joint venture contract. The registered capital must be paid in accordance with the terms and conditions of the joint venture contract and may take the form of cash, land use rights, capital goods, intellectual property rights and know-how. Transfer of the contribution(s) in the registered capital of a joint venture partner to any other person(s) requires the consent of the other joint venture partner(s) and the approval of the original approval authority.

The total amount of investment of an equity joint venture is the sum of capital construction funds and the circulating funds required for the scale of its operations and production. The proportion of the investment contributed by a foreign joint venture partner in the registered capital of the joint venture in general shall not be less than 25%. Under the Provisional Regulations concerning the Ratio of Registered Capital and Total investment of Sino-foreign Equity Joint Venture () promulgated by the SAIC on 1st March, 1987, the ratios between the amount of registered capital and the amount of total investment are prescribed. For example, where the amounts of total investment is between US\$10 million and US\$30 million, the amount of registered capital must not be less than 40% of the amount of total investment.

The profits, risks and losses of an equity joint venture are shared by the joint venture partners in proportion to their contributions to the registered capital.

The operations of an equity joint venture are regulated by an extensive body of laws and regulations, both national and regional, governing such matters as registration, capital contribution, foreign exchange, accounting, taxation and labour.

(c) *Sino-foreign cooperative joint ventures*

A co-operative joint venture may or may not be registered as an independent legal entity. If a co-operative joint venture is registered as an independent legal person, the joint venture entity will take the form of a limited liability company. The joint venture partners of a co-operative joint venture that has not applied for the status of an independent legal person are required to assume civil liabilities in accordance with the applicable PRC civil law.

Matters relating to the establishment, approval procedures, capital contribution, foreign exchange, accounting, taxation and labour of a co-operative joint venture are substantially the same as those of an equity joint venture.

Under the Cooperative Joint Venture Law and its implementing rules, the joint venture partners have a greater degree of flexibility to structure the joint venture arrangements and to determine their respective rights, obligations and liabilities. Profits and losses of a cooperative joint venture may be distributed to and shared by the joint venture partners in such manner as those partners may agree to, instead of in proportion to their respective contribution to the registered capital of the joint venture. In addition, where the cooperative joint venture contract provides for the reversion of all fixed assets of the cooperative joint venture to the local joint venture partner upon the expiry of the term of the joint venture, the joint venture partners may agree in the relevant joint venture contract the mechanism of profit distribution whereby the foreign joint venture partner may have priority in recovering investment during the term of the joint venture.

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(d) *Management*

Under the Equity Joint Venture Law and the Cooperative Joint Venture Law, the highest authority of a joint venture is vested in its board of directors. There is no requirement under the applicable law for the holding of meetings of joint venture partners.

The powers and functions of the board of directors are generally governed by the provisions of the joint venture contract and the articles of association of the joint venture. Meetings of the board of directors of a joint venture are required to be held at least once every year. In general, major decisions affecting the joint venture (such as development plans, production and business plans, budget, distribution of profits, termination of business and appointment of key personnel) are to be determined by the board of directors. The daily operation and management of a joint venture is vested in the management office which has a general manager and several deputy managers who assist the general manager. The general manager and deputy general managers of a joint venture are engaged by its board of directors. A general manager is required to act in accordance with the directions and guidance of the board of the directors.

(e) *Profit distribution*

Under the Regulations on the Financial Management of Foreign Investment Enterprises of the PRC () promulgated on, and effective as of, 24th June, 1992, the after tax profits of a joint venture shall be applied in the following order:

- (i) towards the payment of compensation, liquidated damages, late- payment penalties, penalty interests, and fines;
- (ii) to make up the accumulated losses of the joint venture;
- (iii) allocations to the reserve fund, enterprise development fund and staff bonus and welfare fund at the respective ratios determined by the board of directors of the joint venture; and
- (iv) distribution to the joint venture partners in accordance with, in the case of an equity joint venture, the ratio of contributions of each joint venture partner to the registered capital, and, in the case of a cooperative joint venture, the terms of the joint venture contract.

7. **Wholly foreign-owned enterprise**

Wholly foreign-owned enterprises are governed by the Law of the people's Republic of China Concerning Enterprises with Sole Foreign Investments (), which was promulgated on 12th April, 1986, and its Implementation Regulations promulgated on 12th December, 1990 (together the "Foreign Enterprises Law").

(a) *Procedures for establishment of a wholly foreign-owned enterprise*

The establishment of a wholly foreign-owned enterprise will have to be approved by MOFTEC (or its delegated authorities). If two or more foreign investors jointly apply for the establishment of a wholly foreign-owned enterprise, a copy of the contract between the parties must also be submitted to MOFTEC (or its delegated authorities) for its record. A wholly foreign-owned must also obtain a business licence from SAIC before it can commence business.

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(b) *Nature*

A wholly foreign-owned enterprise is a limited liability company under the Foreign Enterprise Law. It is a legal person which may independently assume civil obligations, enjoy civil rights and has the right to own, use and dispose of property. It is required to have a registered capital contributed by the foreign investor(s). The liability of the foreign investor(s) is limited to the amount of registered capital contributed. A foreign investor may make its contributions by instalments and the registered capital must be contributed within the period as approved by MOFTEC (or its delegated authorities) in accordance with relevant regulations.

(c) *Profit distribution*

The Foreign Enterprise Law provides that after payment of taxes, a wholly foreign-owned enterprise must make contributions to a reserve fund and an employee bonus and welfare fund. The allocation ratio for the employee bonus and welfare fund may be determined by the enterprise. However, at least 10% of the after tax profits must be allocated to the reserve fund. The enterprise is prohibited from distributing dividends unless the losses (if any) of previous years have been made up.

8. Laws and regulations relating to rare earth and refractory products

The amended (The Directions Concerning Foreign Investment) promulgated by the State Development Planning Commission (), the State Economic and Trade Commission () and the Ministry of Foreign Trade and Economic Co-operation () on 31st December, 1997 and came into effect on 1st January, 1998. Under these regulations, the mining, selection, smelting, extraction and separation of rare earth are classified as restricted businesses, which cannot be operated by wholly foreign-owned enterprises. The setting up of equity joint ventures or cooperative joint ventures for operating such businesses requires the approval from the relevant industry administrative authorities of the State Council and the Ministry of Foreign Trade and Economic Co-operation or its relevant delegated authorities.

The export of rare earth products is regulated by a quota and export permit system. The relevant enterprise has to obtain quota certificate and export permit prior to the export of rare earth products.

The PRC government allows foreign investors to participate in the refractory materials industry. The establishment of a foreign owned enterprise engaging in the refractory materials industry is to be approved by the local bureau.

9. Legal opinion

Commerce & Finance Law Office, the Company's legal advisers on PRC law, has sent to the Company a letter confirming that they have reviewed the summary of relevant PRC laws and regulations contained in this Appendix and that in their opinion, the summary is a correct summary of the relevant PRC law and regulations. A copy of this letter is available for inspection as referred to in the paragraph headed "Documents available for inspection" in Appendix VII. Any person wishing to have detailed advice on PRC laws is recommended to seek independent legal advice.

FURTHER INFORMATION ABOUT THE COMPANY**1. Incorporation**

The Company was incorporated in the Cayman Islands under the Companies Law as an exempted company on 27th July, 1999 with an authorised share capital of HK\$100,000 divided into 1,000,000 Shares of HK\$0.10 each. On 13th August, 1999, one Share was allotted and issued to Codan Trust Company (Cayman) Limited for cash at par. On the same date, Codan Trust Company (Cayman) Limited transferred the one Share to YY Holdings Limited (“YY Holdings”) and 999,999 Shares were allotted and issued to YY Holdings nil paid. All such Shares were subsequently paid up in the manner described in paragraph 4 below.

The Company is incorporated in the Cayman Islands and is subject to the Cayman Islands law. Its constitution comprises a memorandum of association and articles of association. A summary of certain relevant parts of its constitution and certain relevant aspects of the Cayman Islands company law is set out in Appendix IV to this prospectus.

2. Changes in share capital

Pursuant to resolutions in writing of the sole shareholder of the Company passed on 29th September, 1999, the share capital of the Company was increased to HK\$200,000 by the creation of a further 1,000,000 Shares, which were on that date allotted and issued, credited as fully paid, as described in paragraph 4 below.

Immediately following completion of the Share Offer and the Capitalisation Issue but taking no account of any Shares which may be issued upon the exercise of the Over-Allotment Option, the authorised share capital of the Company will be HK\$100,000,000 divided into 1,000,000,000 Shares of which 600,000,000 Shares will be allotted and issued fully paid or credited as fully paid, and 400,000,000 Shares will remain unissued. On the basis that the Over-Allotment Option is exercised in full, 622,500,000 Shares will be allotted and issued fully paid or credited as fully paid and 377,500,000 Shares will remain unissued. Other than pursuant to the exercise of the Over-Allotment Option or any options which may be granted under the Share Option Scheme, there is no present intention to issue any of the authorised but unissued share capital of the Company and, without the prior approval of the members in general meeting, no issue of Shares will be made which would effectively alter the control of the Company.

Save as disclosed herein and in paragraphs 1 and 3 of this Appendix, there has been no alteration in the share capital of the Company since its incorporation.

3. Resolutions of the sole shareholder of the Company passed on 29th September, 1999

On 29th September, 1999 pursuant to further resolutions in writing passed by the sole shareholder of the Company:

- (a) the Company adopted its existing articles of association;
- (b) conditional on the Listing Committee of the Stock Exchange granting listings of and permission to deal in the Shares in issue and to be issued as mentioned herein and on the obligations of the Underwriters under the Underwriting Agreement becoming unconditional

and not being terminated in accordance with the terms of the Underwriting Agreement or otherwise, in each case on or before the date following 30 days after the date of this prospectus:

- (i) the authorised share capital was increased from HK\$200,000 to HK\$100,000,000 by the creation of a further 998,000,000 Shares;
- (ii) the Share Offer and the Over-Allotment Option were approved and the Directors were authorised to allot and issue the New Shares pursuant to the Share Offer and such number of Shares as may be allotted and issued upon the exercise of the Over-Allotment Option;
- (iii) the rules of the Share Option Scheme, the principal terms of which are set out in paragraph 14 of this Appendix, were approved and adopted and the Directors were authorised to grant options to subscribe for Shares thereunder and to allot, issue and deal with Shares pursuant to the exercise of options granted under the Share Option Scheme;
- (iv) conditional on the share premium account of the Company being credited as a result of the Share Offer, the Directors were authorised to capitalise HK\$44,800,000 standing to the credit of the share premium account of the Company by applying such sum in paying up in full at par 448,000,000 Shares for allotment and issue to holders of Shares whose names appear on the register of members of the Company at the close of business on 29th September, 1999 (or as they may direct) in proportion (as nearly as possible without involving fractions) to their then existing holdings;
- (v) a general unconditional mandate was given to the Directors to allot, issue and deal with, otherwise than by way of rights, scrip dividend schemes or similar arrangements in accordance with the articles of association of the Company, or pursuant to the exercise of any options which may be granted under the Share Option Scheme or under the Share Offer or the Capitalisation Issue or upon the exercise of the Over-Allotment Option, Shares with an aggregate nominal amount not exceeding the sum of (aa) 20% of the aggregate nominal amount of the share capital of the Company in issue immediately following the Share Offer, the Capitalisation Issue and the exercise (if any) of the Over-Allotment Option and (bb) the nominal amount of the share capital of the Company which may be repurchased by the Company pursuant to the authority granted to the Directors as referred to in paragraph (vi) below, until the conclusion of the next annual general meeting of the Company, or the date by which the next annual general meeting of the Company is required by the articles of association of the Company or any applicable Cayman Islands law to be held or the passing of an ordinary resolution by shareholders of the Company revoking or varying the authority given to the Directors, whichever occurs first; and
- (vi) a general unconditional mandate was given to the Directors to exercise all powers of the Company to repurchase Shares with an aggregate nominal amount not exceeding 10% of the aggregate nominal amount of the share capital of the Company in issue and to be issued immediately following the Share Offer, the Capitalisation Issue and the exercise (if any) of the Over-Allotment Option until the conclusion of the next annual general meeting of the Company, or the date by which the next annual general meeting

of the Company is required by the articles of association of the Company or any applicable Cayman Islands law to be held or the passing of an ordinary resolution by shareholders of the Company revoking or varying the authority given to the Directors, whichever occurs first.

4. Group reorganisation

The companies comprising the Group underwent a reorganisation to rationalise the Group's structure in preparation for the listing of the Shares on the Stock Exchange. The reorganisation involved the transfer to the Company by YY Holdings of 20 shares, in aggregate, being the entire issued share capital in Lee Shing Holdings Limited ("Lee Shing Holdings"), the intermediate holding company of the Group, in consideration and in exchange for which the Company (i) allotted and issued, credited as fully paid, 1,000,000 new Shares to YY Holdings and (ii) credited as fully paid at par the 999,999 Shares allotted and issued to YY Holdings nil paid on 13th August, 1999.

In addition to the transfer of shares in Lee Shing Holdings referred to above, the Group also underwent the following corporate restructuring:

- (a) On 16th May, 1999, Yixing Yimei Fluorescent Materials Co., Ltd. was dissolved and its assets were distributed to Yixing Xinwei Group Limited ("Xinwei Group Limited").
- (b) On 3rd May, 1999, Shanghai Yuelong Chemicals Factory ("Chemicals Factory"), Qian Zhiming (), Sun Xibin (), Xu Xiaoxian (), Xu Zhongquan (), Wang Ruixiang (), Xinwei Group Limited, Mrs. Jiang and Mr. Jiang entered into an agreement whereby Chemicals Factory transferred its 40.6% equity interest in Yixing Shengyi Ytterbium Co., Ltd ("Shengyi Co.") to Xinwei Group Limited; Qian Zhiming (), Sun Xibin (), Xu Xiaoxian (), Xu Zhongquan (), Wang Ruixiang () respectively transferred their 24.7%, 18.9%, 0.7%, 0.7% and 0.3% equity interest in Shengyi Co. to Mrs. Jiang; and Qian Zhiming () transferred his 2.4% equity interest in Shengyi Co. to Mr. Jiang at the consideration of RMB 701,506.3, RMB 426,778.4, RMB 326,563.3, RMB 12,095, RMB 12,095, RMB 5,183.5 and RMB 41,468.3, respectively.
- (c) On 7th May, 1999, Xinwei Group Limited entered into an agreement with Shengyi Co., Yixing Rare Earth Refinery Factory ("Rare Earth Refinery Factory") and Yixing Xinwei Materials Trading Company ("Xinwei Materials Trading Company") whereby Xinwei Group Limited took over all the assets and liabilities of those three companies following which the three companies were dissolved.
- (d) On 4th May, 1999, Xinwei Group Limited, Japan Materials, Inc. (), Mrs. Jiang and Mr. Jiang entered into an agreement whereby Xinwei Group Limited transferred its 46% and 5% equity interest in Yixing Wellfire Refractory Materials Co., Ltd ("Wellfire Refractory Materials") to Mrs. Jiang and Mr. Jiang respectively at the respective consideration of RMB1,306,412.4 and RMB142,001.3; and Japan Materials, Inc, () transferred its 49% equity interest in Wellfire Refractory Materials to Mrs. Jiang at a consideration of US\$490,000.

- (e) On 3rd May, 1999, Jiang Hung San (江洪山), Mr. Jiang and Mrs. Jiang entered into an agreement whereby Jiang Hung San and Mr. Jiang transferred their respective 73% and 22% equity interest in Yixing Longwei Special Refractory Materials Factory (“Longwei Factory”) to Mrs. Jiang at the respective consideration of RMB1 and RMB1.
- (f) On 10th May, 1999, Yixing Xinwei Refractory Materials Factory (“Xinwei Refractory Factory”) entered into an agreement with Longwei Factory whereby Xinwei Refractory Factory took over all the assets and liabilities of Longwei Factory following which Longwei Factory was dissolved.
- (g) On 25th June, 1999, Xinwei Group Limited and Lee Shing Holdings entered into an agreement whereby Xinwei Group Limited transferred to Lee Shing Holdings 95% of its assets and liabilities relating to its rare earth products operations in consideration of the issue and allotment by Lee Shing Holdings of 15 shares of US\$1 each in Lee Shing Holdings, credited as fully paid, to Mrs. Jiang as directed by Xinwei Group Limited.
- (h) On 12th July, 1999, Xinwei Refractory Factory and Lee Shing Holdings entered into an agreement whereby Xinwei Refractory Factory transferred to Lee Shing Holdings all its assets and liabilities relating to its refractory materials operations in consideration of: (a) the issue and allotment by Lee Shing Holdings of three shares of US\$1 each in Lee Shing Holdings, credited as fully paid, to Mrs. Jiang as directed by Xinwei Refractory Factory; and (b) the payment of the sum of RMB1,656,148.63 to Mr. Jiang as directed by Xinwei Refractory Factory.
- (i) On 12th July, 1999, Wellfire Refractory Materials and Lee Shing Holdings entered into an agreement whereby Wellfire Refractory Materials transferred to Lee Shing Holdings all its assets and liabilities relating to its refractory materials operations in consideration of: (a) the issue and allotment by Lee Shing Holdings of one share of US\$1 each in Lee Shing Holdings, credited as fully paid, to Mrs. Jiang as directed by Wellfire Refractory Materials; and (b) the payment of the sum of RMB268,001.35 to Mr. Jiang as directed by Wellfire Refractory Materials.
- (j) On 5th July, 1999, Mr. Chiu Yan Sze transferred 1,000,000 shares of HK\$1 each in Xinwei Rare Earth Group (Hong Kong) Limited (“Xinwei HK”) to Mrs. Jiang at the consideration of HK\$1.
- (k) On 20th July, 1999
 - (i) the authorised share capital of Xinwei HK was increased from HK\$10,000,000 to HK\$10,010,000 by the creation of 10,000 new shares of HK\$1 each;
 - (ii) one share of HK\$1 in Xinwei HK was allotted and issued for cash at par to each of Lee Shing Holdings and its nominee, CCM Nominees Limited;
 - (iii) the 10,000,000 shares of HK\$1 each in the issued share capital of Xinwei HK and held and beneficially owned, as to 7,000,000 shares by Mr. Jiang and as to 3,000,000 shares by Mrs. Jiang prior to the allotment and issue of the two shares referred to in sub-paragraph (ii) above were converted into 10,000,000 non-voting deferred shares of HK\$1 each carrying the rights and subject to the restrictions set out in paragraph 6 of this Appendix;

- (iv) each of the two shares referred to in sub-paragraph (ii) above was designated an ordinary share of HK\$1;
- (v) each of the 9,998 unissued shares in the authorised capital of Xinwei HK was designated as one unclassified share of HK\$1;
- (vi) in consideration for the conversion of their respective shares held in Xinwei HK into non-voting deferred shares carrying the rights and subject to the restrictions set out in paragraph 6 of this Appendix, a cash consideration of \$1 was paid to each of Mr. Jiang and Mrs. Jiang respectively;
- (l) On 14th September, 1999, Mrs. Jiang transferred 20 shares of US\$1 each in Lee Shing Holdings to YYT Limited at nil consideration; and
- (m) On 17th September, 1999, YYT Limited transferred 20 shares of US\$1 each in Lee Shing Holdings to YY Holdings at a consideration of US\$18,775,000.

5. Changes in share capital of the Company's subsidiaries

The subsidiaries of the Company are listed in the accountants' report set out in Appendix I to this prospectus. The following alterations in the share capitals of the Company's subsidiaries took place within the two years immediately preceding the date of this prospectus:

- (a) on 24th October, 1997, the registered capital of Yixing Xinwei Leeshing Rare Earth Co., Ltd ("Xinwei Leeshing Rare Earth") was increased from US\$4.8 million to US\$20 million;
- (b) on 9th February, 1998, the registered capital of Xinwei Leeshing Rare Earth was changed from US\$20 million to US\$15,660,000 and it has been fully paid;
- (c) on 23rd October, 1998, Xinwei HK was incorporated with an authorised share capital of HK\$10,000,000 divided into 10,000,000 shares of HK\$1 each. The shares were subscribed as to 7,000,000 shares by Mr. Jiang, 2,000,000 shares by Mrs. Jiang and 1,000,000 shares by Mr. Chiu Yan Sze;
- (d) on 3rd December, 1998, Lee Shing Holdings was incorporated with an authorised capital of US\$50,000 divided into 50,000 shares of US\$1 each;
- (e) on 8th June, 1999, one share of US\$1 in Lee Shing Holdings was issued and allotted to Mrs. Jiang for cash at par;
- (f) on 30th July, 1999, Yixing Xinwei Leeshing Refractory Materials Co., Ltd ("Xinwei Leeshing Refractory Materials") was incorporated as a wholly foreign owned enterprise.

Save as disclosed herein and in paragraph 4 of this Appendix, there has been no alteration in the share capital of any of the subsidiaries of the Company within the two years immediately preceding the date of this prospectus.

6. Rights and restrictions of the non-voting deferred shares

The rights and restrictions of the non-voting deferred shares in the capital of Xinwei HK, referred to in paragraph 4 of this Appendix are set out below:

- (a) as regards income, the holders of non-voting deferred shares shall not be entitled to any dividend on their non-voting deferred shares and the net profits of the relevant company available for dividend as earned in the year in respect which a dividend is declared shall be distributed among the holders of ordinary shares accounting to the amounts paid up on the ordinary shares held by them respectively and all dividends shall be apportioned and paid pro rata according to the amounts paid up on the shares during the portion or portions of the period in respect of which the dividend is paid, except that if any share is issued on terms providing that it shall rank for dividend as if paid up (in whole or in part) as from a particular date, such share shall rank for dividend accordingly;
- (b) as regards capital, on a return of capital on liquidation or otherwise, the assets of the relevant company available for distribution among the holders of ordinary shares and the holders of non-voting deferred shares shall be applied first in paying to the holders of ordinary shares the sum of HK\$1,000 million per ordinary share secondly in repaying to the holders of non-voting deferred shares the nominal amount paid up or credited as paid up on such shares, and the balance of the relevant company's asset shall belong to and be distributed among the holders of ordinary shares in proportion to the amount paid up or credited as paid up on such ordinary shares respectively;
- (c) as regards voting, the non-voting deferred shares shall not entitle the holders thereof to receive notice of or to attend or vote at any general meeting of the relevant company; and
- (d) an allotment, issue or creation of securities or options for the subscription of securities of the relevant company with preferential rights or entitlements to or which rank pari passu with the non-voting deferred shares shall not be and shall be deemed not to be a variation or abrogation of the rights attaching to the non-voting deferred shares in issue from time to time.

7. Repurchase by the Company of its own securities

This paragraph 7 includes information required by the Stock Exchange to be included in this prospectus concerning the repurchase by the Company of its own securities.

(a) *Stock Exchange Rules*

The Listing Rules permit companies with a primary listing on the Stock Exchange to repurchase their securities on the Stock Exchange subject to certain restrictions, the more important of which are summarised below:

(i) Shareholders' approval

All proposed repurchases of securities (which must be fully paid up in the case of shares) by a company with a primary listing on the Stock Exchange must be approved in advance by an ordinary resolution of the shareholders, either by way of general mandate or by specific approval of a particular transaction.

Note: Pursuant to a resolution in writing passed by the sole shareholder of the Company on 29th September, 1999 a general unconditional mandate (the “Repurchase Mandate”) was given to the Directors authorising any repurchase by the Company of Shares on the Stock Exchange or on any other stock exchange on which the securities of the Company may be listed and which is recognised by the Securities and Futures Commission and the Stock Exchange for this purpose, of up to 10% of the aggregate nominal value of the share capital of the Company in issue and to be issued immediately following the Share Offer, the Capitalisation Issue and the exercise (if any) of the Over-Allotment Option, such mandate to expire at the conclusion of the next annual general meeting of the Company, or the date by which the next annual general meeting of the Company is required by the articles of association of the Company or any applicable Cayman Islands law to be held or when revoked or varied by ordinary resolution of shareholders in general meeting of the Company, whichever shall first occur.

(ii) Source of funds

Repurchases must be paid out of funds legally available for the purpose in accordance with the Company’s memorandum and articles of association and the Companies Law. A listed company may not repurchase its own securities on the Stock Exchange for a consideration other than cash or for settlement otherwise than in accordance with the trading rules of the Stock Exchange. Under the Cayman Islands law, repurchases by the Company may only be made out of profits of the Company or out of the proceeds of a fresh issue of shares made for the purpose, or, if so authorised by its articles of association and subject to the provisions of the Companies Law, out of capital. Any premium payable on a redemption or purchase over the par value of the shares to be purchased must be provided for out of profits of the Company or out of the Company’s share premium account, or, if so authorised by its articles of association and subject to the provisions of the Companies Law, out of capital.

(iii) Trading restrictions

The total number of shares which a company may repurchase on the Stock Exchange is shares representing up to a maximum of 10% of the aggregate number of shares in issue. A company may not issue or announce a proposed issue of new securities for a period of 30 days immediately following a repurchase (other than an issue of securities pursuant to an exercise of share options or similar instruments requiring the company to issue securities which were outstanding prior to such repurchase) without the prior approval of the Stock Exchange. In addition, the repurchases of securities on the Stock Exchange in any calendar month are limited to a maximum of 25% of the trading volume of such securities on the Stock Exchange in the immediately preceding calendar month. The Listing Rules also prohibit a company from repurchasing its securities on the Stock Exchange if the repurchase would result in the number of listed securities which are in the hands of the public falling below the relevant prescribed minimum percentage as required by the Stock Exchange. A company is required to procure that the broker appointed by it to effect repurchase of securities discloses to the Stock Exchange such information with respect to the repurchase as the Stock Exchange may require.

(iv) Status of repurchased securities

All repurchased securities (whether effected on the Stock Exchange or otherwise) will be automatically delisted and the certificates for those securities must be cancelled and destroyed. Under the Cayman Islands law, a company’s repurchased shares will be treated as cancelled.

(v) Suspension of repurchase

A company may not make any repurchase of securities after a price sensitive development has occurred or has been the subject of a decision until such time as the price sensitive information has been made publicly available. In particular, during the period of one month immediately preceding either the preliminary announcement of a company's annual results or the publication of its interim report, a company (other than an investment company listed pursuant to the provisions of Chapter 21 of the Listing Rules) may not repurchase its securities on the Stock Exchange unless the circumstances are exceptional. In addition, the Stock Exchange may prohibit a repurchase of securities on the Stock Exchange if a company has breached the Listing Rules.

(vi) Reporting requirements

Repurchases of securities on the Stock Exchange or otherwise must be reported to the Stock Exchange not later than 9:30 a.m. (Hong Kong time) on the following business day. In addition, a company's annual report is required to disclose details regarding repurchases of securities made during the year, including a monthly analysis of the number of securities repurchased and the aggregate prices paid.

(vii) Connected parties

A company is prohibited from knowingly repurchasing securities on the Stock Exchange from a "connected person", that is, a director, chief executive or substantial shareholder of the Company or any of its subsidiaries or any of their associates (as defined in the Listing Rules) and a connected person shall not knowingly sell his securities to the company on the Stock Exchange.

(b) *Reasons for repurchases*

The Directors believe that it is in the best interests of the Company and its shareholders for the Directors to have general authority from the shareholders to enable the Company to repurchase Shares in the market. Such repurchases may, depending on market conditions and funding arrangements at the time, lead to an enhancement of the net asset value per Share and/or earnings per Share and will only be made if the Directors believe that such repurchases will benefit the Company and its shareholders.

(c) *Funding of repurchases*

In repurchasing securities, the Company may only apply funds legally available for such purpose in accordance with its memorandum and articles of association, the Listing Rules and the applicable laws of the Cayman Islands.

On the basis of the current financial position of the Group as disclosed in this prospectus and taking into account the current working capital position of the Group, the Directors consider that, if the repurchase mandate were to be exercised in full, it might have a material adverse effect on the working capital and/or the gearing position of the Group as compared with the position disclosed in this prospectus. However, the Directors do not propose to exercise the repurchase mandate to such an extent as would, in the circumstances, have a material adverse effect on the working capital requirements of the Group or the gearing level which in the opinion of the Directors are from time to time appropriate for the Group.

The exercise in full of the Repurchase Mandate, assuming that the Over-Allotment Option is not exercised and on the basis of 600,000,000 Shares in issue immediately after the listing of the Shares, would result in up to 60,000,000 Shares being repurchased by the Company during the period in which the Repurchase Mandate remains in force. An exercise of the Repurchase Mandate in full, assuming that the Over-Allotment Option is exercised in full and on the basis of 622,500,000 Shares in issue immediately after the exercise of the Over-Allotment Option and the listing of the Shares, would result in up to 62,250,000 Shares being repurchased by the Company during the same period.

(d) *General*

None of the Directors nor, to the best of their knowledge having made all reasonable enquiries, any of their associates (as defined in the Listing Rules) currently intends to sell any Shares to the Company or its subsidiaries.

The Directors have undertaken to the Stock Exchange that, so far as the same may be applicable, they will exercise the repurchase mandate in accordance with the Listing Rules and the applicable laws of the Cayman Islands.

If, as a result of a securities repurchase, a shareholder's proportionate interest in the voting rights of the Company is increased, such increase will be treated as an acquisition for the purpose of the Hong Kong Code on Takeovers and Mergers (the "Takeovers Code"). Accordingly, a shareholder or a group of shareholders acting in concert could obtain or consolidate control of the Company and become obliged to make a mandatory offer in accordance with rule 26 of the Takeovers Code. Save as aforesaid, the Directors are not aware of any consequences which would arise under the Takeovers Code as a consequence of any repurchases pursuant to the Repurchase Mandate.

Any purchase of Shares which results in the number of Shares held by the public being reduced to less than 25% of the Shares then in issue could only be implemented with the agreement of the Stock Exchange to waive the Listing Rules requirements regarding the public shareholding referred to above. It is believed that a waiver of this provision would not normally be given other than in exceptional circumstances.

No connected person (as defined in the Listing Rules) has notified the Company that he has a present intention to sell Shares to the Company, or has undertaken not to do so if the Repurchase Mandate is exercised.

8. Registration under Part XI of the Companies Ordinance

The Company has established a place of business in Hong Kong at Room 1301, 13th Floor, Ruttonjee House, Ruttonjee Centre, 11 Duddell Street, Central, Hong Kong. The Company has been registered as an overseas company under Part XI of the Companies Ordinance. Ms. To Siu Mui, Annie and Mr. Cheng Man For, Jeffrey have been appointed as agents of the Company for the acceptance of service of process in Hong Kong.

FURTHER INFORMATION ABOUT THE BUSINESS OF THE GROUP

9. Summary of material contracts

The following contracts (not being contracts in the ordinary course of business) have been entered into by members of the Group within the two years preceding the date of this prospectus and are or may be material:

- (a) an agreement in Chinese dated 3rd May, 1999 between Chemicals Factory, Qian Zhiming (), Sun Xibin (), Xu Xiaoxian (), Xu Zhongquan (), Wang Ruixiang () as vendors and, Xinwei Group Limited, Mrs. Jiang and Mr. Jiang as purchasers for the transfer by: (i) Chemicals Factory of its 40.6% equity interest in Shengyi Co. to Xinwei Group Limited; (ii) Qian Zhiming (), Sun Xibin (), Xu Xiaoxian (), Xu Zhongquan (), Wang Ruixiang () respectively of their 24.7%, 18.9%, 0.7%, 0.7% and 0.3% equity interest in Shengyi Co. to Mrs. Jiang; and (iii) Qian Zhiming () of his 2.4% equity interest in Shengyi Co. to Mr. Jiang, at the consideration of RMB 701,506.3, RMB 426,778.4, RMB 326,563.3, RMB 12,095, RMB 12,095, RMB 5,183.5 and RMB 41,468.3, respectively;
- (b) an agreement in Chinese dated 7th May, 1999 between Xinwei Group Limited, Shengyi Co., Rare Earth Refinery Factory and Xinwei Materials Trading Company for the acquisition by Xinwei Group Limited of all the assets and liabilities of Shengyi Co., Rare Earth Refinery Factory and Xinwei Materials Trading Company;
- (c) an agreement in Chinese dated 4th May, 1999 between Xinwei Group Limited and Japan Materials, Inc. () as vendors and Mrs. Jiang and Mr. Jiang as purchasers for the transfer by: (i) Xinwei Group Limited of its 46% and 5% equity interest in Wellfire Refractory Materials to Mrs. Jiang and Mr. Jiang respectively at the respective consideration of RMB 1,306,412.4 and RMB 142,001.3; and (ii) Japan Materials, Inc. () of its 49% equity interest in Wellfire Refractory Materials to Mrs. Jiang at a consideration of US\$490,000;
- (d) an agreement in Chinese dated 3rd May, 1999 between Jiang Hung San () and Mr. Jiang as vendors and Mrs. Jiang as purchaser for the transfer by Jiang Hung San () and Mr. Jiang of their respective 73% and 22% equity interest in Longwei Factory to Mrs. Jiang at the respective consideration of RMB 1 and RMB 1;
- (e) an agreement in Chinese dated 10th May, 1999 between Xinwei Refractory Factory and Longwei Factory for the acquisition by Xinwei Refractory Factory of all the assets and liabilities of Longwei Factory;
- (f) an agreement in Chinese dated 25th June, 1999 between Xinwei Group Limited as vendor and Lee Shing Holdings as purchaser for the acquisition by Lee Shing Holdings of 95% of the assets and liabilities of Xinwei Group Limited relating to its rare earth products operations in consideration of the issue and allotment by Lee Shing Holdings of 15 shares of US\$1 each in Lee Shing Holdings, credited as fully paid, to Mrs. Jiang as directed by Xinwei Group Limited;

- (g) an agreement in Chinese dated 12th July, 1999 between Xinwei Refractory Factory as vendor and Lee Shing Holdings as purchaser for the acquisition by Lee Shing Holdings of all the assets and liabilities of Xinwei Refractory Factory relating to its refractory materials operations, in consideration of: (i) the issue and allotment by Lee Shing Holdings of three shares of US\$1 each in Lee Shing Holdings, credited as fully paid, to Mrs. Jiang as directed by Xinwei Refractory Factory; and (ii) the payment of the sum of RMB 1,656,148.63 to Mr. Jiang as directed by Xinwei Refractory Factory;
- (h) an agreement in Chinese dated 12th July, 1999 between Wellfire Refractory Materials as vendor and Lee Shing Holdings as purchaser for the acquisition by Lee Shing Holdings of all the assets and liabilities of Wellfire Refractory Materials relating to its refractory materials operations in consideration of: (a) the issue and allotment by Lee Shing Holdings of one share of US\$1 each in Lee Shing Holdings, credited as fully paid, to Mrs. Jiang as directed by Wellfire Refractory Materials; and (b) the payment of the sum of RMB268,001.35 to Mr. Jiang as directed by Wellfire Refractory Materials;
- (i) an agreement dated 29th September, 1999 among (i) YY Holdings as vendor, (ii) Mrs. Jiang as warrantor, (iii) Mr. Jiang and (iv) the Company as purchaser for the acquisition of the entire issued share capital of Lee Shing Holdings in consideration of (i) the allotment and issue, credited as fully paid, of an aggregate of 1,000,000 Shares to YY Holdings and (ii) crediting as fully paid the 999,999 Shares issued nil paid to YY Holdings, and which contains certain non-competition undertakings more particularly referred to in the paragraph headed “non-competition undertaking” in the section headed “Business of the Group”;
- (j) a deed of indemnity dated 4th October, 1999 given by YY Holdings, Mr. Jiang and Mrs. Jiang in the favour of the Group containing the indemnities in respect of estate duty and taxation referred to in paragraph 15 of this Appendix; and
- (k) the Underwriting Agreement.

10. Intellectual property rights of the Group

Trade mark

Pursuant to a trademark assignment dated 30th August, 1999, Wellfire Refractory Materials has assigned to Yixing Xinwei Leeshing Refractory Materials the following trade mark at nil consideration:

Trade mark	Place of registration	Class	Registration number	Registration date	Products covered	Expiry date
.	PRC	19	659637 of 1993	28th September, 1993	Zircon brick, Zirconia-corundum brick, Zirconia-mullite brick, Semi-zircon brick	27th September, 2003

APPENDIX VI**STATUTORY AND GENERAL INFORMATION**

Pursuant to three trademark assignments, each dated 30th August, 1999, Xinwei Group Limited has assigned to Xinwei Leeshing Rare Earth the following trade marks, each at nil consideration:

Trade mark	Place of registration	Class	Registration number	Registration date	Products covered	Expiry date
	PRC	1	542061 of 1991	10th February, 1991	rare earth oxides	9th February, 2001
	PRC	1	990102 of 1997	28th April, 1997	rare earth metals, rare earth oxides, rare earth compounds, mixed rare earth, fluorescent powder	27th April, 2007
	PRC	1	653212 of 1993	14th August, 1993	trichromatic fluorescent powder	13th August, 2003

Pursuant to a trademark assignment dated 30th August, 1999, Xinwei Group Limited has assigned to Xinwei Leeshing Refractory Materials the following trade mark at nil consideration:

Trade mark	Place of registration	Class	Registration number	Registration date	Products covered	Expiry date
	PRC	19	964749 of 1997	21st March, 1997	refractory materials for construction use and its products	20th March, 2007

Applications are in the process of being made to the relevant authorities for the registration of such assignments. The Group does not anticipate any difficulty in registering the assignments. The Directors expected that the registration procedures will be completed by the end of October 1999. In addition, the Directors consider that the business of the Group is not dependent on the trade marks.

Patents

Pursuant to two user agreements, each dated 30th August, 1999, Xinwei Group Limited has granted to Xinwei Leeshing Refractory Materials the use of the following registered patents until the expiry of the registration of the respective patents, each at an annual fee of RMB1:

Patent (type and description)	Place of registration	Patent number	Date of application	Date of expiry
Coal gasifier	the PRC	ZL 95 2 40363.3	16th August, 1995	15th August, 2005
Refractory bricks	the PRC	ZL 95 3 14308.2	16th August, 1995	15th August, 2005

Applications are in the process of being made to the relevant authorities for the registration of such user agreement. The Group does not anticipate any difficulty in registering the user agreement. The Directors expected that the registration procedure will be completed by the end of November 1999.

11. Further information about the Group's equity joint venture and wholly-foreign owned enterprise in the PRC

The Group has established a Sino-foreign equity joint venture enterprise (namely, Xinwei Leeshing Rare Earth) and a wholly-foreign owned enterprise (namely, Xinwei Leeshing Refractory Materials) in the PRC.

(a) Xinwei Leeshing Rare Earth

Summaries of corporate information and the principal terms of the joint venture contract in respect of Xinwei Leeshing Rare Earth are as follows:

Economic nature:	Sino-foreign equity joint venture enterprise
Joint venture partners:	(a) Lee Shing Holdings as the foreign joint venture partner; and (b) Xinwei Group Limited as the PRC joint venture partner
Total investment:	US\$22,530,000 (or approximately HK\$174,562,440)
Total registered capital:	US\$15,660,000 (or approximately HK\$121,333,680)
Attributable interest of the Company:	95%
Term of joint venture:	30 years from the date of issue of the business licence
Nature of business:	manufacture and sale of rare earth products.

The board of directors of Xinwei Leeshing Rare Earth consists of five directors, two of whom (including the vice-chairman) are appointed by the PRC joint venture partner and the remaining three (including the chairman) are appointed by the Group.

Each party to the joint venture has pre-emptive rights over the sale of any interest in the joint venture by the other joint venture partner.

The profit of Xinwei Leeshing Rare Earth is shared between the Group and the PRC joint venture partner in proportion to their respective equity interests in Xinwei Leeshing Rare Earth. Upon the termination of the joint venture contract, the assets of Xinwei Leeshing Rare Earth will be distributed to the Group and the PRC joint venture partner in proportion to their respective equity interests in the joint venture.

(b) Xinwei Leeshing Refractory Materials

Summaries of corporate information in respect of Xinwei Leeshing Refractory Materials are as follows:

Economic nature:	wholly foreign-owned enterprise
Total investment:	US\$8 million (or approximately HK\$62 million)
Total registered capital:	US\$4 million (or approximately HK\$31 million)
Term of operation:	30 years from the date of issue of the business licence
Nature of business:	manufacture and sale of refractory materials products.

FURTHER INFORMATION ABOUT THE DIRECTORS, MANAGEMENT, STAFF AND EXPERTS**12. Disclosure of interests***(a) Disclosure of interests of the Directors and the experts*

- (i) Save as disclosed in this prospectus, none of the Directors or their associates (as defined in the Listing Rules) were engaged in any dealings with the Group during the two years preceding the date of this prospectus.
- (ii) Each of Mrs. Jiang and Mr. Jiang is interested in the corporate reorganisation referred to under paragraph 4 of this Appendix.

(b) Particulars of Directors' service contracts

Each of Mrs. Jiang, Mr. Jiang, Mr. Fan Yajun, Ms. To Siu Mui, Annie and Mr. Gu Aoxing, being all the executive Directors, has entered into a service contract with the Company for an initial term of three years commencing from 1st September, 1999, and will continue thereafter until terminated by not less than three months' notice in writing served by either party on the other. Each of these executive Directors is entitled to the respective basic salary set out below (subject to an annual increment after 31st December, 2000 at the discretion of the Directors of not more than 15% of the annual salary immediately prior to such increase). In addition, each of the executive Directors is also entitled to a management bonus. The aggregate amount of the bonuses payable to all the executive Directors who are entitled to such bonuses for any financial year of the Company may not exceed 5% of the audited consolidated or combined net profit of the Company (after taxation and minority interests and payment of such bonuses but before extraordinary items) in respect of that financial year of the Company. The Directors' entitlement to the management bonus in respect of the year ending 31st December, 1999 is conditional upon the combined net profit of the Company (after taxation and minority interests and the payment of such bonus but before extraordinary items) for that year exceeding HK\$80,000,000. An executive Director may not vote on any resolution of the Directors regarding the amount of the management bonus payable to him. The current basic annual salaries of the executive Directors are as follows:

Name	Annual salary
Mr. Jiang	HK\$800,000
Mrs. Jiang	HK\$420,000
Mr. Fan Yajun	HK\$200,000
Ms. To Siu Mui, Annie	HK\$240,000
Mr. Gu Aoxing	HK\$150,000

In addition, each of Mr. Jiang, Mrs. Jiang and Mr. Fan Yajun is entitled to the use of a car and driver and fuel and maintenance (including insurance) expenses in respect of the car.

Each of Mr. Jiang, Mrs. Jiang, Mr. Fan Yajun, Ms. To Siu Mui, Annie and Mr. Gu Aoxing is also entitled to a housing allowance of HK\$400,000, HK\$360,000, HK\$60,000, HK\$60,000 and HK\$50,000 per annum respectively.

Save as aforesaid, none of the Directors has or is proposed to have a service contract with the Company or any of its subsidiaries (other than contracts expiring or determinable by the employer within one year without the payment of compensation (other than statutory compensation)).

(c) *Directors' remuneration*

- (i) During the year ended 31st December, 1998, the aggregate emoluments paid by the Group to the Directors was approximately HK\$2,096,000.
- (ii) Under the arrangements currently in force, the aggregate emoluments payable by the Group to the Directors for the year ending 31st December, 1999 are set out in section 8 of the accountants' report set out in Appendix I to this prospectus.

(d) *Interests of the Directors in the share capital of the Company after the Share Offer and the Capitalisation Issue*

- (i) Immediately following the Share Offer and the Capitalisation Issue and assuming that the Over-Allotment Option is not exercised, the interests of the Directors in the share capital of the Company and its associated corporations (within the meaning of the Securities (Disclosure of Interests) Ordinance (Chapter 396 of the Laws of Hong Kong) (the "SDI Ordinance")) which will have to be notified to the Company and the Stock Exchange pursuant to section 28 of the SDI Ordinance (including interests in which they are taken or deemed to have under section 31 of, or Part I of the Schedule to, the SDI Ordinance) once the Shares are listed or which will be required pursuant to section 29 of the SDI Ordinance to be entered in the register referred to therein, once the Shares are listed, or pursuant to the Model Code for Securities Transactions by Directors of Listed Companies in the Listing Rules, to be notified to the Company and the Stock Exchange once the Shares, are listed will be as follows:

Director	No. of Shares				Total interest
	Corporate interests	Personal interests	Family interests	Other interests	
Mrs. Jiang	450,000,000 (Note 1)	—	—	—	450,000,000

Notes:

1. These shares are held by YY Holdings. The shares in YY Holdings are in turn held by the trustee of the Jiang family trust, the discretionary object of which is a company wholly owned by Mrs. Jiang.
2. On the basis that the Over-Allotment Option is exercised in full, the total interest of Mrs. Jiang will be reduced from 75% to 72.3%.
3. YY Holdings has agreed with China Everbright that, if so requested by China Everbright, it will make available or procure that there are made available to China Everbright, on a temporary basis and by way of stock lending, up to 22,500,000 Shares held by YY Holdings, in order to cover over-allocations in connection with the Placing. Any Shares lent to China Everbright will be subject to the condition that the same number of Shares must be returned to YY Holdings or its nominees (as the case may be) within three business days after the lapse of the Over-Allotment Option or if

earlier, the exercise in full of the Over-Allotment Option. YY Holdings has applied to the Stock Exchange for a waiver from strict compliance with Rule 10.07 of the Listing Rules in circumstances where YY Holdings, at the request of China Everbright, makes available Shares under such stock lending arrangement.

- (ii) 5% of the equity interest in Xinwei Leeshing Rare Earth is beneficially owned by Xinwei Group Limited, which is a partnership owned as to 95% by Qian Zhiming and as to the remaining 5% by Mr. Jiang.
- (iii) 10,000,000 non-voting deferred shares in Xinwei HK are beneficially owned as to 7,000,000 by Mr. Jiang and 3,000,000 by Mrs. Jiang. The rights and restrictions attaching to such non-voting deferred shares are set out in paragraph 6 of this Appendix.

(e) *Agency fees or commission*

Save as disclosed in this prospectus, within the two years preceding the date of this prospectus, no commission, discounts, brokerages or other special terms have been granted in connection with the issue or sale of any share or loan capital of the Company or any of its subsidiaries.

(f) *Personal guarantees*

Mrs. Jiang has provided a personal guarantee in favour of the landlord of the Group's leased property in Hong Kong for the obligations of the Group under such tenancy agreement. The landlord has agreed in principle that upon the request of the tenant of such tenancy agreement the personal guarantee will be released and replaced by guarantee from the Company or other member of the Group following the listing of the Shares on the Stock Exchange.

(g) *Related parties transactions*

- (i) During the two years preceding the date of this prospectus, the Group had engaged in dealings with certain Directors and their associates as described in note (f) to section 3 of the accountants' report set out in Appendix I to this prospectus.
- (ii) Pursuant to two lease agreements, both dated 1st September, 1999, Mr. Jiang has agreed to lease to the Group the property at Rooms G&H, 8th Floor, Zhao Feng Universe Building, 1800 Zhong Shan Xi Road, Shanghai, the PRC. Particulars of the leases are set out in the paragraph headed "Connected transactions" under the section headed "Business" of this prospectus.

(h) *Disclaimers*

Save as disclosed in this prospectus:

- (i) and taking no account of any Shares which may be taken up or acquired under the Share Offer or upon the exercise of the Over-Allotment Option or the exercise of any option which may be granted under the Share Option Scheme, the Directors are not aware of any person who immediately following the Share Offer and the Capitalisation Issue and the exercise (if any) of the Over-Allotment Option will hold either directly or indirectly, or be beneficially interested in, Shares representing 10% or more of the share capital of the Company in issue and to be issued as mentioned herein;

- (ii) none of the Directors has for the purpose of section 28 of the SDI Ordinance or the Listing Rules, nor is any of them taken to or deemed to have under section 31 of, or Part 1 of the Schedule to, the SDI Ordinance, any interests in the securities of the Company or any associated corporations (within the meaning of the SDI Ordinance) or any interests which will have to be entered in the register to be kept by the Company pursuant to section 29 of the SDI Ordinance or which will be required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies once the Shares are listed on the Stock Exchange;
- (iii) and in particular as disclosed in this paragraph 12, none of the Directors or the experts named in paragraph 20 of this Appendix has been interested in the promotion of, or has any direct or indirect interest in any assets acquired or disposed of by or leased to, any member of the Group within the two years immediately preceding the date of this prospectus, or which are proposed to be acquired or disposed of by or leased to any member of the Group nor will any Director apply for New Shares either in his own name or in the name of a nominee;
- (iv) and in particular as disclosed in this paragraph 12 of this Appendix, no Director is materially interested in any contract or arrangement subsisting at the date of this prospectus which is significant in relation to the business of the Group taken as a whole; and
- (v) none of the experts named in paragraph 20 of this Appendix has any shareholding in any company in the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any company in the Group.

13. Substantial shareholders

So far as the Directors are aware, immediately following the Share Offer and the Capitalisation Issue and assuming that the Over-Allotment Option is not exercised, but taking no account of Shares which may be taken up under the Share Offer, the following shareholder will be interested in more than 10% of the Shares then in issue:

Name	Number of shares	Percentage of issued shares
YY Holdings Limited	450,000,000 (Note 1)	75% (Note 2)

Notes:

- The shares in YY Holdings are held by the trustee of the Jiang family trust, the discretionary object of which is a company wholly owned by Mrs. Jiang.
- On the basis that the Over-Allotment Option is exercised in full, the percentage of issued shares held by YY Holdings will be reduced from 75% to 72.3%.

14. Share Option Scheme*(a) Summary of terms**(i) Who may join*

The Directors may, at their absolute discretion, invite any full time employee (“eligible employee”) of the Company or any of its subsidiaries, including any executive director of the Company or any such subsidiary, to take up options to subscribe for Shares.

(ii) Price for Shares

The subscription price for Shares under the Share Option Scheme will be a price determined by the Directors, but may not be less than the higher of 80% of the average of the closing price of Shares on the Stock Exchange for the five trading days immediately preceding the date of the offer of the grant of the option or the nominal value of the Shares. A nominal consideration of HK\$1 is payable on acceptance of the grant of an option.

(iii) Maximum number of Shares

(aa) The maximum number of Shares in respect of which options may be granted under the Share Option Scheme may not (when aggregated with Shares subject to any other employee share option scheme) exceed in nominal amount 10% of the issued share capital of the Company from time to time, excluding for this purpose, Shares issued upon the exercise of any options granted under the Share Option Scheme (or any other employee share option scheme).

(bb) No option may be granted to any one person which, if exercised in full, will result in the total number of Shares already issued and which may fall to be issued to him under all the options previously granted to him pursuant to the Share Option Scheme exceeding 25% of the maximum aggregate number of Shares for the time being issued and which may fall to be issued under the Share Option Scheme.

(iv) Time of exercise of option

An option may be accepted by an employee within 21 days from the date of the offer of grant of the option.

An option may be exercised in accordance with the terms of the Share Option Scheme at any time during a period to be determined and notified by the Directors to each grantee, which period may commence on a day after the date upon which the offer for the grant of options is accepted but shall end in any event not later than 10 years from the date of grant of the option subject to the provisions for early termination thereof.

(v) Rights are personal to the grantee

An option is personal to the grantee and shall not be transferable or assignable save as provided under the rules of the Share Option Scheme.

(vi) Rights on ceasing employment

If the grantee of an option ceases to be an eligible employee of the Group for any reason other than death, ill-health or retirement in accordance with his contract of employment or for serious misconduct or other grounds referred to in sub-paragraph (viii) below before exercising his option in full, the option (to the extent not already exercised) will lapse on the date of cessation and will not be exercisable unless the Directors otherwise determine in which event the grantee may exercise the option (to the extent not already exercised) in whole or in part within such period as the Directors may determine following the date of such cessation, which will be taken to be the last day on which the grantee was at work with the Group whether salary is paid in lieu of notice or not.

(vii) Rights on death, ill-health or retirement

If the grantee of an option ceases to be an eligible employee of the Group by reason of his death, ill-health or retirement in accordance with his contract of employment before exercising the option in full, his personal representative(s), or, as appropriate, the grantee may exercise the option (to the extent not already exercised) in whole or in part within a period of 12 months following the date of cessation which date shall be the last day on which the grantee was at work with the Group whether salary is paid in lieu of notice or not or such longer period as the Directors may determine.

(viii) Rights on dismissal

If the grantee of an option ceases to be an eligible employee of the Group by reason that he has been guilty of serious misconduct or has committed any act of bankruptcy or has become insolvent or has made any arrangements or composition with his creditors generally, or has been convicted of any criminal offence (other than an offence which in the opinion of the Directors does not bring the grantee or the Company into disrepute), his option will lapse automatically and will not in any event be exercisable on or after the date of cessation to be an eligible employee.

(ix) Effect of alterations to capital

In the event of any alteration in the capital structure of the Company whilst an option remains exercisable, such corresponding alterations (if any) certified by the auditors for the time being of the Company as fair and reasonable will be made to the number or nominal amount of Shares the subject matter of the Share Option Scheme and the option so far as unexercised and/or the option price and/or the method of exercise of the option concerned, provided that such alteration will be made on the basis that the aggregate subscription price payable by the grantee upon the full exercise of any option shall remain as nearly as possible the same (but shall not be greater than) it was before such event, but so that no alteration shall be made the effect of which would be to enable a Share to be issued at less than its nominal value or to increase the proportion of the issued share capital of the Company for which any grantee is entitled to subscribe pursuant to the option granted to him immediately prior to such alteration; provided that the issue of securities of the Company as consideration in a transaction shall not be regarded as a circumstance requiring any such adjustment.

(x) Rights on a general offer, a compromise or arrangement

If a general or partial offer, whether by way of take-over offer, share re-purchase offer, or scheme of arrangement or otherwise in like manner is made to all the holders of Shares, or all such holders other than the offeror and/or any person controlled by the offeror and/or any person acting in association or concert with the offeror, the Company shall use all reasonable endeavours to procure that such offer is extended to all the grantees on the same terms, *mutatis mutandis*, and assuming that they will become, by the exercise in full of the options granted to them, shareholders of the Company. If such offer becomes or is declared unconditional, a grantee shall be entitled to exercise his option (to the extent not already exercised) to its full extent or to the extent specified in the grantee's notice to the Company in exercise of his option at any time before the close of such offer (or any revised offer). Subject to the above, an option will lapse automatically (to the extent not exercised) on the date on which such offer (or, as the case may be, revised offer) closes.

(xi) Rights on winding up

In the event of an effective resolution being proposed for the voluntary winding-up of the Company during the option period, the grantee may, subject to the provisions of all applicable laws, by notice in writing to the Company at any time prior to the date on which such resolution is passed, exercise his option (to the extent not already exercised) either to its full extent or to the extent specified in such notice in accordance with the provisions of the Share Option Scheme and shall accordingly be entitled, in respect of the Shares falling to be allotted and issued upon the exercise of his option, to participate in the distribution of the assets of the Company available in liquidation *pari passu* with the Shares in issue on the day prior to the date of such resolution.

(x) Ranking of Shares

(aa) Shares allotted upon the exercise of an option will be subject to all the provisions of the articles of association of the Company and will rank *pari passu* in all respects with the fully paid Shares in issue on the date on which the option is duly exercised (the "Exercise Date") and accordingly will entitle the holders thereof to participate in all dividends or other distributions paid or made on or after the Exercise Date other than any dividend or other distribution previously declared or recommended or resolved to be paid or made if the record date therefor shall be before the Exercise Date. A Share allotted upon the exercise of an option shall not carry voting rights until the completion of the registration of the grantee as the holder thereof.

(bb) Unless the context otherwise requires, references to "Shares" in this paragraph include references to shares in the ordinary equity share capital of the Company of such nominal amount as shall result from a sub-division, consolidation, re-classification or reduction of the share capital of the Company from time to time.

(xi) Period of the Share Option Scheme

The Share Option Scheme will remain in force for a period of 10 years commencing on the date on which the Share Option Scheme becomes unconditional.

(xii) Others

- (aa) The Share Option Scheme is conditional on the Listing Committee of the Stock Exchange granting approval of such scheme, the subsequent grant of options by the Company pursuant thereto and listing of and permission to deal in the Shares to be issued pursuant to the exercise of any options which may be granted under the Share Option Scheme.
- (bb) The terms and conditions of the Share Option Scheme shall not be altered to the advantage of grantees of the options except with the approval of the shareholders in general meeting
- (cc) Any alterations to the terms and conditions of the Share Option Scheme which are of a material nature must be approved by the Stock Exchange, except where the alterations take effect automatically under the existing terms of the Share Option Scheme.

(b) *Present status of the Share Option Scheme*

Application has been made to the Listing Committee of the Stock Exchange for the approval of the Share Option Scheme, the subsequent grant of options under the Share Option Scheme and the listing of and permission to deal in the Shares to be issued pursuant to the exercise of any options which may be granted under the Share Option Scheme.

As at the date of this prospectus, no options have been granted or agreed to be granted under the Share Option Scheme.

OTHER INFORMATION**15. Estate duty and tax indemnity**

Each of YY Holdings, Mr. Jiang and Mrs. Jiang (collectively the “Indemnifiers”) has entered into a deed of indemnity with and in favour of the Group (being the material contract (j) referred to in paragraph 9 of this Appendix) to provide indemnities on a joint and several basis in respect of, among other matters, any liability for Hong Kong estate duty which might be incurred by any member of the Group and/or its associated companies by reason of any transfer of property (within the meaning of section 35 of the Estate Duty Ordinance) to any member of the Group on or before the date on which the Share Offer becomes unconditional. The Directors have been advised that no material liability for estate duty is likely to fall on the Company or any of its subsidiaries in the Cayman Islands, the British Virgin Islands and the PRC.

Under the deed of indemnity, YY Holdings, Mr. Jiang and Mrs. Jiang have also given indemnities to the Group on a joint and several basis in relation to taxation which might be payable by any member of the Group in respect of any income, profits or gains earned, accrued or received on or before the date on which the Share Offer becomes unconditional, save in certain circumstances where:

- (a) provision has been made for such taxation in the audited accounts of any member of the Group up to 30th April, 1999;

- (b) any increase in the claim for taxation or the amount of any increase in any claim to the extent such claim or such increased portion of the claim arises or is incurred as a result of the imposition of taxation as a consequence of any retrospective change in the law or in the rate of taxation coming into force on or after the date when the Share Offer becomes unconditional;
- (c) adjustments have been made in the adjusted net tangible assets of the Group as set out in the paragraph headed “Adjusted Net Tangible Assets” in the section headed “Financial Information” in this prospectus, to the extent that the amount of such adjustments are proved to be adequate and sufficient for the purpose of calculating the adjusted net tangible assets of the Group; and
- (d) any provisions or reserve made for such claim for taxation in the audited accounts of any member of the Group up to 30th April, 1999 which is finally established to be an over-provision or an excessive reserve, then the Indemnifiers’ liability (if any) in respect of such taxation shall be reduced by an amount not exceeding such over-provision or excessive reserve provided that the amount of any such provisions or excessive reserve applied to reduce the Indemnifiers’ liability in respect of such claim for taxation shall not be available in respect of any such liability arising thereafter in which event the Indemnifiers shall be obliged to indemnify each member of the Group against any liability, loss or damages arising from such liability.

16. Litigation

Neither the Company nor any of its subsidiaries is engaged in any litigation or arbitration of material importance and no litigation or claim of material importance is known to the Directors to be pending or threatened against the Company or any of its subsidiaries.

17. Sponsor

China Everbright and Vickers, together with the Company, have made an application to the Listing Committee of the Stock Exchange for the listing of, and permission to deal in, the Shares in issue and to be issued as mentioned herein, and Shares which may fall to be issued upon the exercise of the Over-Allotment Option and Shares which may fall to be issued pursuant to the exercise of options which may be granted under the Share Option Scheme.

18. Preliminary expenses

The estimated preliminary expenses of the Company are approximately US\$2,500 and are payable by the Company.

19. Promoter

- (a) The promoter of the Company is YY Holdings, which is incorporated in the British Virgin Islands on 13th July, 1999. Mr. Jiang is the director of YY Holdings.
- (b) Save as disclosed herein, within the two years preceding the date of this prospectus, no cash, securities, or other benefit has been paid, allotted or given or proposed to be allotted or given to the promoter named in sub-paragraph (a) above.

20. Qualification of experts

The qualifications of the experts who have given opinions in this prospectus and/or whose names are included in this prospectus are as follows:

Name	Qualification
China Everbright Capital Limited	Registered investment adviser
Vickers Ballas Capital Limited	Registered investment adviser
Arthur Andersen & Co.	Certified public accountants
Vigers Hong Kong Limited	Professional surveyors
Conyers Dill & Pearman, Cayman	Cayman Islands barristers and attorneys
Commerce & Finance Law Office	Licensed legal advisers on PRC securities law

21. Consents of experts

China Everbright, Vickers, Arthur Andersen & Co., Vigers, Conyers Dill & Pearman, Cayman and Commerce & Finance Law Office have given and have not withdrawn their respective written consents to the issue of this prospectus with copies of their reports, valuation, letters or opinions (as the case may be) and the references to their names or summaries of opinions included herein in the form and context in which they respectively appear.

22. Binding effect

This prospectus shall have the effect, if an application is made in pursuance hereof, of rendering all persons concerned bound by all of the provisions (other than the penal provisions) of sections 44A and 44B of the Companies Ordinance so far as applicable.

23. Taxation of holders of Shares**(a) Hong Kong**

Dealings in Shares will be subject to Hong Kong stamp duty. The sale, purchase and transfer of Shares are subject to Hong Kong stamp duty the current rate of which is HK\$2.5 for every HK\$1,000 (or part thereof) of the consideration or, if higher, the fair value of the Shares being sold or transferred.

Profit from dealings in the Shares arising in or derived from Hong Kong may also be subject to Hong Kong profits tax.

The Shares are Hong Kong property for the purposes of the Estate Duty Ordinance (Chapter 111 of the Laws of Hong Kong) and, accordingly, Hong Kong estate duty may be payable in respect thereof on the death of an owner of Shares.

(b) Cayman Islands

Under present Cayman Islands law, transfers and other dispositions of Shares are exempt from Cayman Islands stamp duty.

(c) *Professional tax advice recommended*

Intending holders of Shares are recommended to consult their professional advisers if they are in any doubt as to the taxation implications of subscribing for, purchasing, holding or disposing of or dealing in Shares. It is emphasised that none of the Company, the Directors or the other parties involved in the Share Offer can accept responsibility for any tax effect on, or liabilities of, holders of Shares resulting from their subscription for, purchase, holding or disposal of or dealing in Shares.

24. **Miscellaneous**

(a) Save as disclosed herein:

(i) within two years preceding the date of this prospectus:

(aa) no share or loan capital of the Company or of any of its subsidiaries has been issued, agreed to be issued or is proposed to be issued fully or partly paid either for cash or for a consideration other than cash; and

(bb) no commissions, discounts, brokerages or other special terms have been granted in connection with the issue or sale of any share or loan capital of the Company or any of its subsidiaries;

(ii) no share or loan capital of the Company or any of its subsidiaries is under option or is agreed conditionally or unconditionally to be put under option; and

(iii) there has been no material adverse change in the financial or trading position or prospects of the Group since 30th April, 1999 (being the date to which the latest audited financial statements of the Group were made up).

(b) The Company has no founder shares, management shares or deferred shares.

(c) Subject to the provisions of the Companies Law, the register of members of the Company will be maintained in the Cayman Islands by Bank of Butterfield International (Cayman) Limited and a branch register of members of the Company will be maintained in Hong Kong by Central Registration Hong Kong Limited. Unless the Directors otherwise agree, all transfers and other documents of title of Shares must be lodged for registration with and registered by, the Company's share registrar in Hong Kong and may not be lodged in the Cayman Islands.

(d) All necessary arrangements have been made to enable the Shares to be admitted to CCASS.

APPENDIX VII DOCUMENTS DELIVERED TO THE REGISTRAR OF COMPANIES IN HONG KONG AND AVAILABLE FOR INSPECTION

DOCUMENTS DELIVERED TO THE REGISTRAR OF COMPANIES

The documents attached to the copy of this prospectus delivered to the Registrar of Companies in Hong Kong for registration were copies of the white and yellow application forms, the written consents referred to in the paragraph headed “Consents of experts” in Appendix VI to this prospectus and copies of the material contracts referred to in the paragraph headed “Summary of material contracts” in Appendix VI to this prospectus.

DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection at the offices of Chiu & Partners, 41st Floor, Jardine House, 1 Connaught Place, Central, Hong Kong during normal business hours up to and including 19th October, 1999;

- (a) the memorandum and articles of association of the Company;
- (b) the combined audited financial statements of the Group for the two years ended 31st December, 1998 and the four months ended 30th April, 1999;
- (c) the accountants’ report, the text of which is set out in Appendix I to this prospectus ;
- (d) the letters relating to the profit forecast of the Group, the texts of which are set out in Appendix II to this prospectus;
- (e) the letter, summary of values and valuation certificate prepared by Vigers, the text of which is set out in Appendix III to this prospectus;
- (f) the rules of the Share Option Scheme;
- (g) the letter of advice prepared by Conyers Dill & Pearman, Cayman referred to at the end of Appendix IV to this prospectus;
- (h) the Companies Law;
- (i) the material contracts referred to in the paragraph headed “Summary of material contracts” of Appendix VI to this prospectus;
- (j) the written consents referred to in the paragraph headed “Consents of experts” of Appendix VI to this prospectus;
- (k) the service contracts referred to in the paragraph headed “Particulars of Directors’ service contracts” of Appendix VI to this prospectus; and
- (l) the letter of advice prepared by Commerce & Finance Law Office referred to in paragraph 9 of Appendix V to this prospectus.