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**CHINA SHANSHUI CEMENT GROUP LIMITED**

**中國山水水泥集團有限公司**

(於開曼群島註冊成立之有限公司)

(股份代號：691)

### 發行優先票據的建議

本公司建議在國際發售票據，並由二零一一年七月十一日或前後起，開始向亞洲的機構投資者進行一連串的路演簡介會。現建議本公司若干在中國境外組建的附屬公司按優先償還的基準為票據提供擔保。中銀國際、瑞信、德銀和瑞銀已獲委任為聯席牽頭經辦人兼聯席賬簿管理人。票據發行建議只會根據《證券法》S規例向身處美國境外之人士提呈發售。本公司為進行票據發行建議，將向若干機構投資者提供本集團最新的企業和財務資料，包括但不限於最新的風險因素、本公司業務概況說明、管理層對財務狀況及經營業績的討論與分析、對業務策略、關聯方交易及其它重大債務、管理人員及主要股東的概況說明；其中部份資料從未公開。本公告附連該等近期資料的節錄，當中部份是過往從未公開過的，而本公司向機構投資者發放該等資料時，該等節錄資料亦差不多同時會在本公司網站[www.shanshuigroup.com](http://www.shanshuigroup.com)登載。

票據訂價，包括本金總額、發售價及息率，將由聯席牽頭經辦人通過入標定價方式釐定。票據條款一經落實，聯席牽頭經辦人和本公司等將訂立《購買協議》和其他附屬文件。

本公司目前擬將票據發行建議所得資金用作現有借款的再融資，以及作一般的公司用途。本公司有可能因應日後出現的事件或發展而重新調配所得資金淨額。

票據已獲新交所原則上批准上市及報價。新交所原則上的批准不應視為本公司、其附屬公司或票據價值的指標。新交所不對本公告內任何陳述或當中任何意見或所載任何報告的準確性承擔任何責任。本公司沒有也不會申請將票據在香港上市。

截至本公告發出當日為止，各方尚未為票據發行建議訂立任何具約束力的協議，故票據發行建議不一定得以完成。票據發行建議能否完成，需視乎市況和投資者的反應而定。投資者與本公司股東在買賣本公司證券時，務必審慎行事。《購買協議》若得以簽署的，本公司將就票據發行建議另行公告。

## 發行票據建議

### 引言

本公司建議在國際發售票據，並由二零一一年七月十一日或前後起，開始向亞洲的機構投資者進行一連串的路演簡介會。現建議本公司若干在中國境外組建的附屬公司按優先償還的基準為票據提供擔保。中銀國際、瑞信、德銀和瑞銀已獲委任為聯席牽頭經辦人兼聯席賬簿管理人。票據發行建議只會根據《證券法》S規例向身處美國境外之人士提呈發售。本公司不會在香港向公眾人士要約出售票據，亦不會向本公司任何關連人士配售票據。

本公司為進行票據發行建議，將向若干機構投資者提供本集團最新的企業和財務資料，包括但不限於最新的風險因素、本公司業務概況說明、管理層對財務狀況及經營業績的討論與分析、對業務策略、關聯方交易及其它重大債務、管理人員及主要股東的概況說明；其中部份資料從未公開。本公告附連該等近期資料的節錄，當中部份是過往從未公開過的，而本公司向機構投資者發放該等資料時，該等節錄資料亦差不多同時會在本公司網站[www.shanshuigroup.com](http://www.shanshuigroup.com)登載。

建議發行的票據的訂價，包括本金總額、發售價及息率，將由聯席牽頭經辦人通過入標定價方式釐定。票據條款一經落實，聯席牽頭經辦人和本公司等將訂立《購買協議》和其他附屬文件，而聯席牽頭經辦人將根據該等文件成為票據的初步買家。

## 進行票據發行建議的理由

本集團是中國以產量計最大規模的熟料水泥生產商之一，特別是在山東遼寧兩省。本公司已經抓住自身在山東遼寧兩省的市場領導地位的優勢，把握山西和內蒙兩地建設和基建行業的良好發展機會，通過實質業務發展與併購交易，迅速在該等地區建立市場地位。本集團也正通過新的發展項目拓展至新疆地區。本集團利用新型乾法生產技術生產不同等級的水泥產品出售，主要產品包括生產熟料，即生產水泥的主要成份。此外，本集團亦生產和銷售其他產品，如混凝土。本集團的水泥產品銷量由二零零八年的25,100,000噸增加至二零零九年的29,400,000噸，至二零一零年時再升至39,300,000噸。本集團生產的熟料雖有大部份用作自身的水泥生產，但在二零零八年、二零零九年及二零一零年亦向對外客戶分別銷售5,500,000噸、8,400,000噸及9,800,000噸熟料。

本公司擬將票據發行建議所得資金用作現有借款的再融資，以及作一般的公司用途。

然而，本公司將視乎日後出現的事件或發展，例如整體市況、市場對本集團產品的需求、水泥業前景，以及本集團經營業務所在城市的社會狀況、政治狀況、經濟狀況與監管環境的變化，與本集團的資金需求和可動用的融通資金的變化，而以有別於上述的方式使用資金淨額。

## 上市

票據已獲新交所原則上批准上市及報價。新交所原則上的批准不應視為本公司、其附屬公司或票據價值的指標。新交所不對本公告內任何陳述或當中任何意見或所載任何報告的準確性承擔任何責任。本公司沒有也不會申請將票據在香港上市。

## 一般事宜

截至本公告發出當日為止，各方尚未為票據發行建議訂立任何具約束力的協議，故票據發行建議不一定得以完成。票據發行建議能否完成，需視乎市況和投資者的反應而定。投資者與本公司股東在買賣本公司證券時，務必審慎行事。《購買協議》若得以簽署的，本公司將就票據發行建議另行公告。

## 另行公告

票據的條件及條款，包括但不限於本金總額、發售價及利率目前仍有待確定，可能有變。票據的條款條件一經落實，本公司將就票據發行建議另行公告。

## 釋義

本公告內，除內文另有界定或文義另有所指外，以下詞彙具有下列涵義：

「董事會」	指	本公司董事會
「中銀國際」	指	中銀國際亞洲有限公司，票據發行建議的聯席牽頭經辦人兼聯席賬簿管理人之一
「瑞信」	指	Credit Suisse (Hong Kong) Limited，票據發行建議的聯席牽頭經辦人兼聯席賬簿管理人之一
「德銀」	指	Deutsche Bank AG (德意志銀行) 香港分行，票據發行建議的聯席牽頭經辦人兼聯席賬簿管理人之一
「中國」	指	中華人民共和國，除文義另有規定外，本公告內「中國」不包括香港、中國澳門特別行政區和台灣
「本公司」	指	中國山水水泥集團有限公司，開曼群島註冊成立的有限公司，股份在聯交所主板上市
「關連人士」	指	《上市規則》所賦予的意思
「本集團」	指	本公司與其附屬公司
「香港」	指	中國香港特別行政區
「聯席牽頭經辦人」	指	中銀國際、瑞信、德銀及瑞銀
「《上市規則》」	指	《香港聯合交易所有限公司證券上市規則》
「票據」	指	本公司將發行的優先票據
「發售價」	指	票據的最終售價
「票據發行建議」	指	本公司在國際發售票據

「《購買協議》」	指	建議將由（其中包括）本公司、聯席牽頭經辦人和擔保人等各方就票據發行建議而訂立認購票據的協議
「《證券法》」	指	美國《一九三三年證券法》（經修訂版本）
「新交所」	指	新加坡證券交易有限公司
「聯交所」	指	香港聯合交易所有限公司
「瑞銀」	指	UBS AG（瑞士銀行）香港分行，票據發行建議的聯席牽頭經辦人兼聯席賬簿管理人之一

承董事會命  
中國山水水泥集團有限公司  
董事長  
張才奎

香港，2011年7月11日

於本公告發出之日，本公司董事會成員包括四名執行董事，即張才奎（董事長）、董承田、于玉川及張斌（副董事長兼總經理）；兩名非執行董事，即孫弘及焦樹閣；及三名獨立非執行董事，即孫建國、王燕謀及王堅。

## RISK FACTORS

### Risks Relating to Our Business

*Our business depends significantly on the level of activity and growth in the construction industry in Shandong and Liaoning provinces.*

Until recently, our cement products have been sold exclusively in Shandong and Liaoning provinces. Although we have expanded into other areas of China as our target markets, we expect Shandong and Liaoning provinces will remain our core markets in the near future. As a result, the demand for our products is predominantly dependent on the level of activity and growth in the construction industry in Shandong and Liaoning provinces, which in turn depends on factors such as general economic conditions, government policy, GDP growth, fixed asset investment (“FAI”), consumer confidence, inflation and demographic trends in Shandong and Liaoning provinces. Our lack of geographical diversity exposes us to risks associated with fluctuations in the political and economic conditions of Shandong and Liaoning provinces.

We have historically benefited from the high rate of growth in the economy of Shandong and Liaoning provinces. Since 2001, the growth rates of Shandong and Liaoning provinces’ respective GDP and FAI have consistently been above the national averages. For the year ended December 31, 2010, according to Shandong Provincial Bureau of Statistics, Shandong province’s GDP and FAI increased by approximately 12.5% and 22.3%, respectively, compared with 2009, and according to Liaoning Provincial Bureau of Statistics, Liaoning province’s GDP and FAI increased by approximately 14.1% and 30.5%, respectively, compared with 2009, while GDP and FAI for China increased by approximately 10.3% and 23.8%, respectively, during the same period. As a result of the economic development and growth in Shandong and Liaoning provinces, the demand for construction materials, including cement, grew rapidly. Meanwhile, as a result of the PRC government’s policy mandating phasing out of obsolete production facilities, supply of cement products decreased significantly. The fast growth of the economy and the construction industry, particularly government infrastructure projects, and decreased supply of cement products in the market, have been the main drivers of the growth of the cement industry in Shandong and Liaoning provinces and the growth of our business.

We cannot assure you that the GDP, FAI or the demand for cement in Shandong and Liaoning provinces will continue to grow at historical rates, or at all. Any slowdown in the growth of Shandong and Liaoning provinces’ economy or a downturn in the construction industry, particularly government infrastructure projects, in Shandong and Liaoning provinces could affect the demand for our products, which in turn could have a material and adverse effect on our business, financial condition and results of operations.

*We may face difficulties in integrating acquired businesses with our own, and if we do not realize the anticipated benefits from the acquired businesses or our strategic investments, our business, results of operations and financial condition may be adversely affected.*

In 2010, we acquired equity interests in 12 entities engaged in the cement business in Shanxi province, Shaanxi province, Inner Mongolia and Tianjin municipality, and we may make similar acquisitions in the future. We may experience difficulties in integrating the acquired businesses, and their personnel and products with those of ours due to differences in our respective business cultures or other factors. Our management’s time and attention may as a result be diverted from other business concerns, and we may experience difficulties in retaining key employees and customers of the acquired businesses or strategic investments. In addition, we may incur higher capital expenditure and integration costs than we initially anticipated. Our acquisitions or strategic investments may also result in the incurrence and/or assumption of debt or other liabilities and the amortization of expenses related to goodwill and other intangible assets, which could have a material adverse effect on our results of operations and financial condition. We cannot assure you that we will be successful in realizing all of the anticipated benefits in the acquisitions or strategic investments that we have made or may make in the future. Failure to realize these anticipated benefits may materially adversely affect our business, results of operations and financial condition.

***We may not be successful in identifying and acquiring suitable acquisition targets or making strategic investments, which could adversely affect our growth.***

We have in the past expanded, and intend to expand in the future, our operations and markets through acquisitions or strategic investments. The identification and completion of such acquisitions or investments are dependent upon various factors, including satisfactory completion of due diligence, negotiation of definitive agreements and our ability to compete with other entities to acquire attractive targets. There is no assurance that in the future we will be able to identify and acquire appropriate acquisition targets on commercially acceptable terms, if at all, or will have sufficient capital to fund such acquisitions or investments. Failure in identifying and acquiring suitable acquisition targets or making strategic investments in the future could adversely affect our growth.

***We may not be able to continue to grow at rates comparable to our historical growth rates, or we may have difficulty managing our future growth and expansion into new markets.***

Our revenue and net profit have grown significantly during the years ended December 31, 2008, 2009 and 2010. Our revenue was approximately RMB7,500.7 million, RMB8,727.6 million and RMB11,854.1 million, respectively, representing a CAGR of 16.5%, and our net profit for the same periods was approximately RMB549.1 million, RMB714.0 million and RMB1,004.9 million, respectively, representing a CAGR of 22.3%. The significant increases in our revenue and net profit were mainly due to the growth in the demand for our products and the expansion of our production capacity, which in turn were attributable to the growth of the economy in general and the construction industry in Shandong and Liaoning provinces.

We may not be able to grow, either in terms of revenue or net profit, at rates comparable to our historical growth rates, or at all. Our plan to expand capacity in certain markets may involve our construction of additional production lines and acquisitions of other companies, which in turn may strain our managerial, operational, technical support, financial and human resources. We have until recently only operated in Shandong and Liaoning provinces. Given suitable business opportunities, we have expanded and continue to expand our operations into other parts of China, in particular western China, where we believe there is substantial opportunities for growth. If we were to expand into other provinces or regions, we cannot assure you that we would be able to overcome challenges posed by the new markets we choose to enter, including different customer and supplier practices and differing regulations and regulatory environment. As a result, we may not be able to manage such growth in a cost effective manner. Failure to effectively manage our growth could have a material adverse effect on our business, financial condition and results of operations, and could jeopardize our ability to achieve our business strategies and maintain our market position.

***Our profitability and results of operations are subject to fluctuations in the supply and costs of raw materials, coal and electricity, and we may be unable to pass on some or all of any the increases in such costs to our customers.***

The costs of limestone, coal and electricity account for a substantial portion of our production costs. For the years ended December 31, 2008, 2009 and 2010, the aggregate costs of raw materials, coal and electricity represented 84.0%, 77.7% and 77.6%, of our total cost of sales, respectively. See “Business – Raw Materials, Coal and Electricity.”

We rely on third party suppliers and our own limestone mines for the supply of limestone. For the years ended December 31, 2008, 2009 and 2010, we sourced 57.0%, 54.5% and 46.6% of our limestone supply from third party suppliers. Since January 2007, we have experienced a surge in limestone prices caused by the closure of small-scale limestone processing plants mandated by the PRC government. Our unit purchase price of limestone increased from RMB12.72 per ton in 2008 to RMB13.53 per ton in 2010. As a result, we used a greater amount of our own limestone mine reserves in 2010 than in previous years to support our production. Meanwhile, our mining rights to our limestone mines are subject to certain conditions and various national and local government regulations. The mining rights we have obtained are

valid for a period of 2 to 13 years and generally renewable upon expiration. As of December 31, 2010, the ownership certificates for certain limestone mining rights with a carrying amount of RMB123.5 million have not been obtained. To the extent we are ordered by the relevant authorities to cease excavation of the mines pending ownership certificates, we may be subject to fines and disgorge profits obtained from the relevant mines. There is no assurance that our mining rights to our limestone mines will not be revoked or will be renewed upon expiration, or significant restrictions on the usage of the rights will not be imposed on us in the future. In addition, there is no assurance that in the future we will be able to acquire more limestone reserves and obtain relevant mining rights. Furthermore, we have experienced significant increases in coal prices in recent years due to a surge in coal demand coupled with transportation bottlenecks in China. Our unit purchase price of coal per ton increased from RMB680.1 in 2008 to RMB691.8 in 2010. Such increase in coal prices may also cause an increase in electricity prices. Our average purchase price of electricity increased from RMB0.46 KWh in 2008 to RMB0.53 KWh in 2010. If our raw materials and energy costs were to continue to increase and if we were unable to fully pass on any increased costs to our customers, our profitability and results of operations may be materially adversely affected.

***The cement industry is capital intensive, and we may need to seek additional financing to support our growth.***

The cement industry is highly capital intensive. We require a substantial amount of capital to build our production facilities, purchase production equipment, develop and implement new technologies in our new and existing facilities and undertake business acquisitions. For the years ended December 31, 2008, 2009 and 2010, our capital expenditures, as represented by payment for purchase of fixed assets, payment for purchase of intangible assets and acquisition of subsidiaries, net of cash acquired, were approximately RMB2,394.6 million, RMB2,155.3 million and RMB2,851.9 million, respectively, accounting for approximately 31.9%, 24.7% and 24.1% of our revenue for the same periods. Such amounts have exceeded our net cash generated from operating activities in the years ended December 31, 2008, 2009 and 2010. We expect to continue incurring significant capital expenditures which may continue to exceed our net cash from operating activities.

If our internally generated capital resources, net proceeds from the offering of the Notes and available credit facilities are insufficient to finance our capital expenditure and growth plans, we may have to seek additional financing from third parties, including banks, private equity funds, joint-venture partners and other strategic investors. We may also consider raising funds through issuance of new shares, which would lead to dilution of our existing shareholders' interests in our company. Our ability to obtain external financing in the future and the cost of such financing are subject to uncertainties, including our future financial and cash flow conditions and results of operations, general economic and capital market conditions, the cement industry conditions, credit availability from financial institutions, investors' confidence in our company and the legal and economic environment in China.

We recorded net current liabilities as of December 31, 2008, 2009 and 2010. We may record net current liabilities after the offering of the Notes and in future periods as we continue to expand and make significant capital investments. Our net current liabilities position exposes us to liquidity risks. Our future liquidity, the payment of trade and other payables and the repayment of our outstanding debt obligations as and when they become due will depend primarily on our ability to maintain adequate cash inflows from operating activities. There is no assurance that external sources of financing will be available on reasonable terms or at all, in the future to fund our existing operations and business expansion. Failure to obtain such financing may force us to delay our expansion plans, downsize or abandon such plans, which may materially and adversely affect our business, financial condition and results of operations, as well as our future prospects.

*We had high gearing ratios in the past and our financial performance and operating results could be materially and adversely affected by our indebtedness.*

We have historically relied on both short-term and long-term borrowings to fund a portion of our capital requirements, and expect to continue to do so in the future. As of December 31, 2008, 2009 and 2010, we had total debt (including loans and borrowings as well as convertible notes and corporate bonds) of approximately RMB4,767.4 million, RMB5,755.2 million and RMB7,398.7 million, respectively, and we had net current liabilities (total current liabilities minus total current assets) of approximately RMB2,079.5 million, RMB1,663.0 million and RMB2,253.6 million, respectively, as of the same dates. Our gearing ratios (net debt divided by total capital) as of December 31, 2008, 2009 and 2010 were 43.6%, 48.2% and 50.4%, respectively.

Our level of indebtedness could have a materially adverse effect on us. For example, it could:

- require us to dedicate a large portion of our cash flow from operations to fund repayments of our debt, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- increase our vulnerability to adverse general economic or industry conditions;
- limit our flexibility in planning for, or reacting to, changes in our business or the industry in which we operate;
- limit our ability to raise additional debt or equity capital in the future or increase the cost of such funding;
- restrict us from making strategic acquisitions or exploring business opportunities; and
- increase our exposure to interest rate fluctuations.

Our net current liabilities positions as of December 31, 2008, 2009 and 2010 were primarily due to our large amounts of borrowings, which mainly included short-term and long-term bank borrowings from commercial banks in China. We have historically repaid the short-term loans and the portions due within one year of our long-term loans by rolling over the loans on an annual basis. We cannot assure you that we will be able to continue to roll over our bank loans when they become due. We may not have sufficient funds available to repay our borrowings, particularly our short-term borrowings, upon maturity. Failure to service our debt could result in the imposition of penalties, including among other things, increases in rates of interest that we pay on our debt and legal actions against us by our creditors, and may negatively impact our business operations.

Our bank borrowings from certain PRC commercial banks have terms that require our subsidiaries to maintain certain financial ratios and conditions of assets related to cement operations. For details of these ratios and conditions, see “Description of Other Material Indebtedness.” If we breach any of these terms, the loans will become repayable on demand. As of December 31, 2010, with respect to such bank borrowings from certain PRC commercial banks with a total outstanding balance of RMB160.0 million, certain subsidiaries did not meet their respective covenants in the relevant long-term loan agreements and their lenders provided confirmations that the non compliance would not accelerate repayment of these loans.

Our liquidity depends on cash generated from operations, cash and cash equivalents, and our access to further financial resources to fulfill our short-term payment obligations, which will be affected by our future operating performance, prevailing economic conditions, and financial, business and other factors, many of which are beyond our control.

***We have a substantial amount of bank borrowings and some of our bank loans have floating interest rates and an increase in the interest rate may have an adverse effect on our financial performance.***

As of December 31, 2010, we had total debt of approximately RMB7,398.7 million, among which a number of loans have floating interest rates linked to, among others, one to three years benchmark rates of the People's Bank of China ("PBOC") and the London Interbank Offered Rate ("LIBOR"). If there is a material increase in the reference rates during the term of our relevant loan facilities or when our current loan facilities become due, our finance costs may increase substantially and our results of operations and financial performance may be adversely affected.

***We rely on our key management personnel.***

Our performance and implementation of our business plan rely, to a significant extent, on the service of our Directors, particularly Mr. Caikui Zhang, our chairman and executive director, and Mr. Bin Zhang, our vice chairman, executive director and general manager, and other senior management. We do not maintain key employee insurance. In the event that we lose the services of any key management personnel, we may be unable to identify and recruit suitable replacements in a timely manner or at all. In addition, if any member of our senior management were to join a competitor or form a competing company, we may lose some of our know-how and customers. These will materially adversely affect our business and operations. We may also need to employ and retain more management personnel to support our expansion into other new target markets in the future. We cannot assure you that we will be able to attract and retain qualified personnel. If we are unable to hire and retain qualified management personnel, our business and future growth may be adversely affected.

***Our business depends on our ability to manage our working capital successfully.***

We depend on cash from our operating activities and short-term bank loans for our working capital needs. Our success depends on our ability to continue to secure and successfully manage sufficient amounts of working capital. Such successful management primarily involves (i) timely payments of, or rolling over of, our short-term indebtedness and securing new loans on favorable terms, (ii) timely payments or re-negotiation of our payment terms for our trade payables, (iii) efficiently utilizing banking facilities, (iv) timely collection of trade receivables and (v) establishing and executing accurate and feasible budgets for our business operations. If we cannot manage our working capital successfully, our business, financial condition and results of operations could be materially and adversely affected.

***Our operations rely on a continuous power supply and the ready availability of utilities. Any shortages or interruptions could disrupt our operations and increase our expenses.***

The production of our cement and clinker products relies on a continuous and uninterrupted supply of electric power, water and natural gas, as well as water, waste and emissions discharge facilities. Any shortage or interruption of such supply could significantly disrupt our operations and increase our expenses. We do not have backup generators or alternate sources of power to support our production in the event of a blackout. In addition, our insurance coverage does not extend to any damages resulting from interruption in our power supply. Any interruption in our ability to continue operations at our facilities may have an adverse effect on our operations and reputation, or our ability to retain existing customers or attract new customers, any of which could have a material adverse effect on our business, financial condition and results of operations.

***Our operations are subject to relevant environmental laws and regulations.***

Our operations are subject to various national and regional laws and regulations relating to environmental protection. These include provisions for prevention and treatment of noise, water, soil and air pollution and other industrial pollution. Failure to comply with these laws and regulations could result in legal proceedings, the assessment of damages or imposition of fines or penalties against us, suspension of production or cessation of our operations. The implementation of more stringent laws and regulations, or stricter interpretation of the existing laws and regulations, may require us to incur additional expenses to comply with such laws and regulations, which may adversely affect our profitability and results of operations.

***We may not have sufficient insurance coverage against potential operational risks and losses.***

We face various risks in connection with our business and operations which may not be completely eliminated through the implementation of preventive measures. The insurance industry in China is still at an early stage of development. Insurance companies in China offer limited commercial insurance products for the manufacturing sector and do not generally offer them on terms which are commercially acceptable to us. We maintain an all-risks property insurance policy covering our equipment and facilities for loss due to fire or natural disasters, excluding earthquake and floods. We also maintain public liability insurance, profit loss insurance, machinery break-down insurance and product liability insurance. However, we do not maintain key employee insurance. If we incur substantial liabilities that were not covered by insurance or our insurance coverage was not sufficient for the liabilities, or if our business operations were interrupted for more than a short period of time, we could incur costs and losses that could materially and adversely affect our results of operations.

***Our results of operations are subject to seasonal changes in demand for our products.***

We usually experience a reduction in sales during the first quarter of each calendar year. Our sales volume of cement products in the first quarters of 2008, 2009 and 2010 accounted for approximately 19.7%, 15.7% and 13.7%, respectively, of our total sales volume in 2008, 2009 and 2010. Demand for our products is seasonal because climatic conditions, such as cold weather, snow and heavy or sustained rainfall, negatively affect the level of activity in the construction industry, which in turn results in a decrease in demand for and sales of our products. As a result of the seasonal fluctuations, our quarterly results may not be indicative of our business and financial performance for a given year as a whole.

***Any failure to maintain an effective quality control system at our production facilities could have a material and adverse effect on our business, financial condition and results of operations.***

The quality of our products is critical to the success of our business. The quality of our products depends on the effectiveness of our quality control system, which in turn depends on a number of factors, including the design of the system, the quality control training program, and our ability to ensure that our employees adhere to our quality control policies and guidelines. Any failure of our quality control system could result in the production of defective or substandard products, which in turn may result in delays in the delivery of our products, the need to replace defective or substandard products and damage to our reputation, which could have a material and adverse effect on our business, financial condition and results of operations.

***We currently enjoy certain PRC government incentives. Expiration of, or changes to, these incentives could have a material adverse effect on our results of operations.***

Shandong Shanshui, one of our subsidiaries in the PRC, is one of 12 national cement producers that are entitled to government support in the form of priority with respect to project approvals, land use right grants and credit approvals when undertaking mergers, acquisitions and project investments. The PRC government is also currently offering VAT refunds and enterprise income tax exemptions to cement producers that use a certain level of recycled materials, such as slag and fly ash. In 2010, VAT refunds from selling

cement products produced using recycled materials represented approximately 7.67% of our profit before taxation. There is no assurance that we will be able to continue to enjoy such preferential treatments, incentives and favorable support on the same terms, or at all in the future. Unfavorable changes in such preferential treatments, incentives or support will adversely affect our business, results of operations and financial condition.

***Any unauthorized use of our brand names, trademarks and other intellectual property rights may adversely affect our business.***

We rely on the PRC intellectual property and anti-unfair competition laws and contractual restrictions to protect our brand names, trademarks and other intellectual property rights. We believe our brand names, trademarks and other intellectual property rights are important to our business. We market and sell most of our products under our “Shanshui Dongyue” brand name (山水東岳), which has been designated by Jinan Administration for Industry and Commerce as a “Famous Trademark.” Any unauthorized use of our brand names, trademarks and other intellectual property rights could adversely affect our business, reputation and market position. Our “Shanshui Dongyue” brand name has been subject to third party infringement in the past. In an effort to prevent infringements of our intellectual property, we have, among other things, established a committee to focus on intellectual property infringement issues and implemented policies and procedures to address such issues. These policies and procedures include, among other things, using an authenticity code on the package of our products that can be easily identified by our customers. However, any measure we take to protect our intellectual property rights may not be sufficient. Furthermore, the application of laws governing intellectual property rights in China and abroad is uncertain and evolving, and could expose us to substantial risks. If we are unable to adequately protect our brand names, trademarks and other intellectual property rights, our reputation and profitability may be materially and adversely affected.

***Product liability claims may be brought against us and may materially and adversely affect our business, results of operations and financial condition.***

We produce and sell a wide variety of cement products with different specifications and formulations. Although cement products must pass applicable industry tests and comply with contractual specifications and regulatory requirements, there is no assurance that product claims will not be brought against us in the future. If such claims are brought against us, they may adversely affect the reputation of our brand and may materially and adversely affect our business, results of operations and financial condition.

***We may become involved in legal and other proceedings from time to time and may suffer significant liabilities or other losses as a result.***

We have in the past, and may in the future, become involved in disputes with various parties, which may lead to legal or other proceedings and may result in substantial costs and diversion of resources and management’s attention. See “Business – Legal and Administrative Proceedings.” Third parties that are found to be liable to us may not have resources to compensate us for the costs and damages we incurred. In addition, we may be required to pay significant costs and damages if we do not prevail in any such disputes or proceedings.

***Our business operations and construction of new facilities may be disrupted by reasons beyond our control, which could materially and adversely affect our business, results of operations and financial condition.***

Our business operations and construction of new facilities may be disrupted by, among other things, extreme climatic and weather conditions, fires, natural disasters, epidemics, raw material supply shortages, equipment and system failures and labor force shortages. In addition, due to the nature of our business and despite compliance with requisite safety requirements and standards, our operations are subject to operational risks associated with building materials production, including storage tank leaks and ruptures, explosions, discharges or releases of hazardous substances and malfunctioning of production machinery. These risks may result in personal injuries, property damage and imposition of civil or criminal penalties.

In August 2010, certain inventories of Gongyuan Cement located in Dandong city, Liaoning province were damaged as a result of a serious flood, and we incurred a loss totaling RMB10.2 million. Our assets, business operations, customers and suppliers are principally located in Shandong and Liaoning provinces. If floods or other natural disasters continue to occur in or affect Shandong province or Liaoning province in which we have operations, our business, results of operations and financial condition may be materially and adversely affected.

***We outsource some of our limestone mining activities to third-party contractors and we may be liable for the contractors' failure to comply with applicable laws and regulations.***

We outsource a portion of the mining of our limestone reserves to third party contractors whose operations are beyond our control. We cannot assure you that these third-party contractors would continue to provide the limestone excavation services to us. If any or all of them cease to provide such services or fail to perform to our satisfaction, we may not be able to locate suitable replacements to ensure a continuous and adequate supply of limestone for our production of cement products, and our results of operation and financial performance could be adversely affected.

In addition, we require our contractors to provide us with the applicable licenses and renewal certificates, as mandated under the relevant PRC laws and regulations, as well as conduct safety inspections at the quarries. However, we may still be held liable by the authority if any of our contractors failed to comply with relevant PRC laws and regulations and we may be subject to fine or other penalties, which may negatively and adversely affect our results of operation and financial performance.

***We have not obtained legal titles to some of the properties we occupy and certain of our leased properties may be subject to title encumbrances.***

We have not obtained land use rights and building ownership certificates relating to some of the properties we occupy. For instance, Tianjin Tianhui and Zibo Shuangfeng currently occupy land by leases from the local village committees, pending finalization of official transfer of such land from the local land authorities. In addition, Chifeng Yuanhang currently occupies land allocated by the local government, pending the official change of land use for our production purposes and transfer of such properties from the local government. If any ownership dispute or claim regarding such properties occurs, or we could not obtain the land use rights certificates for such properties and could not secure alternative and comparable sites and properties at reasonable costs or at all, our operating rights and production in connection with these properties may be adversely affected, which could in turn materially and adversely affect our business, results of operations and financial condition. In addition, there is no assurance that we would not be subject to any claims for compensation with respect to any actual or alleged illegal and/or unauthorized use of land or buildings owned by third parties.

***We may not have obtained the necessary licenses, permits and approvals for our production and construction projects.***

As of the date of this document, we were in the process of applying certain licenses and permits for some of our production and construction projects. We are currently in the process of applying for 13 construction land planning permits, 14 construction project planning permits, 16 construction commencement permits and 12 industrial products production permits for 22 production lines of our various products. A failure to obtain these licenses or permits could subject us to fines, penalties and/or sanctions for the operations. We have not in the past experienced any suspension in production arising from a lack of requisite licenses. However, there is no assurance that we will not be required to cease production by the relevant local authority or subject to fines due to the lack of the above licenses, permits and approvals. If we are required to cease production, we will not be able to use the facilities and will suffer financial losses.

***If we fail to maintain effective internal control over financial reporting, our business, results of operations and reputation could be materially and adversely affected.***

Our internal control system is essential to the integrity of our business, results of operations and reputation. To help us address prior deficiencies and weaknesses in our internal control over financial

reporting, we engaged an independent internal control consulting firm in connection with our initial public offering on the Hong Kong Stock Exchange in 2008 to review our key business and management processes and to assist us in establishing and improving relevant internal control processes and developing related organizational structures and systems. With the assistance of this consulting firm, we have established various plans and procedures that we believe will allow us to remedy our prior internal control deficiencies and weaknesses. In particular, we have provided and are continuing to provide further training to our financial and accounting staff to enhance their knowledge of the IFRSs and improve our overall corporate governance. However, we cannot assure you that similar or other deficiencies or weaknesses in our internal control over financial reporting will not be discovered in the future. If we fail to maintain effective internal control over financial reporting in the future, our business, results of operations and reputation may be materially and adversely affected. Our efforts to improve our internal control over financial reporting have also required, and may in the future continue to require, increased costs and significant management time and commitment.

***Our business, financial condition and results of operations may be adversely affected by the downturn in the global or Chinese economy.***

The global financial markets have experienced significant disruptions since 2008 and the effect of the crisis persisted in 2009. China's economy has also faced challenges. Although there have been improvements in some geographical areas, it is uncertain whether such recovery is sustainable. Because we derive substantially all of our revenues from China, uncertainties in China's economy could materially and adversely affect the construction and infrastructure sectors in China, thereby our business and prospects may be materially and adversely affected.

Moreover, a slowdown in the global or Chinese economy or the recurrence of any financial disruptions may have a material and adverse impact on financings available to us. Any financial turmoil affecting the financial markets and banking system may significantly restrict our ability to obtain financing in the capital markets or from financial institutions on commercially reasonable terms, or at all. We are uncertain about the extent to which a global financial and economic crisis and slowdown of the Chinese economy may impact our business in the long term. There is a risk that our business, results of operations and prospects would be materially and adversely affected by the global economic downturn and the slowdown of the Chinese economy.

## **Risks Relating to China's Cement Industry**

***The cement industry is subject to significant regulation by the PRC government.***

Various PRC government authorities, including the National Development and Reform Commission of the PRC ("NDRC"), the Ministry of Land and Resources, the State Environmental Protection Administration, the General Administration of Quality Supervision Inspection and Quarantine, or GAQSIQ, the Ministry of Commerce of the PRC, or MOFCOM, the Ministry of Industry and Information Technology and the Ministry of Construction of the PRC, have the authority to issue and implement regulations governing various aspects of cement production.

In order to engage in cement production, we are required to maintain certain licenses and permits such as the cement production permit and the production safety permit in China. In addition, our products are also required to meet certain standards stipulated by various PRC government authorities. For example, GAQSIQ issued the B175-2007 standards that govern certain aspects of the production and sales of cement products. All cement producers in the PRC must comply with these standards, and cement products that fail to meet the relevant quality standards may not be sold in the PRC. These standards provide strict guidelines regarding the composition and technical specifications for cement products. They also standardize the testing methods for cement products and the types of packaging permitted. Should there be any change to the existing requirements or new requirements applicable to our cement products, we may need to incur additional expenses to ensure compliance and we cannot assure you that we will successfully obtain such

licenses, permits or approvals in a timely manner, or at all. If we are not able to meet all the licensing conditions or the regulatory requirements, our business, financial condition and results of operations could be adversely and materially affected.

The cement industry has traditionally been subject to government control at the policy level in terms of production method and volume, product mix and environmental protection. While the PRC government's current policies in respect of the domestic cement industry are generally market oriented, the PRC government still closely monitors the development of the cement industry and may from time to time regulate the industry by issuing and implementing new regulations and policies. For example, according to the Notice Regarding Replacement of Obsolete Cement Production Capability issued by NDRC on February 18, 2007, local governments are required to gradually phase out cement producers with annual output of less than 200,000 tons and those with production methods that are less environmentally friendly. In addition, according to the State Council's Notice Approving the NDRC's Guidelines on Redundant Construction, Curbing Overcapacity in Certain Industries and the Healthy Development of Industries promulgated on September 26, 2009, or the "2009 Notice," the industrial policies on the cement industry in the PRC are, among others, to strictly control newly added cement capacities and phase out obsolete cement production capacity. For instance, newly constructed projects' heat consumption of cement and clinker burning should be lower than 105 kg of standard coal/ton of clinker and the comprehensive electricity consumption for cement should be lower than 90KWh/ton of cement; the limestone reserve life must be more than 30 years; the density of waste gas and dust content must be lower than 50 mg/standard cubic meter.

In addition, according to the Criteria for Entry to the Cement Industry newly promulgated by the Ministry of Industry and Information Technology, which came into effect on January 1, 2011, the entry barriers for the new expansion of cement production have been significantly increased. The Criteria for Entry to Cement Industry requires any relevant cement production expansion to have a production capacity of new dry process cement clinker of more than 900 kilogram per capita and sets strict requirements for new cement production projects in terms of production volume, production methods, energy conservation and environmental protection.

In addition to the entry barriers, the cement industry has been subject to a credit control policy in recent years as it is an energy intensive industry. In June 2007, the PBOC promulgated the Guidelines on the Enhancement and Improvement of Financial Services in Energy Saving and Environmental Protection Fields, or the "2007 Guidelines," which tightened credit in energy intensive and heavily polluting industries and effectively constrained bank lending to PRC cement companies. Although we have adopted energy saving and environmentally friendly production technologies, and our production facilities are in compliance with relevant industry policies, we may still have limited access to RMB-denominated loans from time to time due to different interpretations and implementation of the 2007 Guidelines by various PRC banks.

Moreover, projects involving significant capital investment are subject to approval or filing requirements at different levels of the PRC government. Compliance with these government regulations and policies and efforts to obtain such approvals may result in significant adjustments to our current or future development plans, increase our costs and divert our management resources, which may adversely affect our profitability and growth prospects.

***Compliance with environmental and energy conservation regulations can be expensive, and any failure to comply with these regulations could result in adverse publicity, significant monetary damages and fines and suspension of our business operations.***

As an industry that generates significant levels of pollution and consumes large amounts of energy, the cement industry is subject to national and local environmental protection and energy conservation laws and regulations. As the production of cement is regarded as one of the major sources of pollution in the PRC, the PRC government has adopted a series of environmental policies to reduce the adverse effects of the cement industry on the environment, such as the requirement to use the more environmentally friendly NSP production technology. Governmental requirements that affect our operations include those relating to noise,

soil, air quality, solid waste management, and waste-water treatment. In addition, the PRC government has adopted energy saving policies specifically for the cement industry. On November 25, 2010, the Ministry of Industry and Information Technology issued the Guidelines on Energy Saving and Emission Reduction of the Cement Industry, which aims to conserve energy and reduce the emissions resulting from cement production in the coming years. Failure to comply with these policies and regulations may result in the assessment of damages or imposition of penalties, fines, administrative sanctions, proceedings and/or suspension of production or cessation of our operations or revocation of our licenses or permits to conduct our business. With the increasing awareness of environmental protection and energy conservation issues, we anticipate that the PRC regulatory framework will become increasingly stringent. The implementation of more stringent laws and regulations or stricter interpretation of the existing laws and regulations may require us to incur additional expenses for compliance purposes. We cannot assure you that we will be able to comply with any additional regulations in the future, or enhanced implementation of such existing regulations, on a cost-effective basis, or at all. In such circumstances, our business, financial condition and results of operations could be adversely and materially affected.

***We are subject to safety and health laws and regulations in China, and any failure to comply could adversely affect our operations.***

We are required to comply with the applicable production safety standards in relation to our production processes. Our production plants and facilities are subject to regular inspections by the regulatory authorities for compliance with the Safe Production Law of the PRC. Furthermore, under the PRC Labor Law and the PRC Law on the Prevention and Treatment of Occupational Diseases, we must ensure that our facilities comply with PRC standards and requirements on occupational safety and health conditions for employees. We also provide our employees with labor safety training, all necessary protective tools and facilities, and regular health examinations for those who may be exposed to risks of occupational hazards. Nevertheless, failure to meet the relevant legal requirements on production safety and labor safety could subject us to warnings from relevant governmental authorities, governmental orders to rectify such non-compliance within a specified time frame and maximum fines of up to RMB500,000 per incident. We may also be required to suspend our production temporarily or cease our operations permanently for significant non-compliance, which may have a material adverse effect on our reputation, business, financial condition and results of operations.

***We are heavily dependent on the performance of the construction industry in China.***

Cement is one of the basic construction materials. Demand for our products depends on the condition and growth of the construction industry, which in turn depend on macro-economic conditions and other factors, such as interest rates, inflation, unemployment levels, demographic trends and consumer confidence. There is no assurance that China's economy will continue to grow at the current speed or the demand for cement will continue to grow or remain at the same level. Since early 2004, the PRC government has implemented certain measures to control the pace of economic growth, in particular to curtail the overheating of the real estate sector. Such measures include more stringent approval processes for large-scale fixed asset investment projects and tightening of credit to fund these projects. Any slowdown or decline in China's economy and/or construction industry growth may materially and adversely affect the cement industry, which in turn would have an adverse effect on our business, results of operations and financial condition.

***We face intense competition from other cement producers.***

China's cement industry is highly competitive and extremely fragmented, with over 5,000 cement producers as recorded in November 2010 according to Hexun.com. Our major competitors are national players that have presence in Shandong and Liaoning provinces, as well as smaller scale regional cement producers in the individual markets in which we compete. Some of our competitors have financial and technological support from well-established international players. If we cannot compete effectively on the basis of, among other things, product quality, variety of product offerings, technology, location of production

facilities, access to resources, sales and marketing network and brand image, we may not be able to maintain our leading market position and the same level of profitability in the future in light of the highly competitive market environment.

Furthermore, the intense competition in the cement industry in China exerts significant influence on cement prices in the markets in which we operate. Cement prices have been relatively stable in the past few years and experienced certain increase in recent months. However, this trend may not continue and cement prices may be subject to significant fluctuations or a downward trend in the future, which may materially and adversely affect our profitability and results of operations.

### **Risks Relating to Conducting Business in the PRC**

*PRC economic, political and social conditions, as well as government policies, could affect our business.*

Substantially all of our assets are located in the PRC, and all of our revenue is derived from within the PRC. Accordingly, our results of operations, financial position and prospects are significantly subject to the economic, political and legal developments of the PRC. The economy of the PRC differs from the economies of most developed countries in many respects, including but not limited to:

- structure;
- level of government involvement;
- level of development;
- growth rate;
- control of foreign exchange; and
- allocation of resources.

While the PRC economy has grown significantly in the past 20 years, growth has been uneven, both geographically and across the various sectors of the economy. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also negatively affect our operations. For example, our financial condition and results of operations may be materially and adversely affected by the PRC government's control over capital investments and changes in tax regulations or foreign exchange controls that are applicable to us.

The PRC economy has been transitioning from a planned economy to a market-oriented economy. For the past two decades, the PRC government has implemented economic reform measures emphasizing the utilization of market forces in the development of the PRC economy. Although we believe these reforms will have a positive effect on our overall and long-term development, we cannot predict whether changes in the PRC's economic, political and social conditions, laws, regulations and government policies will have any material and adverse effect on our current or future business, results of operations or financial condition.

*Governmental control of currency conversion may affect the value of your investment.*

The PRC government imposes controls on the convertibility of Renminbi into foreign currencies and, in certain cases, the remittance of currency to jurisdictions outside China. We receive substantially all of our revenue in Renminbi. Under our current structure, our income is primarily derived from dividend payments from our PRC subsidiaries. Shortages in the availability of foreign currency may restrict the ability of our

PRC subsidiaries to remit sufficient foreign currency to pay dividends or other payments to us or otherwise satisfy their foreign currency denominated or settled obligations, such as the Notes. Under the PRC's foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade, may be made in foreign currencies without prior approval, subject to certain procedural requirements. However, strict foreign exchange controls continue for capital account transactions, including repayment of loan principal and return of direct capital investments and investments in negotiable securities. The PRC government may also, at its discretion, restrict access to foreign currencies for current account transactions in the future. In the past, there have been shortages of US dollars or other foreign currency available for conversion of Renminbi in the PRC, and it is possible that such shortages could recur, or that restrictions on conversion could be re-imposed. If the PRC foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, our PRC subsidiaries may not be able to pay dividends in foreign currencies to us and we may not be able to service our debt obligations denominated or settled in foreign currencies, such as the Notes.

***There are significant uncertainties under the PRC enterprise income tax law relating to the withholding tax liabilities of our PRC subsidiaries.***

Under the Enterprise Income Tax Law of the PRC and its implementation rules (collectively, the "EIT Law"), the profits of a foreign invested enterprise generated in 2008 and onwards which are distributed to its immediate holding company outside the PRC will be subject to a withholding tax rate of 10.0% or a lower treaty rate. Pursuant to a special arrangement between Hong Kong and the PRC, such rate is lowered to 5.0% if a Hong Kong resident enterprise owns over 25% of the PRC company. Some of our PRC subsidiaries are currently wholly owned by Hong Kong subsidiaries. However, according to the Circular of State Administration of Taxation on Printing and Issuing the Administrative Measures for Non-resident Individuals and Enterprises to Enjoy the Treatment Under Taxation Treaties, which became effective on October 1, 2009, the 5% withholding tax rate does not automatically apply and approvals from competent local tax authorities are required before an enterprise can enjoy any benefits under the relevant taxation treaties. Moreover, according to a tax circular issued by the State Administration of Taxation ("SAT") in February 2009, if the main purpose of an offshore arrangement is to obtain a preferential tax treatment and the offshore entity is not the beneficial owner of the relevant income, the PRC tax authorities have the discretion to adjust the preferential tax rate for which an offshore entity would otherwise be eligible. Furthermore, the SAT issued Circular 601 on October 27, 2009 to clarify that a beneficial owner should be a person engaged in actual operation and this person could be an individual or any other entity. Circular 601 expressly excludes a "conduit company," which is established for the purposes of tax avoidance and dividend transfers and is not engaged in actual operations such as manufacturing, sales and management, from being a beneficial owner. It is still unclear how Circular 601 is being implemented by SAT or its local counterparts in practice. The PRC tax authorities might not grant approvals on the 5% withholding tax rate on dividends received by our subsidiaries in Hong Kong from our PRC subsidiaries.

***Under the EIT Law, we may be classified as a "resident enterprise" of China. Such classification could result in unfavorable tax consequences to us and our non-PRC noteholders.***

Under the EIT Law, an enterprise established outside of China with "de facto management organization" located within China will be considered a "resident enterprise," and consequently will be treated in a manner similar to a Chinese enterprise for enterprise income tax purposes. The implementation rules of the EIT Law define "de facto management" as "substantial and overall management and control over the production and operations, personnel, accounting, and properties" of the enterprise. The SAT issued the Notice Regarding the Determination of Chinese-Controlled Offshore Incorporated Enterprises as PRC Tax Resident Enterprises on the Basis of De Facto Management Organization ("SAT Circular 82") on April 22, 2009. SAT Circular 82 provides certain specific criteria for determining whether the "de facto management organization" of a Chinese-controlled offshore incorporated enterprise is located in China. Although SAT Circular 82 only applies to offshore enterprises controlled by PRC enterprises, not those controlled by PRC individuals, the determining criteria set forth in Circular 82 may reflect the SAT's general position on how the "de facto management organization" test should be applied in determining the tax resident status of

offshore enterprises, regardless of whether they are controlled by PRC enterprises or individuals. If the PRC tax authorities determine that we are a “resident enterprise” for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. We may be subject to enterprise income tax at a rate of 25% on our worldwide taxable income as well as PRC enterprise income tax reporting obligations. In our case, this would mean that income such as interest from any investment of any portion of the offering proceeds and other income sourced from outside the PRC would be subject to PRC enterprise income tax at a rate of 25%, whereas no direct tax is imposed on enterprises under the laws of the Cayman Islands. Furthermore, as described in “Taxation – PRC,” if we are considered a “resident enterprise,” interest payable to certain “non-resident enterprise” holders on the Notes may be treated as income derived from sources within China and be subject to PRC withholding tax at a rate of 10%, or a lower rate for holders who qualify for the benefits of a double-taxation treaty with China, and capital gains realized by holders of Notes may be treated as income derived from sources within China and be subject to a 10% PRC tax. If we are required under the EIT Law to withhold PRC tax on our interest payable to our non-resident noteholders who are “non-resident enterprises,” we will be required to pay such additional amounts as will result in receipt by a holder of a Note of such amounts as would have been received by the holder had no such withholding been required. The requirement to pay additional amounts will increase the cost of servicing interest payments on the Notes, and could have a material adverse effect on our ability to pay interest on, and repay the principal amount of, the Notes, as well as our profitability and cash flow. In addition to the uncertainty as to the application of the new “resident enterprise” classification, the PRC government could amend or revise the taxation laws, rules and regulations to impose stricter tax requirements, higher tax rates or apply the EIT Law, or any subsequent changes in PRC tax laws, rules or regulations retroactively. As there may be different applications of the EIT Law and any amendments or revisions, comparisons between our past financial results may not be meaningful and should not be relied upon as indicators of our future performance. If such changes occur or are applied retroactively, they could materially and adversely affect our results of operations and financial condition.

***PRC regulations relating to the investment in offshore special purpose companies by PRC residents may subject our shareholders that are PRC residents to personal liability, limit our ability to contribute capital into or provide loans to our PRC subsidiaries, limit our subsidiaries’ ability to increase their registered capital, pay dividends or otherwise distribute profits to us, or otherwise adversely affect us.***

The PRC’s State Administration of Foreign Exchange (“SAFE”) has promulgated several regulations, including the Notice on Relevant Issues Concerning Foreign Exchange Administration for PRC Residents to Engage in financing and Inbound Investment via Overseas Special Purpose Vehicles, or Circular No. 75, issued on October 21, 2005, which require PRC residents and PRC corporate entities to register with local branches of SAFE in connection with their direct or indirect offshore investment activities.

Under these SAFE regulations, PRC residents who make, or have previously made, direct or indirect investments in offshore companies are required to register those investments with the local branch of SAFE. In addition, any PRC resident who is a direct or indirect shareholder of an offshore company is required to update the previously filed registration with the local branch of SAFE, to reflect any material change involving that offshore company’s round-trip investment, capital variation, such as an increase or decrease in capital, transfer or swap of shares, merger, division, long-term equity or debt investment or creation of any security interest, and the PRC subsidiaries of the relevant offshore company are required to urge the PRC resident shareholders to do so. If any PRC shareholder fails to make the required initial SAFE registration or update the previously filed registration, the PRC subsidiaries of that offshore parent company may be prohibited from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation to their offshore parent company, and the offshore parent company may also be prohibited from injecting additional capital into its PRC subsidiaries.

Due to uncertainty concerning the reconciliation of these SAFE rules with other approval or registration requirements, it remains unclear how these rules, and any future legislation concerning offshore or cross-border transactions, will be interpreted, amended and implemented by the relevant government

authorities. We attempt to comply, and attempt to ensure that our shareholders who are subject to these rules comply, with the relevant requirements. However, we cannot assure you that all of our shareholders who are PRC residents, will comply with our request to make or update any applicable registrations or comply with other requirements required by these rules or other related rules. The failure or inability of our PRC resident shareholders to make any required registrations or comply with other requirements may subject such shareholders to fines and legal sanctions and may also limit our ability to contribute additional capital into or provide loans to (including using the proceeds from any equity or debt securities offerings) our PRC subsidiaries, limit our PRC subsidiaries' ability to increase their registered capital, pay dividends or otherwise distribute profits to us, or otherwise materially and adversely affect us.

***Substantially all of our revenue is denominated in Renminbi and fluctuations in the exchange rate of Renminbi may materially and adversely affect our business, financial condition and results of operations.***

Substantially all of our revenue is denominated in Renminbi and must be converted to pay dividends or make other payments in freely convertible currencies. The value of RMB against other foreign currencies is subject to changes in the PRC government's policies and international economic and political developments. Under the current unified floating exchange rate system, the conversion of RMB into foreign currencies, including Hong Kong and U.S. dollars, has been based on rates set by the PBOC, which are quoted daily based on the previous day's inter-bank foreign exchange market rates and current exchange rates on the world financial markets. Since 1994, the official exchange rates for the conversion of RMB to Hong Kong and U.S. dollars have generally been stable. However, with effect from July 21, 2005, the PRC government reformed the exchange rate regime by moving into a managed floating exchange regime based on market supply and demand with reference to a basket of currencies. As a result, the RMB appreciated against the Hong Kong and U.S. dollars by approximately 2% on the same date. In September 2005, the PRC government widened the daily trading band for RMB against non-U.S. dollar currencies from 1.5% to 3.0% to improve the flexibility of the new foreign exchange system. The floating band for the trading prices in the inter-bank foreign exchange market of the Renminbi against the U.S. dollar was expanded from 0.3% to 0.5% around the central parity rate, effective in May 2007. This allows the Renminbi to fluctuate against the U.S. dollar by up to 0.5% above or below the central parity rate published by the PBOC. These changes in currency policy resulted in the Renminbi appreciating against the U.S. dollar by approximately 28.0% from July 21, 2005 to June 30, 2011. Any significant revaluation of the Renminbi may materially and adversely affect our cash flows, revenues, earnings and financial position, and the value of, and any dividends payable to us by our PRC subsidiaries. For example, an appreciation of the Renminbi against the U.S. dollar would make any new Renminbi denominated investments or expenditures more costly to us, to the extent that we need to convert U.S. dollars into Renminbi for such purposes.

***PRC regulations relating to acquisitions of PRC companies by foreign entities may limit our ability to acquire PRC companies and materially and adversely affect the implementation of our strategy as well as our business and prospects.***

The Provisions on the Acquisition of Domestic Enterprises by Foreign Investors (the "M&A Provisions") issued by six PRC ministries including the MOFCOM, effective from September 8, 2006 and further amended on June 22, 2009, provide the rules with which foreign investors must comply should they seek to purchase by agreement the equities of the shareholders of a domestic non-foreign-invested enterprise or subscribe to the increased capital of a domestic non-foreign-invested enterprise, and thus convert the domestic non-foreign invested enterprise into a foreign invested enterprise to conduct asset merger and acquisition. It stipulates that the business scope upon acquisition of domestic enterprises must conform to the Foreign Investment Industrial Guidance Catalog issued by the NDRC and the MOFCOM, which restricts the scope of permitted foreign investment. It also provides the takeover procedures for equity interests in domestic companies.

Our PRC legal advisors have advised us that there are uncertainties as to how the M&A Provisions will be interpreted or implemented. If we decide to acquire a PRC company, we cannot assure you that we

or the owners of such PRC company can successfully complete all necessary approval requirements under the M&A Provisions. This may restrict our ability to implement any acquisition strategy and materially and adversely affect our business and prospects.

***The legal system in the PRC is less developed than in certain other countries and uncertainty with respect to the PRC legal system could affect our operations.***

As substantially all of our businesses are conducted, and substantially all of our assets are located, in the PRC, our operations are governed principally by PRC laws and regulations. The PRC legal system is based on written statutes, and prior court decisions can only be cited as reference. Since 1979, the PRC government has promulgated laws and regulations in relation to economic matters such as foreign investment, corporate organization and governance, commerce, taxation, foreign exchange and trade, with a view to developing a comprehensive system of commercial law. However, China has not developed a fully integrated legal system and recently enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, and because of the limited volume of published decisions and their non-binding nature, the interpretation and enforcement of these laws and regulations involve uncertainties. In addition, the PRC legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies and rules until some time after the violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

***The national and regional economies in the PRC and our prospects may be materially and adversely affected by natural disasters, acts of God, and occurrence of epidemics.***

Our business is subject to general economic and social conditions in the PRC. Natural disasters, epidemics and other acts of God that are beyond our control may adversely affect the economy, infrastructure and livelihood of the people in the PRC. Some regions in the PRC, including the cities in which we operate, are under the threat of flood, earthquake, sandstorm, snowstorm, fire, drought, or epidemics such as Severe Acute Respiratory Syndrome (“SARS”), H5N1 avian flu or the human swine flu, also known as Influenza A (H1N1). For instance, a serious earthquake and its successive aftershocks hit Sichuan province in May 2008 and resulted in tremendous loss of lives and destruction of assets in the region. Past occurrences of epidemics, depending on their scale, have caused different degrees of damage to the national and local economies in the PRC.

In addition, the outbreak of SARS or other virulent contagious diseases, such as the H5N1 avian flu or the human swine flu, could potentially disrupt our operations if any buyers or sellers in our markets are suspected to have contracted such diseases, and our markets are identified as a possible source of spreading the contagious disease infection. We may be required to quarantine tenants who are suspected of being infected. We may also be required to disinfect the affected markets and therefore suffer a temporary suspension of operations. Any quarantine of users or suspension of operations at any one of markets is likely to materially and adversely affect our business, financial condition and results of operations.

***It may be difficult to enforce any judgments obtained from non-PRC courts against us, our directors or our senior management in the PRC.***

Substantially all of our assets are located within the PRC. China does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts with many countries, including Japan, the United States and the United Kingdom. Therefore, it may be difficult for you to enforce any judgments obtained from non-PRC courts against us, any of our directors or our senior management in the PRC.

***We cannot guarantee the accuracy of facts, forecasts and other statistics included in this document that are derived from official government publications with respect to the PRC, the PRC economy and the PRC industries that affect our business.***

Facts, forecasts and other statistics in this document relating to the PRC, the PRC economy and the PRC industries that affect our business have been derived from various official government publications

generally believed to be reliable. However, we cannot guarantee the quality or reliability of such source materials. They have not been prepared or independently verified by us, the Initial Purchasers or any of our or their affiliates or advisors and, therefore, none of them makes any representation as to the accuracy of such facts, forecasts and statistics, which may not be consistent with other information compiled within or outside the PRC. Due to possibly flawed or ineffective collection methods or discrepancies between official government publications and market practice and other problems, the statistics cited in this document may be inaccurate or may not be comparable to statistics produced for other economies and should not be unduly relied upon. Further, they might not be stated or compiled on the same basis or with the same degree of accuracy as may be the case elsewhere. In all cases you should give consideration as to how much weight or importance they should attach to or place on such facts, forecasts or statistics.

## SELECTED FINANCIAL INFORMATION AND OTHER DATA

You should read the following selected financial information and other data together with the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the financial statements and related notes included elsewhere in this document.

We have derived the following selected financial information from our audited consolidated financial statements as of and for the years ended December 31, 2008, 2009 and 2010, which are included elsewhere in this document. We prepare and present our consolidated financial statements in accordance with IFRS.

	2008	2009	2010
	RMB	RMB	RMB
	(in millions, except percentages)		
<b>Consolidated income statement data:</b>			
<b>Revenue</b> .....	7,500.7	8,727.6	11,854.1
Cost of sales.....	(5,914.3)	(6,947.2)	(9,304.0)
<b>Gross profit</b> .....	1,586.4	1,780.4	2,550.1
Other revenue.....	188.2	138.3	148.5
Other net (expenses)/income.....	14.8	(2.3)	(68.3)
Selling and marketing expenses.....	(175.2)	(196.5)	(214.2)
Administrative expenses.....	(553.3)	(469.1)	(689.6)
<b>Profit from operations</b> .....	1,060.9	1,250.8	1,726.5
Finance costs.....	(348.0)	(309.6)	(363.1)
Share of profits less losses of an associate.....	–	–	(0.2)
<b>Profit before taxation</b> .....	712.9	941.2	1,363.2
Income tax.....	(163.8)	(227.2)	(358.3)
<b>Profit for the year</b> .....	549.1	714.0	1,004.9
Attributable to:			
Equity holders of the company.....	539.4	701.6	979.1
Non-controlling interests.....	9.7	12.4	25.8
<b>Other financial data:</b>			
EBITDA <sup>(1)</sup> .....	1,599.6	1,898.8	2,534.0
EBITDA margin <sup>(2)</sup> .....	21.3%	21.8%	21.4%
EBITDA/gross interest expense <sup>(3)</sup> .....	4.9	6.2	7.0
Total debt/EBITDA.....	3.0	3.0	2.9

## As of December 31,

	2008	2009	2010
	RMB	RMB (in millions)	RMB
<b>Consolidated statement of financial position data:</b>			
Non-current assets.....	9,666.6	11,302.3	14,722.4
Current assets .....	3,106.1	3,306.9	4,228.0
Current liabilities .....	5,185.6	4,969.9	6,481.6
Net current liabilities .....	(2,079.5)	(1,663.0)	(2,253.6)
Total assets less current liabilities .....	7,587.1	9,639.3	12,468.8
Non-current liabilities.....	2,981.5	4,410.2	6,319.8
Net assets .....	4,605.6	5,229.1	6,149.0
Capital and reserves .....	4,560.6	5,160.2	5,687.5
Total equity attributable to equity shareholders of the company.....	4,560.6	5,160.2	5,687.5
Non-controlling interest.....	45.0	68.9	461.5
Total equity .....	4,605.6	5,229.1	6,149.0
<b>Consolidated statement of cash flow data:</b>			
Net cash flows from operating activities.....	1,037.3	1,025.7	1,789.0
Net cash flows used in investing activities.....	(2,404.5)	(2,136.4)	(2,926.8)
Net cash flows generated from financing activities.....	1,912.8	748.6	1,398.3
Net increase/(decrease) in cash and cash equivalents .....	545.6	(362.1)	260.5
Cash and cash equivalents at the beginning of the year .....	721.3	1,248.4	886.1
Cash and cash equivalents at the end of the year .....	1,248.4	886.1	1,144.8

The following table sets forth the sales volume and unit selling price for our cement, clinker and concrete products for the periods indicated.

	2008	2009	2010
Sales volume (thousands tons)			
Cement .....	25,112	29,388	39,318
Clinker.....	5,466	8,422	9,844
Concrete .....	513	860	785
Unit selling price			
Cement (RMB per ton) .....	235.2	224.9	235.9
Clinker (RMB per ton).....	213.9	187.5	197.2
Concrete (RMB per cubic meter) .....	274.0	262.3	237.5

- (1) EBITDA consists of profit before income tax expense, depreciation and amortization and finance costs (excluding capitalized interest). EBITDA is not a standard measure under IFRS. EBITDA is a widely used financial indicator of a company's ability to service and incur debt. EBITDA should not be considered in isolation or construed as an alternative to cash flows, net income or any other measure of financial performance or as an indicator of our operating performance, liquidity, profitability or cash flows generated by operating, investing or financing activities. In evaluating EBITDA, we believe that investors should consider, among other things, the components of EBITDA such as sales and operating expenses and the amount by which EBITDA exceeds capital expenditures and other charges. We have included EBITDA because we believe it is a useful supplement to cash flow data as a measure of our performance and our ability to generate cash flow from operations to cover debt service and taxes. EBITDA presented herein may not be comparable to similarly titled measures presented by other companies. Investors should not compare our EBITDA to EBITDA presented by other companies because not all companies use the same definition. Set forth below is a reconciliation of EBITDA to the most directly comparable IFRS measure, profit for the year.

	Year ended December 31,		
	2008	2009	2010
	RMB	RMB (in millions)	RMB
Profit for the year.....	549.1	714.0	1,004.9
Add:			
Amortization .....	83.8	96.6	114.2
Depreciation .....	454.9	551.4	693.3
Finance costs .....	348.0	309.6	363.3
Income tax expense .....	163.8	227.2	358.3
EBITDA.....	<u>1,599.6</u>	<u>1,898.8</u>	<u>2,534.0</u>

(2) EBITDA margin means EBITDA divided by revenue.

(3) Gross interest expense includes interest expense capitalized in property, plant and equipment. Gross interest expense is not a standard measure under IFRS. Gross interest expense presented herein may not be comparable to similarly titled measures presented by other companies. Investors should not compare our gross interest expense to the gross interest expense provided by other companies because not all companies use the same definition.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion and analysis should be read in conjunction with the financial statements and related notes included elsewhere in this document. Those financial statements and related notes have been prepared in accordance with IFRS. This discussion contains forward-looking statements and reflects our current view with respect to future events and financial performance. Actual results may differ materially from those anticipated in these forward-looking statements as a result of factors such as those set forth under "Risk Factors" and elsewhere in this document.*

### Overview

We are one of the largest producers of clinker and cement in China, particularly in Shandong and Liaoning provinces, as measured by production volume. Leveraging our leading market position in Shandong and Liaoning provinces, we have taken advantage of the considerable growth opportunities in the construction and infrastructure sectors within Shanxi province and Inner Mongolia, and quickly established our presence in these areas through organic growth and acquisitions. We are also expanding into Xinjiang province by Greenfield development.

We produce and sell a wide variety of cement products using advanced NSP production technology. Our principal products also include clinker, a key intermediary component of cement. In addition, we produce and sell other products, such as concrete. Our sales volume of cement products increased from 25.1 million tons in 2008 to 29.4 million tons in 2009 and 39.3 million tons in 2010. While most of the clinker we produced was used in our cement production, we also sold 5.5 million tons, 8.4 million tons and 9.8 million tons of clinker to external customers in 2008, 2009 and 2010, respectively. The average unit selling price per ton of our cement products was RMB235.2, RMB224.9 and RMB235.9 in 2008, 2009 and 2010, respectively, and the average unit selling price per ton of our clinker was RMB213.9, RMB187.5 and RMB197.2, respectively, during the same periods. Our products are primarily provided to our customers under our "Shanshui Dongyue" brand name (山水東岳), which was honored the "Famous Trademark of Shandong Province" in September 2008. In addition, in 2010, we were awarded the "Quality Award by Governor of Shandong" and recognized by the Ministry of Railways as the only construction material company with the award for "Beijing-Shanghai High-Speed Rail Best Supplier."

We manage our business by geographic regions. Accordingly, we have three reportable segments, covering our operations located in Shandong province, Northeastern China (including Liaoning province and Inner Mongolia) and Shanxi province, respectively. In 2010, revenue derived from our operations in Shandong province, Northeastern China and Shanxi province accounted for 82.6%, 17.3% and 0.1%, respectively, of our total revenue for the year. With several new projects commencing operations in Shanxi province, we expect our enterprises in the area to contribute more profits in the future.

We have achieved significant revenue and earnings growth in recent years. Our revenue increased from RMB7,500.7 million in 2008 to RMB8,727.6 million in 2009 and RMB11,854.1 million in 2010. Our profit for the year increased from RMB549.1 million in 2008 to RMB714.0 million in 2009 and to RMB1,004.9 million in 2010.

### Factors Affecting Our Results of Operations

#### *Growth of Construction Industry in China and in particular Shandong and Liaoning provinces*

We derive substantially all of our revenue from sales in China. Accordingly, economic growth in China, particularly in areas in which we operate, has a direct impact on virtually all aspects of our operations, including the level of demand for our products, the availability and prices of raw materials we use, costs of coal and electricity and our other operating expenses. In particular, demand for our cement and clinker products is sensitive to the level of construction activities in China. The growth of FAI led to a

significant increase in the demand for building materials, including cement. From 2006 to 2010, China's FAI increased from approximately RMB10,999.8 billion to RMB27,814.0 billion, according to China Statistical Yearbook, representing a CAGR of 79.9%. China's cement consumption during the last decade also experienced a notable growth driven by building and civil engineering construction activities. As a leading cement producer in China, we believe we are well-positioned to capture growth opportunities in China's construction industry.

Our results of operations are directly affected by the market demand of our products in our primary markets, Shandong and Liaoning provinces. Rapid economic growth in Shandong province and Liaoning province in recent years has created increasing market demand for cement products. As a result, our production and sales volumes of cement products increased significantly during the past three years. We produced 25.1 million tons, 29.4 million tons and 39.3 million tons of cement products, respectively, in 2008, 2009 and 2010 and sold 5.5 million tons, 8.4 million tons and 9.8 million tons of clinker products, respectively, during the same periods. We plan to further expand our production capacity, to the extent necessary, to meet growing market demand.

### ***PRC Government Policies***

Changes in PRC government policies regarding the domestic cement industry may also have a direct impact on our business. In recent years, the PRC government has been implementing a series of policies intended to promote the consolidation of the cement industry and the use of more environmentally friendly production techniques, such as rotary kilns using NSP technology. In response to increasing concerns regarding environmental problems in China, the PRC government has implemented various environmental regulations to reduce dust emissions and noise pollution from cement production. These efforts have resulted in the increased use of rotary kilns and NSP technology and decreases in energy consumption, production costs and environmental pollution. Recent improvements in related technologies have increased energy savings and environmentally friendly production process, reducing energy consumption in the cement and clinker production processes. The PRC government also provides tax subsidies for sales of cement products that use recycled materials. We received such tax subsidies in the amounts of RMB144.9 million, RMB80.3 million and RMB104.5 million, respectively, in 2008, 2009 and 2010. We also receive local government grants from relevant PRC authorities for fixed asset investment, such as cement and clinker plants and residual heat generation plants. We received such local government grants in the amounts of RMB25.5 million, RMB19.8 million and RMB21.6 million, respectively, in 2008, 2009 and 2010. The PRC authorities adjust the amounts available for such government grants depending on their budgets from time to time.

In addition, PRC government policies in other industries have an indirect impact on our business. The PRC government from time to time issues new industry policies to adjust the level of investment in infrastructure projects and real estate development using both economic incentives and disincentives and administrative means. Policy changes over the industries in which our customers operate may affect our customers and thereby affect our business. As a result of the PRC government's Eleventh Five-year Plan, released in 2006, economic stimulus measures promoted growth in the areas where we have production facilities. The PRC government made a commitment in its Twelfth Five-Year Plan, released in 2011, to build major infrastructure and undertake major development projects. Infrastructure projects are being approved by the government on an expedited basis in order to spur the economy. The significant increase in government investment infrastructure projects has increased demand for cement products, benefiting large cement manufacturers like us.

### ***Pricing of Our Products***

Competition and demand in our primary markets significantly affect the pricing of our products. We believe the cement industry in China is localized in nature, with a maximum economically feasible product transportation radius of approximately 300 kilometers. Due to industry recognition of the high quality of our products, our cement and clinker products usually enjoy price premiums over products sold by our competitors in the same geographic region. The average unit selling price per ton of our cement products

was RMB235.2, RMB224.9 and RMB235.9 in 2008, 2009 and 2010, respectively, and the average unit selling price per ton of our clinker was RMB213.9, RMB187.5 and RMB197.2, respectively, during the same periods. In 2010, the average unit selling price per ton of our cement products in Shandong province, Northeastern China and Shanxi was RMB238.0, RMB226.2 and RMB314.9, respectively.

### ***Costs of Raw Materials, Coal and Electricity***

The costs of raw materials, coal and power accounted for 27.7%, 34.1% and 15.8%, respectively, of our total cost of sales in 2010. We have experienced increases in limestone, coal and electricity prices in recent years. In particular, our cost of sales has been significantly affected by fluctuations in the price of coal. We experienced significant increases in coal prices in 2010 due to a surge in coal demand coupled with transportation bottlenecks. Our unit purchase price per ton of coal was RMB680.1, RMB569.8 and RMB691.8 in 2008, 2009 and 2010, respectively. The cost of coal accounted for 36.6%, 31.5% and 34.1% of our total cost of sales, respectively, in 2008, 2009 and 2010, respectively. In order to minimize the impact of fluctuations in coal prices on our results of operations, we have long-term relationships with a number of domestic coal suppliers to ensure adequate coal supplies at competitive prices. We also experienced increases in electricity prices in recent years caused by surging coal prices. We have constructed 16 RHR (residual heat recovery) generators with a total installed production capacity of 151,000 KW in 2010 to help us reduce our electricity costs.

### ***Our Business Expansion***

We have expanded our business and operations significantly during the past several years through acquisitions of cement producers and construction of production facilities, and plan to continue our expansion in the future. Since 2009, we have expanded our operations to Inner Mongolia and Shanxi provinces by acquiring Chifeng Yuanhang and Yulin Yatai cement companies. See “Business – Recent Acquisitions” in this document. In 2008, 2009 and 2010, we also constructed eight clinker production lines and 25 cement grinding lines. Our annual production capacity of cement products was 35.8 million tons, 48.3 million tons and 66.5 million tons as of December 31, 2008, 2009 and 2010, respectively, and our annual capacity of clinker was 20.0 million tons, 25.2 million tons and 31.0 million tons, respectively, as of the same dates. We plan to further expand our annual production capacity of cement products to 80 million tons and our annual production capacity of clinker to 40 million tons by the end of 2011. As a result of such expansion, our capital expenditures, financing needs, depreciation and amortization as well as impairment charges related to our various acquisitions and operating expenses have increased significantly and are expected to continue to increase in the near future. In addition, as we expand into other locations such as Xinjiang, we expect such expenses to increase.

### ***Seasonality***

Our operating income and earnings have historically been lower during the first quarter than other quarters. This results from the relatively low level of construction activity during the winter and the Chinese New Year holiday period, which normally falls within the first quarter each year. Therefore, our results of operations and cash flows may fluctuate due to seasonal variations.

## **Selected Income Statement Line Items**

### ***Revenue***

We currently generate the majority of our revenue from the production and sale of cement. We also generate revenue from the sale of a small portion of our clinker to third parties, and the production and sale of other products that use cement as raw materials, including bubble bricks, pipes and concrete. In addition, we generate revenue from various services we render. We provide transportation services and equipment installation services to third parties.

The table below sets forth a breakdown of our revenue by product for the periods indicated.

	Year ended December 31,					
	2008		2009		2010	
	Amount (RMB)	% of Revenue	Amount (RMB)	% of Revenue	Amount (RMB)	% of Revenue
	(in millions, except percentages)					
<b>Revenue</b>						
Sales of cement .....	5,906.8	78.7%	6,608.2	75.7%	9,275.1	78.2%
Sales of clinker.....	1,169.2	15.6%	1,578.9	18.1%	1,941.1	16.4%
Sales of other products <sup>(1)</sup> .....	424.7	5.7%	540.5	6.2%	637.9	5.4%
Total .....	<u>7,500.7</u>	<u>100.0%</u>	<u>8,727.6</u>	<u>100.0%</u>	<u>11,854.1</u>	<u>100.0%</u>

Note:

(1) Includes concrete, pipes and bubble bricks as well as provision of transportation service and equipment installation service.

Our revenue in a given period is affected primarily by the sales volumes of our products in the period and, to a lesser extent, by fluctuations in the average unit selling prices of our products. From 2008 to 2010, we experienced increased sales volumes for our cement and clinker products. Average unit selling prices of our cement and clinker products decreased from 2008 to 2009 primarily due to the decrease in production costs compared to 2008 but increased in 2010.

Sales of cement and clinker products are typically made through short-term agreements with pricing terms negotiated based on the prevailing market prices.

Sales of other products include sales of concretes, pipes and bubble bricks as well as provision of transportation service and equipment installation service.

### *Cost of Sales*

The table below sets forth a breakdown of our cost of sales and each item expressed as a percentage of our revenue for the periods indicated.

	Year ended December 31,					
	2008		2009		2010	
	Amount (RMB)	% of Revenue	Amount (RMB)	% of Revenue	Amount (RMB)	% of Revenue
	(in millions, except percentages)					
<b>Cost of sales</b>						
Raw materials.....	1,759.8	23.5%	2,085.1	23.9%	2,574.2	21.7%
Coal .....	2,165.4	28.9%	2,190.2	25.1%	3,176.6	26.8%
Power .....	1,042.2	13.9%	1,124.8	12.9%	1,471.5	12.4%
Depreciation and amortization.....	460.3	6.1%	562.3	6.4%	709.0	6.0%
Others.....	486.6	6.5%	984.8	11.3%	1,372.7	11.6%
	<u>5,914.3</u>	<u>78.9%</u>	<u>6,947.2</u>	<u>79.6%</u>	<u>9,304.0</u>	<u>78.5%</u>

Our cost of sales primarily includes the cost of raw materials used for our production, such as limestone, gypsum and clay, and the cost of coal and power. We expect the cost of raw materials, coal and power will continue to constitute a substantial portion of our cost of sales in the future.

Our cost of sales also includes depreciation and amortization of production facilities. Other items contributing to our cost of sales are direct labor, which includes salaries and benefits for personnel directly involved in production activities, resources tax for limestone mining and transportation and logistics expenses.

We expect cost of sales to increase as we increase our production capacity and production volume. Potential increases in purchase prices of raw materials, coal and power may also contribute to higher cost of sales.

### ***Other Revenue***

Other revenue mainly consists of interest income on bank deposits, government grants for fixed asset investment, such as current and clinker plants and residual heat generation plants and VAT refunds for sales of certain types of cement products using recycled materials, and sales of power generation right. The table below sets forth a breakdown of other revenue for the periods indicated.

	<b>Year ended December 31,</b>		
	<b>2008</b>	<b>2009</b>	<b>2010</b>
	<b>RMB</b>	<b>RMB</b>	<b>RMB</b>
	<b>(in millions)</b>		
<b>Other revenue</b>			
Interest income on bank deposits .....	12.8	4.3	6.8
Dividend income from listed security .....	0.2	–	–
Government grants .....	170.4	100.1	126.1
Sales of power generation right .....	–	21.0	–
Amortization of deferred income .....	4.3	12.9	15.6
Amortization of financial guarantee issued .....	32.7	33.5	–
Amortization of financial guarantee received .....	(32.2)	(33.5)	–
	<u>188.2</u>	<u>138.3</u>	<u>148.5</u>

Other revenue decreased from RMB188.2 million in 2008 to RMB138.3 million in 2009, but increased to RMB148.5 million in 2010, primarily reflecting the fluctuations in government grants during these periods. Government grants consist of (1) VAT refunds for sales of certain types of cement products that use recycled materials and (2) local government subsidies that represents various subsidies granted by local governments to newly established enterprises as a means to attract investment. VAT refunds amounted to RMB144.9 million, RMB80.3 million and RMB104.5 million in 2008, 2009 and 2010, respectively, and local government subsidies amounted to RMB25.5 million, RMB19.8 million and RMB21.6 million, respectively, during the same periods. There are no unfulfilled conditions and contingencies relating to such local government subsidies. In connection with our business operations in 2008 and 2009, we were an issuer of a financial guarantee in an amount of RMB1,500 million for the benefit of an unrelated third party, which also issued a financial guarantee in an amount of RMB1,500 million for our benefit. The financial guarantee we issued required us to make payments to reimburse the beneficiary of the guarantee for a loss the beneficiary incurred if the third party failed to make payment past due in accordance with the terms of a relevant debt instrument. The amounts of the guarantees initially recognized as deferred income was amortized in profit or loss over the term of the guarantee as income from financial guarantee issued.

### *Other Net (Expenses)/Income*

Other net (expenses)/income mainly consists of debt restructuring gain, net foreign exchange gain or loss, net gain or loss from sale of fixed asset and impairment losses on fixed assets, intangible assets and other long-term assets. The table below sets forth a breakdown of other net (expenses)/income for the periods indicated.

	Year ended December 31,		
	2008	2009	2010
	RMB	RMB (in millions)	RMB
<b>Other net (expenses)/income</b>			
Debt restructuring gain .....	82.0	5.6	97.5
Net foreign exchange gain/(loss) .....	22.5	(0.4)	6.9
Net gain/(loss) from sale of fixed assets .....	(23.0)	(7.1)	1.5
Impairment losses on fixed assets .....	(49.2)	–	(106.5)
Impairment of inventories .....	(4.5)	–	–
Compensation to customer .....	(10.3)	–	–
Impairment losses on intangible assets .....	–	–	(4.3)
Impairment losses on other long-term assets .....	–	–	(35.1)
Donations .....	(5.2)	(1.5)	(1.5)
Penalty expenses .....	(3.4)	(0.5)	(12.9)
Losses incurred on flooding .....	–	–	(10.2)
Others <sup>(1)</sup> .....	5.9	1.6	(3.7)
	<u>14.8</u>	<u>(2.3)</u>	<u>(68.3)</u>

Note:

(1) Mainly included trademark license fee, waived accounts payables and compensation from insurance companies.

We generated other income of RMB14.8 million in 2008, compared to other net expenses that increased from RMB2.3 million in 2009 to RMB68.3 million in 2010. Our other income in 2008 was primarily attributable to our debt restructuring gain of RMB82.0 million and net foreign exchange gain of RMB22.5 million, partially offset by impairment of losses on fixed assets of RMB49.2 million. Debt restructuring gain increased from RMB5.6 million in 2009 to RMB97.5 million in 2010, which increase was offset by impairment losses on fixed assets of RMB106.5 million.

### *Operating Expenses*

Our operating expenses consist of selling and marketing expenses and administrative expenses. The table below sets forth a breakdown of our operating expenses and each item expressed as a percentage of our revenue for the periods indicated.

	Year ended December 31,					
	2008		2009		2010	
	Amount (RMB)	% of Revenue	Amount (RMB)	% of Revenue	Amount (RMB)	% of Revenue
(in millions, except percentages)						
<b>Operating expenses</b>						
Selling and marketing expenses.	175.2	2.3%	196.5	2.3%	214.2	1.8%
Administrative expenses .....	553.3	7.4%	469.1	5.4%	689.6	5.8%
	<u>728.5</u>	<u>9.7%</u>	<u>665.6</u>	<u>7.7%</u>	<u>903.8</u>	<u>7.6%</u>

### *Selling and marketing expenses*

Our selling and marketing expenses primarily consist of sales commission paid to our sales personnel and transportation expenses incurred mainly for export sales of our cement and clinker products overseas. The table below sets forth a breakdown of our selling and marketing expenses for the periods indicated.

	Year ended December 31,		
	2008	2009	2010
	RMB	RMB	RMB
(in millions)			
<b>Selling and marketing expenses:</b>			
Salary and employee benefits .....	48.2	53.4	75.2
Transportation expenses .....	30.6	26.9	21.1
Others <sup>(1)</sup> .....	96.4	116.2	117.9
	<u>175.2</u>	<u>196.5</u>	<u>214.2</u>

Note:

(1) Mainly included advertising expenses, depreciation and amortization, travelling expenses and water and power expenses relating to our sales and marketing activities.

As we expand our current operations in existing markets and consolidate our positions in other geographic markets, we expect to strengthen our sales efforts, and thus our selling and marketing expenses may increase.

### *Administrative Expenses*

Our administrative expenses primarily consist of salaries and benefits of our administrative staff, audit and consulting expenses, other taxes and charges mainly including land use rights tax, property tax, mineral resource compensation fee and cement special levies, amortization charges of fixed assets and intangible assets used for administrative purposes, as well as administrative office expenses including, among others, consumables, traveling and entertainment expenses, water and power expenses, property insurance

premiums, repair expenses and rental expenses. Other items contributing to our administrative expenses include wastewater treatment costs. The table below sets forth a breakdown of our administrative expenses for the periods indicated.

	<b>Year ended December 31,</b>		
	<b>2008</b>	<b>2009</b>	<b>2010</b>
	<b>RMB</b>	<b>RMB</b>	<b>RMB</b>
	<b>(in millions)</b>		
<b>Administrative expenses:</b>			
Salary and employee benefits .....	268.7	160.1	241.7
Audit and consulting expenses.....	19.9	31.7	43.0
Other taxes and charges .....	46.0	55.4	69.3
Depreciation and amortization .....	69.9	68.1	85.1
Office expenses .....	19.2	25.5	31.0
Wastewater treatment costs.....	9.6	18.2	25.0
Others.....	120.0	110.1	194.5
	<b>553.3</b>	<b>469.1</b>	<b>689.6</b>

### ***Finance Costs***

Finance costs primarily consist of interest expenses on borrowings from banks and other financing institutions and bank charges.

### ***Share of Profit less Losses of an associate***

Share of profit less losses of an associate is attributable to our investment in 2010 for 49% interests in Dong'e Shanshui Dongchang Cement Co., Ltd., a company incorporated in February 2010 in Shandong and produces and sells cement, clinker and related products.

### ***Income Tax Expenses***

Income tax expenses primarily consist of provision for PRC current and deferred income tax expenses. Our Company is incorporated in the Cayman Islands as an exempt company with limited liability under the Companies Law. The Cayman Islands currently have no form of income tax or corporate tax. Our wholly owned subsidiaries, China Shanshui (Hong Kong) and Pioneer Cement, are subject to Hong Kong profits tax at the rate of 16.5% on profits derived in Hong Kong. In 2008, 2009 and 2010, we did not make any provisions for Hong Kong profits tax as these two subsidiaries did not derive any assessable profits in Hong Kong. Our subsidiaries incorporated in the PRC are subject to PRC enterprise income tax. See “– Taxation.”

### **Taxation**

PRC enterprise income tax is calculated based on taxable income determined under PRC accounting principles and tax laws and regulations. On March 16, 2007, the National People’s Congress (“NPC”) promulgated the EIT Law, which became effective on January 1, 2008 and superseded the PRC Foreign Invested Enterprise and Foreign Enterprise Income Tax Law and the Provisional Regulations on Enterprise Income Tax of the PRC. The EIT Law consolidates the previous two separate tax regimes for domestic enterprises and foreign-invested enterprises and imposes a unified enterprise income tax rate of 25% for both types of enterprises. Under the EIT Law, enterprises that previously enjoyed a preferential tax rate prior to January 1, 2008 are gradually transitioning to the new tax rate over five years from January 1, 2008. Enterprises that previously enjoyed a fixed period of tax exemption and reduction have continued to enjoy such preferential tax treatment until the expiry of such prescribed period, and for those enterprises whose preferential tax treatment had not commenced due to lack of profit, such preferential tax treatment commenced from January 1, 2008.

Under the previous tax regime, Shandong Shanshui, Anqiu Shanshui and Pingyin Shanshui, being foreign-invested enterprises incorporated prior to March 16, 2007, were exempted from enterprise income tax for their first two years of profitable operations (2006 and 2007) and enjoyed a 50% tax reduction for the following three consecutive years (2008-2010). Continental (Shandong) Cement Mining, Continental (Shandong) Cement Products Manufacturing and Continental (Shandong) Cement did not have any taxable profits in 2008, 2009 and 2010 and therefore were not subject to enterprise income tax during these years. Under the EIT Law, these three entities, as foreign-invested enterprises, were exempted from enterprise income tax in 2008 and 2009, and have been and will be subject to a 12.5% tax rate from 2010 to 2012 and will be subject to a 25% tax rate from 2013 onwards. Our other subsidiaries in the PRC have been subject to a 25% tax rate from 2008. Our effective tax rate was 23.0%, 24.1% and 26.3%, respectively, in 2008, 2009 and 2010. Our effective tax rate was more than 25% for the year ended December 31, 2010, primarily because losses of foreign-invested enterprises may not be deducted from the taxable income of domestic enterprises, accordingly, certain expenses were not be deducted from our pre-tax income.

Under the EIT Law, enterprises are classified as either resident enterprises or non-resident enterprises. A resident enterprise refers to an enterprise that is incorporated under the PRC law, or that is incorporated under the law of a jurisdiction outside the PRC with its de facto management organization located within the PRC. Under the Implementation Rules of the EIT Law, “de facto management organization” is defined as the organization of an enterprise through which substantial and comprehensive management and control over the production and business operations, personnel, accounting and properties of the enterprise are exercised. Non-resident enterprise refers to an enterprise that is incorporated under the law of a jurisdiction outside the PRC with its de facto management organization located outside of the PRC, but which has either set up institutions or establishments in the PRC or it has income originating from the PRC without setting up an institution or establishment in the PRC.

According to the EIT Law and its implementation rules, a resident enterprise will be subject to enterprise income tax at a rate of 25% on its global income. Dividend income between qualified resident enterprises is exempt from enterprise income tax. If the relevant government authorities classify our overseas holding companies, namely our Company, China Shanshui (Hong Kong), Pioneer Cement and Continental Cement (BVI), as resident enterprises, these holding companies will be subject to 25% enterprise income tax on their global income. However, their dividend income from other qualified resident enterprises, including dividends payable by our PRC subsidiaries, will be exempt from PRC enterprise income tax. A non-resident enterprise will be subject to enterprise income tax, generally by way of withholding, at a rate of 10% on any income that is regarded as income from “sources within the PRC.” Under the Implementation Rules of the EIT Law, whether a dividend payment constitutes income from “sources within the PRC” is determined by the location of the enterprise that declares the dividend. Under the Arrangement between the Mainland China and Hong Kong Special Administrative Region on the Avoidance of Double Taxation and Prevention of Fiscal Evasion, which became effective on January 1, 2007, income tax on dividends payable to a company resident in Hong Kong that holds more than a 25% equity interest in a PRC resident enterprise may be reduced to a rate of 5%. If the relevant government authorities classify our overseas holding companies as non-resident enterprises, their dividend income from sources within the PRC will be subject to a 10% or 5% enterprise income tax rate, as applicable. Our financial performance will be adversely affected if such dividends are subject to PRC enterprise income tax.

### **Critical Accounting Policies and Estimates**

We prepare our consolidated financial statements in conformity with International Financial Reporting Standards issued by the International Accounting Standards Board, which requires us to make estimates and assumptions that affect the reported amounts of, among other things, assets, liabilities, revenue and expenses. These estimates and assumptions are periodically re-evaluated by management and are based on experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. Some of our accounting policies require a higher degree of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our financial statements as their application places the most significant demands on our management’s judgment.

## *Property, Plant and Equipment*

Property, plant and equipment, other than construction in progress, are stated at historical cost less accumulated depreciation and provision for any impairment in value. Historical cost includes its purchase price and any other expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to us and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged in the consolidated statements of comprehensive income during the period in which they are incurred.

Except for mining assets, depreciation on property and plant, motor vehicles, electronic and other equipment and machinery is calculated using the straight-line method to allocate their costs or revalued amounts to their residual values of 3-5% over their estimated useful lives, as follows:

Plants and buildings .....	10-40 years
Machinery and equipments .....	10-20 years
Motor vehicles and others.....	5-10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, annually. Construction in progress represents buildings, machinery and equipment on which construction work has not been completed. It is carried at cost which includes construction expenditure and other direct costs less any impairment losses. On completion, construction in progress is transferred to the appropriate categories of property, plant and equipment at cost. No depreciation is provided for construction in progress until they are completed and available for use.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within "other gains/(losses) – net," in the consolidated statements of comprehensive income.

Mining assets include development stripping costs and decommission and restoration provisions.

### *Stripping costs*

Stripping costs incurred as a result of limestone mining are included in the costs of production.

### *Decommissioning, restoration and similar liabilities*

We recognize provision for statutory, contractual, constructive or legal obligations, including those associated with the reclamation of mineral properties and mineral assets under property, plant and equipment, when those obligations result from the acquisition, construction, or normal operation of the assets. Initially, a provision for an asset retirement obligation is recognized at its present value in the period in which it is incurred. Upon initial recognition of the liability, the corresponding asset retirement obligation is added to the carrying amount of the related asset and the cost is amortized as an expense over the economic life of the asset using either the unit-of-production method or the straight-line method, as appropriate. Following the initial recognition of the asset retirement obligation, the carrying amount of the liability is increased for the passage of time and adjusted for changes to the current market-based discount rate, amount or timing of the underlying cash flows needed to settle the obligation. The amounts provided in relation to restoration and environmental clean up costs are reviewed periodically based upon the facts and circumstances available at the time, and the provisions are updated accordingly.

### ***Trade and other receivables***

Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that we will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will become bankrupt or financial reorganization, and default of payments is considered indicators that the receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the assets is reduced through the use of an allowance account, and the amount of the loss is recognized in the consolidated statements of comprehensive income. When a receivable is uncollectible, it is written off against the allowance account for receivables. Subsequent recoveries of amounts previously written off are credited in the consolidated statements of comprehensive income.

We perform ongoing credit evaluations of our customers and adjust credit limits based on payment history and the customer's current credit-worthiness, as determined by the review of their current credit information.

### ***Inventories***

Our inventories primarily consist of: (i) raw materials and consumables; (ii) work in progress; and (iii) finished goods. We state our inventories at the lower of cost and net realizable value. Cost is calculated using the weighted average method. The cost of finished goods and work in progress comprises raw materials, direct labor, other direct costs and related production overheads (based on normal operating capacity). Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses and cost to complete. We write down inventories to net realizable value based on an assessment of the realizability of inventories. The assessment of write-downs requires the management's judgment and estimate. Where the expectation is different from the original estimate, such difference will impact the carrying values of inventories and write-downs of inventories in the period in which such estimates have been changed.

### ***Goodwill***

Goodwill represents the excess of the cost of an acquisition over the fair value of our share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included as goodwill. Goodwill is tested for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. One of our key assumptions is annual growth rates in revenue which vary among different subsidiaries. The growth rates are calculated based on the subsidiaries' growth forecasts and the average long-term growth rate for the relevant industry. Another key assumption for the value-in-use calculations is the stable budgeted gross margin, which is determined based on the subsidiaries' past performance and its expectation for market development.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

### ***Mining Rights***

The cost of acquiring rights for us to excavate a mine over a certain period is capitalized and subsequently stated at cost less accumulated amortization and impairment loss. Amortization of mining rights is calculated to write off the cost less accumulated impairment losses over the useful lives of the mines in accordance with the production plans and reserves of the mines estimated on a unit of production method.

### ***Impairment of customer relationship and trademarks***

Impairment from customer relationships and trademarks is assessed at each statement of financial position date. The estimate is based on recoverable amount which is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to those intangible assets for which the estimates of future cash flows have not been adjusted.

### ***Taxation***

We assess the tax effect of all transactions and make provision for tax obligations. We review the tax treatment of these transactions, considering all amendments of tax laws and regulations. We consumed industrial waste in the production of cement and clinker. Such consumption may qualify for certain government subsidies and corresponding income tax exemptions pursuant to the applicable PRC tax laws and regulations. Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. Deferred income tax is provided on temporary differences arising on investments in subsidiaries except where the timing of the reversal of the temporary difference is controlled by us and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

### ***Going Concern Basis***

We make an assessment of our ability to continue as a going concern when preparing our financial information due to our net current liabilities position over the fiscal years ended December 31, 2008, 2009 and 2010. In assessing whether the going concern assumption is appropriate, we take into account all available information about the future, which is at least, but is not limited to, twelve months from the balance sheet date. The degree of consideration depends on the facts in each case.

We depend on future projections of our profits and cash inflows from operations and our ability to obtain continued bank financing to meet our future working capital and financing requirements. We believe we are able to continue as a going concern after taking into account future projections of our profits and cash inflows from operations and our ability to obtain continued bank financing to finance our continuing operation. Accordingly, we have prepared our financial information on a going concern basis. An adverse change in any of the above conditions would require the financial information to be prepared on an alternative authoritative basis and such basis, together with the fact that the financial information is not prepared on a going concern basis, would need to be disclosed. If we were unable to continue as a going concern, adjustments relating to the recoverability and classification of recorded asset amounts or classification of liabilities may need to be incorporated in our financial information.

## Our Results of Operations

The following table sets forth our summary consolidated statement of operations for the periods indicated. Our historical results presented below are not necessarily indicative of the results that may be expected for any future period.

	<b>Year ended December 31,</b>		
	<b>2008</b>	<b>2009</b>	<b>2010</b>
	<b>RMB</b>	<b>RMB</b>	<b>RMB</b>
	<b>(in millions)</b>		
<b>Revenue</b> .....	7,500.7	8,727.6	11,854.1
Cost of sales.....	(5,914.3)	(6,947.2)	(9,304.0)
<b>Gross profit</b> .....	1,586.4	1,780.4	2,550.1
Other revenue.....	188.2	138.3	148.5
Other net (expenses)/income.....	14.8	(2.3)	(68.3)
Selling and marketing expenses.....	(175.2)	(196.5)	(214.2)
Administrative expenses.....	(553.3)	(469.1)	(689.6)
<b>Profit from operations</b> .....	1,060.9	1,250.8	1,726.5
Finance costs.....	(348.0)	(309.6)	(363.1)
Share of profits less losses of an associate.....	-	-	(0.2)
<b>Profit before taxation</b> .....	712.9	941.2	1,363.2
Income tax.....	(163.8)	(227.2)	(358.3)
<b>Profit for the year</b> .....	549.1	714.0	1,004.9
Attributable to:			
Equity holders of the company.....	539.4	701.6	979.1
Non-controlling interests.....	9.7	12.4	25.8

## Segment Information

The following table sets forth certain information regarding our reportable segments for the periods indicated.

	Year ended December 31,					
	2008		2009		2010	
	RMB	%	RMB	%	RMB	%
	(in millions, except percentages)					
<b>Revenue from external customers</b>						
Shandong province.....	6,599.5	88.0	7,511.2	86.1	9,791.9	82.6
Northeastern China .....	901.2	12.0	1,216.4	13.9	2,055.9	17.3
Shanxi province.....	—	—	—	—	6.3	0.1
	<u>7,500.7</u>	<u>100.0</u>	<u>8,727.6</u>	<u>100.0</u>	<u>11,854.1</u>	<u>100.0</u>
<b>Inter-segment revenue</b>						
Shandong province.....	46.5	95.1	56.6	99.2	18.3	77.9
Northeastern China .....	2.4	4.9	0.5	0.8	5.2	22.1
Shanxi province.....	—	—	—	—	—	—
	<u>48.9</u>	<u>100.0</u>	<u>57.1</u>	<u>100.0</u>	<u>23.5</u>	<u>100.0</u>
<b>Reportable segment revenue</b>						
Shandong province.....	6,646.0	88.0	7,567.8	86.1	9,810.2	82.6
Northeastern China .....	903.6	12.0	1,216.9	13.9	2,061.1	17.4
Shanxi province.....	—	—	—	—	6.3	0.1
	<u>7,549.6</u>	<u>100.0</u>	<u>8,784.7</u>	<u>100.0</u>	<u>11,877.6</u>	<u>100.0</u>
<b>Reportable segment profit/(loss) (adjusted profit/(loss) before taxation)</b>						
Shandong province.....	1,086.7	96.4	1,190.5	94.5	1,827.9	100.8
Northeastern China .....	40.1	3.6	69.9	5.5	3.6	0.2
Shanxi province.....	—	—	—	—	(17.3)	(1.0)
	<u>1,126.8</u>	<u>100.0</u>	<u>1,260.4</u>	<u>100.0</u>	<u>1,814.2</u>	<u>100.0</u>

## Year Ended December 31, 2010 Compared With Year Ended December 31, 2009

### Revenue

Our revenue increased by RMB3,126.5 million, or 35.8%, from RMB8,727.6 million in 2009 to RMB11,854.1 million in 2010, primarily due to increases in revenue derived from sales of cement products.

Our revenue derived from sales of cement products amounted to RMB9,275.1 million in 2010, which represented an increase of RMB2,666.9 million, or 40.4%, from 2009, primarily due to increased cement sales volume and average unit selling price. Our sales volume of cement products increased by 33.8% from 29.4 million tons in 2009 to 39.3 million tons in 2010, primarily due to the phasing-out of obsolete cement capacity and the sustained demand from infrastructure construction projects and the property development industry. The average unit selling price of our cement products increased by 4.9% from RMB224.9 per ton in 2009 to RMB235.9 per ton in 2010, primarily due to increased demand for our products and decreased supply in the cement market in Shandong resulting from the phasing out of obsolete facilities mandated by the government.

Our revenue derived from sales of clinker totaled RMB1,941.1 million in 2010, representing an increase of RMB362.2 million, or 22.9%, from 2009, primarily due to increased sales volume and average unit selling price. Our sales volume of clinker increased by 16.9% from 8.4 million tons in 2009 to 9.8 million tons in 2010, mainly due to the sustained demand from infrastructure construction projects and the property development industry. The average unit selling price of clinker increased by 5.2% from RMB187.5 per ton in 2009 to RMB197.2 per ton in 2010, primarily due to decreased supply as a result of decreased capacity in the Shandong clinker market as a result of the phasing-out of obsolete cement capacity.

The revenue derived from the sales of other products and rendering of services, including sales of concrete, pipes and bubble bricks as well as provision of transportation service and equipment installation services, totaled RMB637.9 million in 2010, representing an increase of RMB97.4 million from 2009, primarily reflecting increased sales of pipes, partially offset by decreased sales of concrete.

### ***Cost of sales***

Our cost of sales increased by RMB2,356.8 million, or 33.9%, from RMB6,947.2 million in 2009 to RMB9,304.0 million in 2010, primarily due to increases in costs of raw materials, coal and power as a whole resulting from increases in sales volumes of our cement and clinker products and an increase in the average unit purchase price of coal, partially offset by power cost savings achieved through the installation of RHR generators. Our cost of sales as a percentage of revenue decreased from 79.6% in 2009 to 78.5% in 2010. Our cost of raw materials as a percentage of cost of sales decreased from 30.0% in 2009 to 27.7% in 2010, due to the decrease in the purchase prices of raw materials as a result of standardized procurement procedure and the use of alternative raw materials such as desulfurization gypsum through technology innovation. Our cost of coal as a percentage of cost of sales increased from 31.5% in 2009 to 34.1% in 2010, primarily due to the increase in the purchase price of coal, partially offset by the increased efficiency of coal consumption in our production process. Our average purchase price of coal increased from RMB569.8 per ton in 2009 to RMB691.8 per ton in 2010. The average amount of commercial coal used to produce one ton of clinker decreased from 145 kg to 143 kg and the average amount of standard coal used to produce one ton of clinker decreased from 105 kg to 104 kg<sup>(1)</sup>. Our cost of power as a percentage of cost of sales decreased from 16.2% in 2009 to 15.8% in 2010, primarily reflecting power cost savings achieved through our RHR generators. Depreciation and amortization as a percentage of cost of sales decreased from 8.1% in 2009 to 7.6% in 2010, primarily reflecting our increases in costs of sales.

### ***Gross profit***

As a result of the foregoing, our gross profit increased by RMB769.7 million, or 43.2%, from RMB1,780.4 million in 2009 to RMB2,550.1 million in 2010. Gross profit margin increased from 20.4% in 2009 to 21.5% in 2010.

### ***Other revenue***

Other revenue increased by RMB10.2 million, or 7.4%, from RMB138.3 million in 2009 to RMB148.5 million in 2010, primarily because of increased government grants in 2010 and an increase in interest income, partially offset by sale of power generation rights in 2009.

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<sup>(1)</sup> 1 kg of standard coal equals approximately 1.38 kg of commercial coal of 5,500 kcal.

### ***Selling and marketing expenses***

Selling and marketing expenses increased by RMB17.7 million, or 9.0%, from RMB196.5 million in 2009 to RMB214.2 million in 2010. Total salary and employee benefits increased by RMB21.8 million from RMB53.4 million in 2009 to RMB75.2 million in 2010, primarily due to increased sales volume of cement. Transportation expenses decreased by RMB5.8 million from RMB26.9 million in 2009 to RMB21.1 million in 2010, primarily due to decreases in our volume of overseas export in 2010. The proportion of selling and marketing expenses as a percentage of revenue decreased from 2.3% in 2009 to 1.8% in 2010, primarily due to economies of scale resulting from substantial increase in sales volumes.

### ***Administrative expenses***

Administrative expenses increased by RMB220.5 million, or 47.0%, from RMB469.1 million in 2009 to RMB689.6 million in 2010, primarily due to additional training costs attributable to our continuous expansion of operations and the rise in salaries and labor costs. Employees' salaries and benefits increased by RMB81.6 million from RMB160.1 million in 2009 to RMB241.7 million in 2010, primarily due to increases in the number of our employees and training costs for our employees in the new markets we expanded into. The number of our employees increased from 13,190 in 2009 to 14,714 in 2010. Audit and consulting expenses increased by RMB11.3 million from RMB31.7 million in 2009 to RMB43.0 million in 2010, primarily because the increases in acquisitions we undertook required increases in auditing and consulting services. Other taxes and charges increased by RMB13.9 million from RMB55.4 million in 2009 to RMB69.3 million in 2010, primarily due to increases in production volume, property tax and professional fees attributable to our acquisitions. Depreciation and amortization increased by RMB17.0 million from RMB68.1 million in 2009 to RMB85.1 million in 2010, primarily reflecting the increases in amortization charges as a result of the increased number of consolidated companies by our acquisitions. Our administrative expenses accounted for 5.4% and 5.8% of our revenue in 2009 and 2010, respectively. The increase in proportion was primarily due to additional training costs attributable to our continuous expansion of operations and the rise in salaries and labor costs.

### ***Profit from operations***

As a result of the foregoing, our profit from operations increased by RMB475.7 million, or 38.0%, from RMB1,250.8 million in 2009 to RMB1,726.5 million in 2010.

### ***Finance costs***

Finance costs increased by RMB53.5 million, or 17.3%, from RMB309.6 million in 2009 to RMB363.1 million in 2010, primarily due to increases in our borrowings. The proportion of finance costs to revenue declined slightly from 3.5% in 2009 to 3.1% in 2010.

### ***Profit before taxation***

As a result of the foregoing, our profit before taxation increased by RMB422.0 million, or 44.8%, from RMB941.2 million in 2009 to RMB1,363.2 million in 2010.

### ***Income tax expenses***

Income tax expenses increased by RMB131.1 million, or 57.7%, from RMB227.2 million in 2009 to RMB358.3 million in 2010, primarily due to increased taxable income as a result of increased sales. Our effective tax rate was 24.1% in 2009 and 26.3% in 2010.

### ***Profit for the year***

As a result of the foregoing, our profit for the year increased by RMB290.9 million, or 40.7%, from RMB714.0 million in 2009 to RMB1,004.9 million in 2010. Our profit margin increased from 8.2% in 2009 to 8.5% in 2010.

### ***Profit attributable to equity holders of the company***

Profit attributable to equity holders of the company increased by RMB277.5 million, or 39.6%, from RMB701.6 million in 2009 to RMB979.1 million in 2010.

### **Year Ended December 31, 2009 Compared With Year Ended December 31, 2008**

#### ***Revenue***

Our revenue increased by RMB1,226.9 million, or 16.4%, from RMB7,500.7 million in 2008 to RMB8,727.6 million in 2009, primarily due to increases in sales volume of cement, clinker and other products.

Our revenue derived from sales of cement products amounted to RMB6,608.2 million in 2009, representing an increase of RMB701.4 million, or 11.9%, from 2008, primarily due to increases in sales volume of our cement products, partially offset by a decrease in the average selling price of cement. Our sales volume of cement products increased by 17.0% from 25.1 million tons in 2008 to 29.4 million tons in 2009, primarily due to our extensive market presence, the sustained growth in domestic infrastructure and construction projects, the recovery of property industry and the phasing out of obsolete capacity in 2009. The average unit selling price decreased by 4.4% from RMB235.2 per ton in 2008 to RMB224.9 per ton in 2009, mainly due to the decrease in production costs as compared to 2008.

Our revenue derived from sales of clinker totaled RMB1,578.9 million in 2009, representing an increase of RMB409.7 million, or 35.0%, from 2008, primarily due to the increased sales volume of clinker. Our sales volume of clinker increased by 54.1% from 5.5 million tons in 2008 to 8.4 million tons in 2009. The average unit selling price of clinker decreased by 12.3% from RMB213.9 per ton in 2008 to RMB187.5 per ton in 2009, primarily due to the decrease in production costs as compared to 2008.

The revenue derived from the sales of other products and rendering of services, including sales of concrete, pipes and bubble bricks as well as provision of transportation service and equipment installation services, totaled RMB540.5 million in 2009, representing an increase of RMB115.8 million from 2008 primarily due to increased sales of concrete, increased sales of pipes and increased sales of bubble bricks.

#### ***Cost of sales***

Our cost of sales increased by RMB1,032.9 million, or 17.5%, from RMB5,914.3 million in 2008 to RMB6,947.2 million in 2009, primarily due to increases in costs of raw materials and power resulting from increases in sales volumes of our cement products. Our cost of sales as a percentage of revenue increased from 78.9% in 2008 to 79.6% in 2009, mainly attributable to higher maintenance costs as a result of the extreme weather conditions in Shandong and Liaoning provinces, our two major markets in the fourth quarter of 2009. Cost of coal as a percentage of our cost of sales decreased from 36.6% in 2008 to 31.5% in 2009, primarily due to the decreased coal purchase price level from RMB680.1 per ton in 2008 to RMB569.8 per ton in 2009 and increased efficiency of coal consumption in our production process as a result of the inauguration of our new dry process clinker production lines in Liaoning province. The average amount of commercial coal used to produce one ton of clinker decreased from 156 kg to 145 kg. Cost of power as a percentage of cost of sales decreased from 17.6% in 2008 and 16.2% in 2009.

#### ***Gross profit***

As a result of the foregoing, our gross profit increased by RMB194.0 million, or 12.2%, from RMB1,586.4 million in 2008 to RMB1,780.4 million in 2009.

### ***Other revenue***

Other revenue decreased by RMB49.9 million, or 26.5%, from RMB188.2 million in 2008 to RMB138.3 million in 2009, primarily due to decreases in government grants and interest income in 2009, partially offset by amortization of deferred income and sale of power generation right in 2009.

### ***Selling and marketing expenses***

Selling and marketing expenses increased by RMB21.3 million, or 12.2%, from RMB175.2 million in 2008 to RMB196.5 million in 2009. Primarily due to increased sales volume of cement products from 25.1 million tons to 29.4 million tons, total salary and employee benefits increased by RMB5.2 million from RMB48.2 million in 2008 to RMB53.4 million in 2009, which was offset by a decrease of RMB3.7 million in transportation expenses primarily caused by decreased sales volume of clinker for overseas export. The proportion of selling and marketing expenses as a percentage of revenue remained stable in 2008 and 2009 at approximately 2.3%, primarily because our selling and marketing expenses have increased in line with our increases in sales and revenue.

### ***Administrative expenses***

Administrative expenses decreased by RMB84.2 million, or 15.2%, from RMB553.3 million in 2008 to RMB469.1 million in 2009, primarily due to increases in expenses attributable to our internal control system and integration of our acquired entities. Employees' salaries and benefits decreased by RMB108.6 million from RMB268.7 million in 2008 to RMB160.1 million in 2009, primarily due to the decreases in salaries and benefits of our senior administrative employees in 2009. The number of our employees increased from 12,388 in 2008 to 13,190 in 2009. Depreciation and amortization charges decreased by RMB1.8 million from RMB69.9 million in 2008 to RMB68.1 million in 2009. Office expenses increased by RMB6.3 million from RMB19.2 million in 2008 to RMB25.5 million in 2009, primarily reflecting administrative expenses incurred in connection with one new subsidiary and one new branch company. The proportion of administrative expenses to revenue decreased from 7.4% in 2008 to 5.4% in 2009, mainly attributed to the systematic consolidation of the acquired businesses and our effective cost control.

### ***Profit from operations***

As a result of the foregoing, our profit from operations increased by RMB189.9 million, or 17.9%, from RMB1,060.9 million in 2008 to RMB1,250.8 million in 2009.

### ***Finance costs***

Finance costs decreased by RMB38.4 million from RMB348.0 million in 2008 to RMB309.6 million in 2009, primarily due to lower interest rates on our debt.

### ***Profit before taxation***

As a result of the foregoing, our profit before taxation increased by RMB228.3 million, or 32.0%, from RMB712.9 million in 2008 to RMB941.2 million in 2009.

### ***Income tax expenses***

Income tax expenses increased by RMB63.4 million, or 38.7%, from RMB163.8 million in 2008 to RMB227.2 million in 2009, primarily due to increased profit before taxation as a result of higher revenue in 2009. Our effective tax rate increased from 23.0% in 2008 to 24.1% in 2009, primarily due to expiration of preferential tax treatments for certain subsidiaries.

### ***Profit for the year***

As a result of the foregoing, our profit for the year increased by RMB164.9 million, or 30.0%, from RMB549.1 million in 2008 to RMB714.0 million in 2009. Our profit margin increased from 7.3% in 2008 to 8.2% in 2009.

### *Profit attributable to equity holders of the company*

Profit attributable to equity holders of the Company increased by RMB162.2 million, or 30.0%, from RMB539.4 million in 2008 to RMB701.6 million in 2009.

### **Liquidity and Capital Resources**

We fund our working capital needs, including capital expenditures associated with our investments in the construction of and acquisition of cement and clinker production lines, through a variety of sources, including cash inflows from operations and short-term and long-term bank loans. As of December 31, 2008, 2009 and 2010, we had cash and cash equivalents of RMB1,248.4 million, RMB886.1 million and RMB1,144.8 million, respectively. Cash and cash equivalents increased by RMB258.7 million, or 29.2%, as of December 31, 2010 compared to December 31, 2009, primarily due to (i) increased net cash generated from operating activities as a result of increased revenue and (ii) increased net cash generated from financing activities as a result of the issuance of corporate bonds in October 2010. There was a decrease in cash and cash equivalents of RMB362.3 million, or 29.0%, from December 31, 2008 to December 31, 2009, because we received net proceeds from the issuance of shares in 2008 and our net cash generated from operating activities remained relatively stable in 2008 and 2009.

Our capital expenditures primarily comprised expenditures for plants, buildings, equipment, land use rights, construction in progress, intangible assets and acquisition of subsidiaries. Our capital expenditures, as represented by payment for purchase of fixed assets, payment for purchase of intangible assets and acquisitions of subsidiaries, net of cash acquired, were approximately RMB2,394.6 million, RMB2,155.3 million and RMB2,851.9 million in 2008, 2009 and 2010, respectively.

We believe that our current cash and cash equivalents, anticipated cash flow from operations, ability to obtain continued bank financing for our continuing operations and the proceeds from this offering will be sufficient to meet our expected cash requirements, including for working capital and capital expenditure purposes, for at least the next 12 months following the date of this document.

The following table sets forth a summary of our net cash flow for the periods indicated.

	<b>Year ended December 31,</b>		
	<b>2008</b>	<b>2009</b>	<b>2010</b>
	<b>RMB</b>	<b>RMB</b>	<b>RMB</b>
	<b>(in millions)</b>		
Net cash generated from operating activities.....	1,037.3	1,025.7	1,789.0
Net cash used in investing activities.....	(2,404.5)	(2,136.4)	(2,926.8)
Net cash from financing activities.....	1,912.8	748.6	1,398.3
Cash and cash equivalents at year end.....	1,248.4	886.1	1,144.8

### *Net cash generated from operating activities*

We derive our cash inflow from operations primarily from the receipt of payment for sales of our products and provision of our services. Our cash outflow from operations primarily includes purchases of raw materials, coal and power, production facility construction expenses, selling and marketing expenses, staff costs, income tax payments and interest payments.

Our net cash generated from operating activities was RMB1,789.0 million in 2010, resulting from cash generated from operating activities of RMB2,463.8 million, partially offset by interest paid of RMB356.6 million and income tax paid of RMB318.2 million. Cash generated from operating activities primarily included profit before taxation of RMB1,363.2 million, depreciation of RMB693.3 million, finance

costs of RMB363.3 million, an increase in trade and bills payable of RMB263.5 million and a decrease of RMB205.9 million in other receivables and prepayments, partially offset by an increase of RMB238.8 million in trade and bills receivables and an increase of RMB220.5 million in inventories. The increase in trade and bills payables was primarily attributable to the increase in the prices of raw materials and the increases of raw materials purchased due to increased sales volume during the second half of 2010. The decrease in other receivables and prepayments was primarily due to the occupational safety fees refunded by the government and income from sales of power generation rights. The increase in trade and bills receivables was primarily due to our increased sales in the second half of 2010, and the increase in inventories was primarily because of the increased number of subsidiaries in the end of 2010.

Our net cash generated from operating activities was RMB1,025.7 million in 2009, resulting from cash generated from operating activities of RMB1,586.6 million, partially offset by interest paid of RMB301.9 million and income tax paid of RMB259.0 million. Cash generated from operating activities primarily included profit before taxation of RMB941.2 million, depreciation of RMB551.4 million and finance costs of RMB309.6 million, partially offset by an increase of RMB352.1 million in trade and bills receivables, an increase of RMB113.2 million in other receivables and prepayments and a decrease of inventories of RMB58.4 million. The increase in trade and bills receivables was primarily due to the increased number of government projects undertaken resulting in increases in sales on credits as well as the increases in the sales of concrete products. The increase in other receivables and prepayments was primarily because deferred tax income from purchases of fixed assets in the beginning of the period became due in the end of the period.

Our net cash generated from operating activities was RMB1,037.3 million in 2008, resulting from cash generated from operating activities of RMB1,485.4 million, partially offset by interest paid of RMB335.7 million and income tax paid of RMB112.4 million. Cash generated from operating activities primarily included profit before taxation of RMB712.9 million, depreciation of RMB454.9 million, finance costs of RMB348.0 million and a decrease of RMB101.4 million in other receivables and prepayments, partially offset by an increase in inventories of RMB357.6 million and a decrease of RMB105.4 million in other payables and accrued expenses. The increase in inventories was primarily attributable to the increased number of subsidiaries. The decrease in other receivables and prepayments was primarily because of the refunded payments to us on escrow from our acquisitions in 2007. The decrease in other payables and accrued expenses was primarily due to our refunds on escrow to third parties in our acquisitions in 2007.

#### *Net cash used in investing activities*

Our net cash used in investing activities was RMB2,926.8 million in 2010, primarily including RMB2,072.7 million used for purchase of fixed assets and intangible assets and RMB779.2 million for our acquisitions of subsidiaries, net of cash acquired, of RMB41.3 million from sales of property, plant and equipment. Cash outflow for acquisition of fixed assets amounted to RMB2,030.8 million, primarily relating to capital expenditures attributable to our construction of new production lines. Cash outflow for acquisition of intangible assets amounted to RMB41.9 million, primarily relating to the payments for limestone mining rights by our new subsidiaries.

Our net cash used in investing activities was RMB2,136.4 million in 2009, primarily including RMB1,913.4 million used for the purchase of fixed assets and intangible assets and RMB241.9 million for our acquisitions of subsidiaries, net of cash acquired, of RMB14.4 million from sale of property, plant and equipment. Cash outflow for acquisition of fixed assets amounted to RMB1,828.2 million, primarily relating to capital expenditures attributable to our construction of new production lines. Cash outflow for acquisition of intangible assets amounted to RMB85.2 million, primarily relating to the payments for limestone mining rights by our new subsidiaries.

Our net cash used in investing activities was RMB2,404.5 million in 2008, primarily including RMB2,000.0 million used for the purchase of fixed assets and intangible assets and RMB394.5 million used for our acquisitions of subsidiaries, net of cash acquired, of RMB21.4 million from sales of property, plant and equipment. Cash outflow for acquisition of fixed assets amounted to RMB1,992.8 million, primarily relating to capital expenditures attributable to our construction of new production lines. Cash outflow for the acquisition of intangible assets amounted to RMB7.2 million, primarily relating to the payments for limestone mining rights by our new subsidiaries.

*Net cash from (used in) financing activities*

Our net cash generated from financing activities was RMB1,398.3 million in 2010, primarily including proceeds of RMB2,846.5 million from new loans and borrowings and proceeds of RMB991.0 million from the issuance of corporate bond, partially offset by the repayment of borrowings of RMB2,225.1 million and dividend distributions of RMB238.3 million to our shareholders.

Our net cash generated from financing activities was RMB748.6 million in 2009, primarily including proceeds of RMB3,675.0 million from new loans and borrowings, partially offset by the repayment of borrowings of RMB2,755.4 million.

Our net cash generated from financing activities was RMB1,912.8 million in 2008, primarily including proceeds from new loans and borrowings of RMB3,446.0 million and proceeds from the issuance of share capital of RMB1,719.0 million, partially offset by the repayment of bank loans of RMB3,040.8 million and dividend distributions of RMB205.8 million to our shareholders.

**Commercial Commitments and Contingent Liabilities**

*Capital commitments*

We have entered into production facility construction contracts as well as equipment purchase agreements. The table below sets forth the total amount of our commitments as of the balance sheet dates indicated.

	<b>Year ended December 31,</b>		
	<b>2008</b>	<b>2009</b>	<b>2010</b>
	<b>RMB</b>	<b>RMB</b>	<b>RMB</b>
	<b>(in millions)</b>		
Authorized and contracted for plants and equipments.....	371.3	374.1	1,877.3
Authorized but not contracted for plants and equipments.....	279.9	4,508.6	1,845.9
<b>Total .....</b>	<b>651.2</b>	<b>4,882.7</b>	<b>3,723.2</b>

### *Operating lease commitments*

We lease a number of properties under non-cancellable operating leases. The table below sets forth our payable non-cancellable operating lease rentals as of the balance sheet dates indicated.

	Year ended December 31,		
	2008	2009	2010
	RMB	RMB	RMB
		(in millions)	
<b>Payable:</b>			
Within 1 year.....	15.8	15.9	15.6
After 1 year but within 2 years.....	15.8	15.9	15.6
After 2 years but within 5 years.....	46.6	45.8	46.5
After 5 years .....	154.6	133.0	131.5
Total .....	232.8	210.6	209.2

### *Contingent liabilities*

We entered into reciprocal guarantee contracts with a third party to secure certain banking facilities for each other. The maximum exposure relating to financial guarantees issued by us was RMB1,500 million as of December 31, 2008 and 2009. No claims were made against us under any of the guarantee contracts, which expired in January 2010. We had no material contingent liabilities as of December 31, 2010.

### **Indebtedness**

We have financed our operations primarily through cash flows from operations, loans from commercial banks and other financial institutions, related-party advances and proceeds from the issuance of equity and debt securities. The table below sets forth our short-term and long-term borrowings as of the dates indicated.

	As of December 31,		
	2008	2009	2010
	RMB	RMB	RMB
		(in millions)	
<b>Short-term bank loans</b>			
Secured.....	1,342.0	380.0	180.0
Unsecured .....	300.0	330.0	200.0
Current portion of long-term bank loans.....	1,071.8	1,437.0	1,304.5
Current portion of long-term secured loans from equity holders .....	52.6	58.5	106.1
Short-term and current portion of interest-bearing borrowing .....	2,766.4	2,205.5	1,790.6
<b>Long-term bank loans</b>			
Secured.....	2,436.6	3,608.0	3,407.5
Unsecured .....	300.0	1,180.0	2,147.0
Current portion of long-term bank loans .....	(1,071.8)	(1,437.0)	(1,304.5)
Long-term borrowings, less current portion.....	1,664.8	3,351.0	4,250.0

	As of December 31,		
	2008	2009	2010
	RMB	RMB (in millions)	RMB
<b>Loans from equity holders</b>			
Long-term secured loans from equity holders.....	289.2	236.4	454.2
Current portion of loans from equity holders .....	(52.6)	(58.5)	(106.1)
Loans from equity holders, less current portion.....	236.6	177.9	348.1
Long-term unsecured loans from government.....	10.0	10.0	10.0
Corporate bond .....	–	–	1,000.0
Convertible notes .....	89.6	10.8	–
Total debt.....	<u>4,767.4</u>	<u>5,755.2</u>	<u>7,398.7</u>

### ***Total debt***

The total balance of our short-term and long-term debt was RMB7,398.7 million as of December 31, 2010. Long-term debt were RMB4,250.0 million as of December 31, 2010. As of March 31, 2011, the interest rates on the aggregate outstanding amount of our project loans ranged 2.6% to 7.7% per annum.

As of December 31, 2010, our secured loans and borrowings were either pledged by certain items of our property, plant and equipment and land use rights, or pledged by equity interests of certain of our subsidiaries, or guaranteed by third parties and companies within our group. As of the same date, we did not provide any guarantee to any company outside our group.

### ***Convertible Notes***

On September 21, 2007, we issued US\$20.0 million of unsecured, interest-free convertible notes due in July 2011 to MS Cement Limited, MS Cement II Limited, CDH Cement Limited and IFC. The maturity date of the convertible notes is July 2, 2011. The convertible notes would be converted into a total of 114,964,200 shares at approximately US\$0.17 or approximately HK\$1.32 per share upon conversion. If we declare any dividends or distribution on our shares before the notes holders elect to exercise the conversion rights, the notes holders are entitled to receive payments equal to the dividend payable for each share multiplied by the total number of shares issuable upon exercise of the conversion rights. On April 30, 2009 MS Cement Limited, MS Cement II Limited and CDH Cement Limited fully converted their convertible notes. On November 29, 2010, IFC fully converted its convertible notes.

In addition, see “Summary – Recent Developments – 2011 Term Loans.”

### ***8.5% Senior Notes due 2016***

In May 2011, we issued our US\$400 million aggregate principal amount of 8.5% senior notes due 2016. The 2016 Notes mature five years from the date of issuance in May 2016 and are repayable at their principal amount of US\$400 million. As of the date of this document, we had a total of US\$400 million principal amount of the 2016 Senior Notes outstanding. The 2016 Notes are jointly and severally guaranteed by certain subsidiaries of our subsidiaries incorporated or organized outside the PRC. See “Description of Other Material Indebtedness – 8.5% Senior Notes Due 2016.”

### **Off-balance Sheet Arrangements**

As of the date of this document, we do not have any outstanding off-balance sheet arrangements.

## **Inflation**

Inflation in China has not materially impacted our results of operations. According to the PRC National Bureau of Statistics, the change in the consumer price index in China was 5.9%, (0.7)% and 3.3% in 2008, 2009 and 2010 respectively.

## **Quantitative and Qualitative Disclosures about Market Risk**

### *Foreign Exchange Risk*

Our financial statements are expressed in Renminbi and our functional currency for operations in the PRC is the Renminbi. The change in value of the Renminbi against the US dollar, Hong Kong dollar, and other currencies is affected by, among other things, changes in China's political and economic conditions. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi to the US dollar. Under the new policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. As of December 31, 2010, this change in policy has resulted in an approximately 25.4% appreciation of the Renminbi against the US dollar since the date of its announcement. There remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the Renminbi against the US dollar.

Because our income generated from the export of our products is received in US dollars, appreciation of the Renminbi against the US dollar may adversely affect our results of operations and financial condition. Depreciation of the value of the Renminbi will increase the amount of our non-Renminbi debt service in Renminbi terms since we have to convert Renminbi into non-Renminbi currencies to service our US dollar debt.

Very limited hedging transactions are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk other than by retaining foreign currency denominated earnings and receipts to the extent permitted by the State Administration of Foreign Exchange. While we may enter into hedging transactions in the future, the availability and effectiveness of these transactions may be limited and we may not be able to successfully hedge our exposure or at all. In addition, our foreign currency exchange losses may be magnified by the PRC government's exchange control regulations that restrict our ability to convert Renminbi into foreign currencies.

### *Interest Rate Risk*

Our exposure to interest rate risk primarily relates to the interest rates for our cash and cash equivalents, pledged deposits and interest-bearing borrowings. Our interest rate risk primarily arises from interest-bearing borrowings and our corporate bonds. Borrowings issued at variable rates and at fixed rates and our corporate bonds issued at a fixed rate expose us to cash flow interest rate risk and fair value interest rate risk, respectively. As of December 31, 2010, we were exposed to interest rate risk relating to our borrowings and corporate bond, which totaled RMB6,398.7 million and RMB1,000.0 million, respectively. We do not intend to engage in the trading of financial derivatives for the sole purpose of profit making in the future. Our future interest income may be lower than expected due to changes in market interest rates.

### *Credit Risk*

Our credit risk is primarily attributable to trade and bills receivables. In respect of trade and bills receivable for sales of cement, clinker and bubble bricks, we generally require full payment upon delivery of goods and perform credit evaluation only when customers require credit. In respect of trade and bills receivables for sales of pipes and concrete, we allow a credit period ranging from 90 days to 180 days and perform credit evaluation on customers requiring credit over a certain amount. However, we generally do not

require collateral from customers on credit. Our exposure to credit risk is influenced by the individual characteristics of each customer rather than the industry or country in which the customers operate. Therefore, significant concentrations of credit risk primarily arise when we have significant exposure to individual customers. As of December 31, 2010, 2.7% and 3.0% of the total trade and bills receivable were due from our largest customer and our five largest customers, respectively.

### Recent IFRS Pronouncements

The International Accounting Standards Boards (“IASB”) has issued a number of new and revised IFRS, amendments and interpretations which are not effective for accounting periods beginning on January 1, 2010, and we have not early adopted.

	<b>Effective for accounting periods beginning on or after</b>
Amendment to IAS 32, <i>Financial instruments: Presentation – Classification of rights issues</i>	February 1, 2010
IFRIC 19, <i>Extinguishing financial liabilities with equity instruments</i>	July 1, 2010
Improvements to IFRSs 2010	July 1, 2010 or January 1, 2011
Revised IAS 24, Related party disclosures	January 1, 2011
Amendments to IFRIC 14, IAS 19 – <i>The limit on a defined benefit asset, minimum funding requirements and their interaction – Prepayments of a minimum funding requirement</i>	January 1, 2011
Amendments to IFRS 7, <i>Financial Instruments: Disclosures-Transfers of financial assets</i>	July 1, 2011
Amendments to IAS 12, <i>Income taxes – Deferred tax: Recovery of underlying assets</i>	January 2, 2012
IFRS 9, <i>Financial Instruments</i>	January 1, 2013

We are in the process of making an assessment of the impact of these new and revised IFRS upon initial application. So far, we believe that these new and revised IFRS may result in changes in accounting policies and are unlikely to have a significant impact on our results of operations and financial position.

## BUSINESS

### Overview

We are one of the largest producers of clinker and cement in China, particularly in Shandong and Liaoning provinces, as measured by production volume. Leveraging our leading market position in Shandong and Liaoning provinces, we have taken advantage of the considerable growth opportunities in the construction and infrastructure sectors within Shanxi province and Inner Mongolia, and quickly established our presence in these areas through organic growth and acquisitions. We are also expanding into Xinjiang by greenfield developments.

We produce and sell various grades of cement products using advanced NSP production technology. Our principal products also include clinker, a key intermediary component of cement. In addition, we produce and sell other products, such as concrete. Our sales volume of cement products increased from 25.1 million tons in 2008 to 29.4 million tons in 2009 and 39.3 million tons in 2010. While most of the clinker we produced was used in our cement production, we also sold 5.5 million tons, 8.4 million tons and 9.8 million tons of clinker to external customers in 2008, 2009 and 2010, respectively. The average unit selling price per ton of our cement products was RMB235.2, RMB224.9 and RMB235.9 in 2008, 2009 and 2010, respectively, and the average unit selling price per ton of our clinker was RMB213.9, RMB187.5 and RMB197.2, respectively, during the same periods. Our products are primarily provided to our customers under our “Shanshui Dongyue” brand name (山水東岳), which was honored the “Famous Trademark of Shandong Province” in September 2008. In addition, in 2010, we were awarded the “Quality Award by Governor of Shandong” and recognized by the Ministry of Railways as the only construction material company with the award for “Beijing-Shanghai High-Speed Rail Best Supplier.”

Our production facilities are principally located in Shandong province, Liaoning province, the eastern part of Inner Mongolia and Shanxi province, and our clinker production facilities are located near our limestone mines serving cement grinding stations that are strategically located in close proximity to our end-markets and customers. This layout of our production facilities enables us to minimize our logistics and transportation costs, and to broaden our market coverage. As of December 31, 2010, we had a total production capacity (including production lines in test run) of 66.5 million tons of cement and 31.0 million tons of clinker, representing an increase of 18.2 million tons of cement and 5.8 million tons of clinker over the year ended December 31, 2009. As of December 31, 2010, the total capacity of cement and clinker in Shandong province reached 48.1 million tons and 22.1 million tons, respectively, while the total capacity of cement and clinker in Northeast China, including both Liaoning province and Inner Mongolia, reached 17.4 million tons and 8.9 million tons. As of the same date, the cement capacity in Shanxi province reached 1.0 million tons.

The map below indicates the locations of our primary production facilities in Shandong province, Northeastern China (including Liaoning province and Inner Mongolia) and Shanxi province as of December 31, 2010:



We have achieved significant revenue and earnings growth in recent years. Our revenue increased from RMB7,500.7 million in 2008 to RMB8,727.6 million in 2009 and RMB11,854.1 million in 2010. Our profit for the year increased from RMB549.1 million in 2008 to RMB714.0 million in 2009 and to RMB1,004.9 million in 2010.

### **Competitive Strengths**

*Dominant market position in Shandong and Liaoning provinces enhances our ability to attract customers.*

We are a leading producer of clinker and cement in Shandong and Liaoning provinces, as measured by production volume. We have actively carried out market consolidation primarily through acquisitions in Shandong and Liaoning provinces. In addition, we have established a recognized brand for our products. Our brand name “Shanshui Dongyue” (山水東岳) was honored the “Famous Trademark of Shandong Province” in September 2008. In 2010, we were awarded the “Quality Award by Governor of Shandong” and recognized by the Ministry of Railways as the only construction material company with the award for “Beijing-Shanghai High-Speed Rail Best Supplier.” Due to our dominant market position within Shandong and Liaoning provinces as well as industry recognition of the high quality of our products, our cement and clinker products usually enjoy price premiums over products sold by our competitors and we are able to attract key customers in our core markets in Shandong and Liaoning provinces.

***We are well positioned to capture attractive growth opportunities in China's infrastructure projects and construction industry, especially in fast growing regions in China.***

We are well positioned to take advantage of the PRC government's economic policies which have increased and are expected to continue to increase the demand for building and construction materials, including cement, in each of the markets where we have business operations. One of the objectives of the government's "Twelfth Five-Year Plan," released in 2011, and its economic stimulus package under the plan is to foster growth at an accelerated pace in Northwestern China, which includes our new target markets in Shanxi province and Xinjiang as well as Inner Mongolia. According to the local governments' working reports published in 2011, substantial resources have been pledged to construct affordable housing in each of Shandong, Liaoning and Shanxi provinces, Xinjiang and Inner Mongolia. Plans have also been formulated to improve the transportation network by construction of highways and railroads in these areas, including six railroads and eight highways connecting the harbor, the airport and other major locations in Shandong province, approximately 5,000 kilometers of highways connecting neighboring rural villages and industrial parks and harbors in Liaoning province, over 3,000 kilometers of railroads in Inner Mongolia and over 13,000 kilometers of highways in Xinjiang. All these government stimulus measures are expected to accelerate economic developments in these areas, which are also our target markets, creating high demand of our products for infrastructure and construction projects and presenting ample opportunities for our growth.

***Efficient operational management and continuous technological advancement enable us to enjoy sustainable profitability.***

We enjoy sustainable profitability with our efficient operational management system to prepare our annual budget and with our advanced technology in our production process. Our head office delivers the annual business goals down to our operating subsidiaries based on our comparisons with similar enterprises within our industry. Our operating subsidiaries submit monthly reports on their respective achievement of our annual goals for publication within our company. In addition, the command delivered down and the reports submitted up from time to time strengthen our budget preparation. The implementation of approved budget is scrutinized quarterly. Furthermore, we employ advanced technology in our production process, which provides us with substantial cost savings. For instance, our output of residual heat power generation increased from 463 Kwh in 2008 to 914 million Kwh in 2010. As a result of this energy savings technology, we achieved total cost savings of RMB164 million, RMB273 million and RMB347 million in 2008, 2009 and 2010, respectively. Moreover, our use of coal of better quality enabled us to reduce our coal consumption per ton of clinker from 156 kg to 143 kg and avert the worldwide increase in coal price. As a result of our efficient management system and technological advancement, we have been able to achieve substantial cost-savings, allowing us to enjoy sustainable profitability.

***We have an extensive sales network to meet demands of our diverse customer base.***

Our extensive sales network enables us to optimize regional market penetration. We have an extensive direct sales network that is segmented into two geographical groups, Shandong and Liaoning. The Shandong network covers 140 counties and districts in Shandong province and the Liaoning network covers 95 counties and districts in Liaoning province, 26 counties and districts in Inner Mongolia and Shanxi province. As of December 31, 2010, the two networks combined have 53 regional sales branches, 154 local sales offices and approximately 1,300 third-party sales outlets. All of our regional sales branches and local sales offices are centrally managed by the sales department in our headquarters in Jinan. Our direct sales personnel are divided into teams to cover different customer groups in urban areas. Our sales coverage of rural customers is primarily achieved through our third-party sales outlets at which we sell our products to end-users. We believe our extensive sales network enables us to cover a diverse customer base, including concrete station and infrastructure project management offices, aligned with the government's policy of "Bring building materials to the rural area."

***Our production plants are located in proximity to abundant coal reserve and limestone resources, minimizing our transportation costs.***

We carefully select the locations of our production facilities. The strategic layout of our production facilities in our key regional markets enables us to minimize transportation costs by being located in proximity to the sources of coal and limestone. All of our clinker production facilities are located near coal reserves and our limestone mines, serving a network of cement grinding stations that are strategically located in proximity to our end markets. Coal is used during our clinker production process and constitutes the largest cost component of our production. We also have long-term relationships with coal suppliers. Our top ten coal suppliers, who in aggregate provided approximately 40% of our coal supplies in the year ended December 31, 2010, had supplied coal to us for at least two years with some over five years. In addition, we have an investment strategy that acquires limestone resources, which would be sufficient, as required by the PRC government's policy, to provide for at least 30 years for our planned production.

***We have an experienced, stable and professional management team with a proven track record.***

Our senior management team, most of whom have been working for our company since our establishment, has an average of over 28 years of experience working in the PRC cement industry and considerable financial and business management expertise. For example, Mr. Caikui Zhang, our chairman and executive director, has over 42 years of industry experience as chairperson of several industry committees, such as the Jinan Municipal Bureau of Building Materials. Other members of our senior management team also have significant experience in key aspects of our operations, including production management, sales and distribution, financial management, research and development and delivery logistics.

## **Strategy**

***Continue to expand production capacity and increase market presence***

We devise our strategy to align with the government's policy of phasing out outdated enterprises and encouraging consolidation of the cement industry, while leveraging our own competitive strength in terms of established production systems and processes. Our objective is to double our production capacity within the next three years and increase our market presence with the goal of becoming the largest cement producer north of Yangtze River. By the end of 2011, we plan to increase our cement production capacity to 80 million tons from 66.5 million tons for the year ended December 31, 2010. We intend to proactively carry out market research for our strategic target locations, seek opportunities for reorganizations, mergers and acquisitions, and strategically expand our production capacity to improve our presence in key markets. We also plan to establish a strategic development center and integrate our internal organizations and human resources to achieve our goal.

***Promote total budget management initiatives to enhance operational management efficiency***

We plan to revise and improve the various management systems introduced in 2010, enhance internal control systems, and strengthen various fundamental management functions. The following are our objectives in order of priority: (1) use the established procurement and supply center as the platform for centralized purchase of bulk raw materials, fuel and general equipment, and further regulate tender procedures, reduce procurement costs and enhance cooperation between upstream and downstream industries; (2) optimize the integrated production-sale business model for companies under our supervision, further regulate the management of contracts, prices, transportation and settlement to reduce market and operational risks; (3) continue to implement strict funds approval and granting procedures, and to improve financial management, focusing on funds management and increased efficiency in the use of funds; and (4) enhance internal audit and supervision, and establish and improve various processes, procedures and systems to ensure the effective control of our company to cope with rapid business expansion and enlarged management scope.

***Diversify our product offerings such as concrete and aggregate, thereby developing new drivers for profit growth***

Leveraging the favorable environment created by government policies supporting the extension of the whole industry chain and comprehensive utilization of resources, and based on prudent investigation and research, we intend to use Shandong province, where our cement business is most concentrated, as the pilot program to vertically integrate the whole cement industry chain and accelerate the preparation work for businesses such as concrete and aggregate. We intend to adopt the same growth strategy for other regional markets we operate in if the pilot program in Shandong is proven successful, developing new drivers for our growth in the future.

***Optimize the internal and external sale of clinker***

In accordance with the supply and demand condition of clinker in our markets and our operational philosophy of “clinker for profits and cement for market expansion,” we expect to further improve both the internal and external sales models for clinker in order to stabilize and increase the price of clinker to ensure reasonable pricing for cement and to maximize our profit. Because clinker is the intermediate product for cement, the pricing of clinker is an indicator for the pricing of cement. For clinker sold within our company, we plan to adopt market pricing mechanisms to determine the agreed price for clinker. For clinker sold externally, we intend to adopt strategic methods, including adjustments of sales volumes between seasons, to manage our pricing in order to avoid benefiting downstream cement competitors. We believe such strategies enable us to narrow the price of clinker sold internally and externally and to achieve our goals of fully utilizing our own cement grinding capacity while increasing the sales volumes of cement and increasing our market share.

**Our Products**

Our principal products are cement and clinker. The following table sets forth the amount of revenue and percentage of our total revenue by product for the periods indicated.

	<b>Year ended December 31,</b>					
	<b>2008</b>		<b>2009</b>		<b>2010</b>	
	<b>Amount (RMB)</b>	<b>% of Revenue</b>	<b>Amount (RMB)</b>	<b>% of Revenue</b>	<b>Amount (RMB)</b>	<b>% of Revenue</b>
<b>(in millions, except percentages)</b>						
<b>Revenue</b>						
Sales of cement .....	5,906.8	78.7%	6,608.2	75.7%	9,275.1	78.2%
Sales of clinker.....	1,169.2	15.6%	1,578.9	18.1%	1,941.1	16.4%
Sales of other products <sup>(1)</sup> .....	424.7	5.7%	540.5	6.2%	637.9	5.4%
<b>Total .....</b>	<b>7,500.7</b>	<b>100.0%</b>	<b>8,727.6</b>	<b>100.0%</b>	<b>11,854.1</b>	<b>100.0%</b>

Note:

(1) Includes concrete, pipes and bubble bricks as well as provision of transportation service and equipment installation service.

Our sales volume of clinker was 5.5 million tons, 8.4 million tons and 9.8 million tons in 2008, 2009 and 2010, respectively, and our sales volume of cement products was 25.1 million tons, 29.4 million tons and 39.3 million tons, respectively, during the same periods.

Cement is produced by blending gypsum, blast furnace slag or other additives with clinker. We currently produce and sell a variety of cement products, which are mainly used for property construction and infrastructure projects. Our cement products are classified into high grade products and low grade products. We also produce clinker, a key intermediary component in the production of cement, from limestone through a rotary kiln process, primarily for use in making our cement products. To fully utilize our clinker production capacity, we also sell a portion of our clinker to external customers.

High grade cement products, such as PO52.5R, PO42.5R and PO42.5, refer to products with compressive strength greater than or equal to 42.5 megapascals. They are generally applied in major construction projects with special requirements, such as bridges, roads, high-rise buildings and high performance concrete, and projects where a high initial level of strength is required. Low grade cement products, such as PC32.5R and PC32.5, are applied in general industrial construction such as production of surface, underground and underwater concrete as well as reinforced concrete, pre-stressed concrete structures and commercial concrete products. In 2010, sales of high grade cement products accounted for 55.5% of our total sales volume and low grade cement products 44.5%.

Driven by the demand for high grade cement as a result of the government's substantial investment in infrastructure projects and our expanded market coverage of other areas of China, the sales volume of high grade cement increased by 47.0% in 2010 as compared to the same period of 2009. The table below sets forth the sales volume of our high grade and low grade cement products for the periods indicated.

	<b>Year ended December 31,</b>		
	<b>2008</b>	<b>2009</b>	<b>2010</b>
	<b>(in millions of tons)</b>		
High grade cement products.....	10.0	14.8	21.8
Low grade cement products .....	15.1	14.5	17.5

Most of our cement products are sold under the “Shanshui Dongyue” brand name (山水東岳), which is widely used in construction works for roads, bridges, housing and various types of landmark construction projects, and has achieved a good reputation among customers. In 2006, we were presented the “AAA Quality Award by Product Quality Association of China.” In September 2008, the “Shanshui Dongyue” brand (山水東岳) was honored the “Famous Trademark of Shandong Province.” In 2009, we were presented the “30-year Reform Meritorious Enterprise Award” by Shandong provincial government. In 2010, we were awarded and recognized by the Ministry of Railways as the only construction material company with the award for “Beijing-Shanghai High-Speed Rail Best Supplier.”

## **Production**

### *Production Facilities*

Our production facilities are principally located in Shandong region, Liaoning region, the eastern part of Inner Mongolia and Shanxi region, and our clinker production facilities are located near our limestone mines serving cement grinding stations that are strategically located in close proximity to our end-markets and customers. This layout of our production facilities enables us to minimize our logistics and transportation costs, and to broaden our market coverage. As of December 31, 2010, we had a total production capacity (including production lines in test run) of 66.5 million tons of cement and 31.0 million tons of clinker, representing an increase of 18.2 million tons of cement and 5.8 million tons of clinker over the year ended December 31, 2009. Separately, as of December 31, 2010, our total production capacity of cement and clinker in Shandong province reached 48.1 million tons and 22.1 million tons, respectively, while our total production capacity of cement and clinker in Liaoning province and Inner Mongolia reached 17.4 million tons and 8.9 million tons, respectively. As of December 31, 2010, our cement production capacity in Shanxi province reached 1.0 million tons. We have 75, 30, seven and one cement grinding production lines in Shandong region, Liaoning region, Inner Mongolia and Shanxi region, respectively.

We carefully select the locations of our production facilities to lower transportation costs. Our transportation costs consist of the costs relating to transportation of limestone from limestone mines to clinker production facilities, transportation of clinker from clinker production facilities to cement grinding stations and transportation of cement from cement grinding stations to end markets. Since the input-output ratio for limestone to clinker is approximately 1.3:1 and the input-output ratio for clinker to cement is approximately 1:1.7, the layout of our facilities is designed to minimize the total transportation costs by relying on a more extended transportation radius for clinker rather than for limestone or cement. We believe this “hub and spoke” production facility layout has enabled us to achieve significant cost savings and broaden our market coverage.

The table below sets forth our production capacity and total number of production lines as of December 31, 2008, 2009 and 2010 and production volumes for clinker and cement for the years ended December 31, 2008, 2009 and 2010.

	<b>At and for the year ended December 31,</b>		
	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b>Clinker</b>			
Total capacity (in thousands of tons) .....	20,038.4	25,190.4	30,950.4
Total production lines .....	19	23	29
Total production volume (in thousands of tons) .....	21,220.7	25,661.2	32,404.7
<b>Cement</b>			
Total capacity (in thousands of tons) .....	35,846.6	48,335.4	66,535.4
Total production lines .....	78	88	113
Total production volume (in thousands of tons) .....	25,317.7	29,853.3	39,201.4

The table below sets forth the annual production capacity and production volume of the clinker production lines in each area in which we operate.

<b>Location</b>	<b>Annual production capacity<sup>(1)</sup></b>			<b>Production volume</b>		
	<b>for the year ended</b>					
	<b>December 31,</b>					
	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
	<b>(in thousands of tons)</b>			<b>(in thousands of tons)</b>		
Shandong region .....	17,216.0	19,488.0	22,048.0	18,927.6	21,619.3	26,275.9
Liaoning region .....	2,822.4	5,702.4	5,702.4	2,293.1	4,041.9	5,700.2
Inner Mongolia .....	–	–	3,200.0	–	–	428.6
Shanxi region .....	–	–	–	–	–	–
<b>Total .....</b>	<b>20,038.4</b>	<b>25,190.4</b>	<b>30,950.4</b>	<b>21,220.7</b>	<b>25,661.2</b>	<b>32,404.7</b>

Note:

(1) Annual production capacity, including production lines in test run, is calculated based on 320 working days per annum.

The table below sets forth the annual production capacity and production volume of the cement production lines in each area in which we operate.

Location	Annual production capacity <sup>(1)</sup> for the year ended December 31,			Production volume		
	2008	2009	2010	2008	2009	2010
	(in thousands of tons)			(in thousands of tons)		
Shandong region .....	31,845.3	37,729.1	48,129.1	21,850.3	25,540.3	32,419.0
Liaoning region .....	3,540.5	10,145.5	12,145.5	3,053.7	3,852.9	6,144.8
Inner Mongolia region.....	460.8	460.8	5,260.8	413.7	460.1	637.6
Shanxi region .....	–	–	1,000.0	–	–	–
Total .....	<u>35,846.6</u>	<u>48,335.4</u>	<u>66,535.4</u>	<u>25,317.7</u>	<u>29,853.3</u>	<u>39,201.4</u>

Note:

(1) Annual production capacity, including production lines in test run, is calculated based on 320 working days per annum.

All of our automated NSP production lines are equipped with Distributed Control System, an advanced process control system that significantly improves our production efficiency by reducing labor costs associated with our production. In addition, facilities equipped with NSP technology discharge lower levels of harmful emissions than facilities that employ non-NSP technology. As a result, our NSP technology is supported by PRC government policies intended to reduce industrial waste and pollution. In both the Notice Regarding Replacement of Obsolete Cement Production Capability issued on February 18, 2007 and Policies on the Development of the Cement Industry issued on October 17, 2006, the NDRC mandated that all production facilities using less-advanced technologies, including dry hollow kilns and wet kilns, should be replaced. The NDRC also required in these policies that all local governments should phase out cement enterprises with annual production capacities of less than 200,000 tons or which fail to comply with relevant environmental protection requirements or cement product quality standards.

According to Ministry of Industry and Information Technology, a total of 91.6 million tons of obsolete cement production capacity was phased out in China in 2010. According to Shandong Economic and Information Technology Committee, 20.7 million ton of obsolete cement production capacity was phased out in Shandong in 2010.

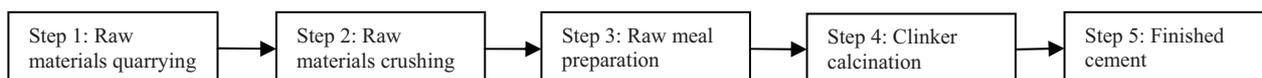
### *Planned Capacity Expansion*

In order to meet the growing market demand for cement products, we plan to further expand our production capacity through the construction of new production facilities. For instance, two cement grinding production lines and one clinker production line are in construction in Xinjiang. The following table sets forth our planned number of production lines, production capacity and production commencement date by products for 2011.

Products	Planned Number of Production Lines	Planned Production Capacity	Anticipated Commencement Date
Clinker .....	8	9,280,000 tons	By the end of 2011
Cement.....	18	17,000,000 tons	By the end of 2011
Concrete.....	11	11,000,000 cubic meters	By the end of 2011

## ***Production Process***

The chart below illustrates the production process of our cement products.



At the crushing stage, limestone, shale, sandstone and iron ore are crushed. To prepare for the cement raw meals, the crushed raw materials are mixed according to designated proportions and then fed into the mills for grinding. The resulted cement raw meals are fed into the kiln system for calcination. After a series of complex physical and chemical reactions, the cement raw meals are turned into clinker. Depending on the type of cement products to be manufactured, the clinker and other aggregates are mixed together in various proportions. The resulting mixtures are fed into the cement grinding mill to be ground to required fineness for cement production. Different proportions of the aggregates are added to the mixtures to produce different types of cement products.

## ***Quality Control***

We enforce national quality standards, develop quality control standards for all production processes on a unified basis, retain professional technical management talents, implement real-time quality control and have established a sound product quality control system. Most of our production facilities are accredited with ISO-9000 quality control system certification, except for the facilities which have recently commenced production, and are in the process of applying. We have also established a central laboratory for quality sampling inspection of our subsidiaries and new product research and development to ensure our products attain national standards.

## ***Production Management and Inventory Control***

We plan our production and manage the inventory level of our finished products on a monthly basis based on projected sales volumes, and make periodic adjustments to the production schedule and volumes based on actual orders received. We closely supervise our daily production and maintain suitable inventory levels of raw materials and finished goods in each production facility through a production management center located at our headquarters in Jinan. This center has a network-based data management system that facilitates the collection, monitoring and analysis of various production and inventory data in each of our production facilities. According to this management system, our headquarters delivers the annual business goals down to our operating subsidiaries based on our comparisons with similar enterprises within our industry and our operating subsidiaries submit monthly reports on their respective achievement of our annual goals for publication within our company. In addition, our operating subsidiaries prepare their respective preliminary budgets, which are gathered, processed, summarized and adjusted by our headquarters. The operating subsidiaries make corresponding adjustments in their respective budgets. The final budget then is submitted to our board of directors for approval. The implementation of the approved budget is monitored quarterly.

We maintain different inventory levels of raw materials and coal depending on the type of product and lead time required to obtain additional supplies. We typically maintain an inventory of 15 to 30 days for limestone and 15 to 20 days for coal. We typically keep an inventory level of cement products to meet anticipated demand for approximately ten days, based on our previous sales experience.

## **Recent Acquisitions**

We acquired the equity interests of the following entities engaged in cement business in Shanxi province, Shaanxi province, Inner Mongolia and Tianjin city during the year ended December 31, 2010. We expect these acquisitions to enhance our market share in the respective regions. The fair value of net identifiable assets of the acquirees is determined based on the valuation carried out by two qualified

independent valuers, Jones Lang LaSalle Sallmanns Limited and Shandong Ruihua Assets Valuation Company Limited. From the date of the relevant acquisitions to December 31, 2010, these acquirees contributed in the aggregate revenue of RMB236.8 million and profit of RMB10.3 million.

<b>Name of company</b>	<b>Acquired interest</b>	<b>Acquisition date</b>	<b>Location</b>	<b>Production capacity</b>	<b>Principal activities</b>
AKBB Cement	Note <sup>(1)</sup>	January 7, 2010	Inner Mongolia	2,500 tons of clinker per day	Production and sale of cement and clinker
Shengfeng Cement	Note <sup>(2)</sup>	March 2, 2010	Inner Mongolia	1,000,000 tons of cement per year	Production and sale of cement
Hequ Zhongtianlong	68%	April 9, 2010	Shanxi province	2,500 tons of clinker per day; 1 million tons of ground cement per year	Production and sale of cement and clinker
Tianjin Tianhui	100%	April 10, 2010	Tianjin city	600,000 tons of cement per year	Production and sale of cement
Lvliang Yilong	90%	May 25, 2010	Shanxi province	4,000 tons of clinker per day and 1 million tons of ground cement per year	Production and sale of cement and clinker
Chifeng Yuanhang	50% <sup>(3)</sup>	September 15, 2010	Inner Mongolia	1.6 million tons of clinker per year and 2.6 million cement per year	Production and sale of cement and clinker
Quanxing Cement	90%	September 30, 2010	Inner Mongolia	80,000 tons of clinker per year	Production and sale of clinker
Tianzhu Cement	90%	September 30, 2010	Inner Mongolia	1.2 million cement per year	Production and sale of cement
Yulin Yatai	62%	October 31, 2010	Shanxi province	1 million tons of cement per year	Production and sale of cement and related products
Dongying Dongxing	70%	December 28, 2010	Shandong province	600,000 tons of cement per year	Production and sale of cement and clinker

<b>Name of company</b>	<b>Acquired interest</b>	<b>Acquisition date</b>	<b>Location</b>	<b>Production capacity</b>	<b>Principal activities</b>
Dongying Shenglv	90%	December 28, 2010	Shandong province	700,000 tons of cement per year	Production and sale of cement and clinker
Heju Shanshui	90%	December 31, 2010	Shanxi province	4,500 tons of clinker per day and 2 million tons of ground cement per year	Establishment of cement production line

Notes:

- (1) On January 7, 2010, Alu Kerqin Qi Shanshui Cement Co., Ltd. ("Alu Kerqin Cement"), our 85%-owned subsidiary, entered into an agreement with AKBB Cement for the acquisition of a group of net assets in AKBB Cement for an aggregate consideration of RMB73.13 million. The group of net assets acquired constituted a business and therefore is accounted for as business combination in accordance with IFRS 3, Business Combination.
- (2) On March 2, 2010, Huolin Guole Shanshui Cement Co., Ltd., our 85%-owned subsidiary, signed an agreement to acquire a group of net assets in Shengfeng Cement for a total cash consideration of RMB14.0 million. The group of net assets acquired constituted a business and therefore is accounted for as business combination in accordance with IFRS 3, Business Combination.
- (3) Pursuant to the relevant agreement, we agreed to acquire an additional 30% equity interest of Chifeng Yuanhang within 13 months after our acquisition of this 50% equity interest at the purchase price calculated based on the then actual value of the assets to be acquired.

### **Raw Materials, Coal and Electricity**

In 2008, 2009 and 2010, purchases of raw materials, coal and electricity from our five largest suppliers accounted for 21.0%, 18.9% and 16.6% of our total cost of sales, respectively, and purchases from our largest supplier accounted for 7.8%, 5.0% and 4.4% of our total cost of sales, respectively.

#### ***Raw Materials***

The principal raw material for the production of clinker and cement is limestone. Other raw materials include clay, shale, pyrite cinder, sandstone and gypsum. Our raw materials costs accounted for 29.8%, 30.0% and 27.7% of our total cost of sales for the years ended December 31, 2008, 2009 and 2010, respectively.

We seek to diversify the sources of raw materials and have not in the past experienced any disruption of our production process due to insufficient supply of raw materials. We have maintained long term relationships with several suppliers for each type of raw materials. We select our raw materials suppliers based primarily on quality, pricing, delivery time, distance to our facilities, after-sales services and reliability. All of our raw materials are locally sourced, which enables us to shorten our lead time and reduce transportation costs. We are typically required to make full payments for raw materials supplies within three months after delivery.

We conduct a portion of our limestone mining ourselves to utilize our existing mining facilities and outsource the remaining mining activities to third-party contractors, paying them on a per tonnage basis to reduce our production costs.

In order to diversify our limestone supply, capitalize on regional price discrepancies and preserve our own limestone reserves, we source a significant portion of the limestone used for our cement production from outside suppliers and expect to continue to do so in the near future. We sourced approximately 57.0%, 54.6% and 46.6% of our limestone supply from outside suppliers in 2008, 2009 and 2010, respectively. We typically enter into supply contracts whose terms may vary from six months to three years with pricing terms that are negotiated based on market prices.

## *Coal*

Coal is used as fuel in our clinker production process for all of our facilities. We maintain long-term relationships with a number of third-party domestic coal suppliers to secure adequate coal supply at competitive prices. We typically enter into supply contracts with these coal suppliers based on the estimates of our needs and priced with reference to the prevailing market prices. We are typically required to pay in full for these supplies after our receipt of the coal. During periods of supply shortage, we have been required to make partial prepayments for our coal deliveries. As part of our continuing cost control measures, we have centralized the purchase of coal for most of our clinker production lines through our headquarters in Jinan to obtain better pricing terms from our coal suppliers.

Coal constituted approximately 36.6%, 31.5% and 34.1% of our total cost of sales for the years ended December 31, 2008, 2009 and 2010, respectively. Our coal consumption was 156 kg, 145 kg and 143 kg of coal per kilogram of clinker in 2008, 2009 and 2010, respectively. See “Risk factors – Risks Relating to Our Business – Our profitability and results of operations are subject to fluctuations in the supply and costs of raw materials, coal and electricity, and we may be unable to pass on some or all of any the increases in such costs to our customers.”

## *Electricity*

Electricity constituted 17.6%, 16.2% and 15.8% of our total cost of sales for the years ended December 31, 2008, 2009 and 2010, respectively. We have not in the past experienced any disruption of our operations due to insufficient supply of electricity and do not anticipate any significant interruption in electricity supply that would have a material impact on our business. However, we have experienced increases in electricity prices in recent years caused by surging coal prices. We are typically required to prepay for our electricity expenses at the beginning of each month based on estimates and settle the balance at the beginning of the next month based on actual expenses incurred.

We have adopted RHR technology for all of our clinker production facilities. RHR generators collect residual heat from the clinker production process to generate power that can be re-utilized for clinker production. The average costs of electricity produced through these generators ranged from RMB0.15 to RMB0.20 per KWh in 2010, significantly lower than our average electricity purchase price of RMB0.59 per KWh during the same period. Using RHR technology, we increased our output of residual heat power generation, producing 4.6 Gwh, 7.2 Gwh and 9.1 Gwh in 2008, 2009 and 2010, respectively.

## **Sales and Marketing**

### *Sales Network*

In 2008, 2009 and 2010, the substantial majority of our products were sold to customers in Shandong province. We also sold a small portion of our products to customers located in relatively close proximity to our cement production facilities, including those in Henan province, Hebei province, Inner Mongolia and Tianjin city.

We sell our products directly in China to end-users through our extensive sales network that is segmented into two geographical groups, Shandong and Liaoning. As of December 31, 2010, the Shandong network covers 140 counties and districts in Shandong province, certain areas in Hebei and Henan provinces and Tianjin by 40 regional sales branches, 98 local sales offices and approximately 1,200 third-party sales outlets. As of December 31, 2010, the Liaoning network covers 95 counties and districts in Liaoning province, 26 counties and districts in Inner Mongolia, Heilongjiang, Jilin and Shanxi province by 13 regional sales branches, 56 local sales offices and approximately 125 third-party sales outlets. All of our regional sales branches and local sales offices are centrally managed by the sales department in our headquarters in Jinan. Our direct sales personnel are divided into teams to cover different customer groups in urban areas. Our sales coverage of rural customers is primarily achieved through our third-party sales outlets at which we

sell our products to end-users. As of December 31, 2010, we had 1,363 direct sales personnel, who are responsible for marketing and selling our products in their assigned areas and providing after-sales support to our customers. They also collect customer feedback and market data by visiting customers on a regular basis. Our direct sales personnel are required to meet monthly and annual sales targets, and we provide sales commission to those who meet or exceed the targets. We closely monitor the sales performance of our sales personnel to avoid the overstating of sales through a network-based data management system that generates and maintains detailed records of each sale upon receipt of payments from our customers. We regularly check the accuracy of the records generated by the data management system based on original documentation for each sale, including the receipts of payments.

Our sales to rural customers are primarily conducted through our sales outlets, most of which are retail shops of construction materials located in rural areas. We commenced establishing our business relationships with these retail outlets since 2005. As of December 31, 2010, we had approximately 1,300 third-party sales outlets and 150 local sales offices. We sell our products directly to these sales outlets, which then resell our products to end-users located in rural areas. These sales outlets are owned and operated by various independent parties. We provide these sales outlets the right to market and sell our cement products in their respective geographic region. Our products are sold to these sales outlets at the same price with products sold through our direct sales channel. We do not provide any credit sales to, nor allow any return of our products from, these sales outlets. We typically enter into sales agreements with these sales outlets on an annual basis. We do not have minimum purchase amount set up for these sales outlets. As an incentive to increase the sales volume of our cement products, we provide sales commission to the sales outlets based on their sales volumes. The sales outlets are typically responsible for taking delivery of our products at our production facilities and the associated delivery costs. We are not responsible for any expenses incurred by these sales outlets. Our direct sales personnel closely supervise and monitor the activities of these sales outlets and their compliance with our guidelines and policies, including requiring them to maintain detailed records of the sales of our cement products on a daily basis, checking the accuracy of such records based on original documentation for each sale on a weekly basis, investigating any non-compliance on a monthly basis and determining appropriate penalties based on our guidelines and policies. We have not discovered in the past any material non-compliance by these sales outlets with our guidelines and policies. We are entitled to impose monetary penalties on these sales outlets for non-compliance, such as selling cement products of our competitors. In the case of serious non-compliance, we are entitled to terminate our sales agreements with the sales outlets.

### *Customers*

Our cement products are primarily sold to contractors or sub-contractors of construction and infrastructure projects, ready-mixed concrete stations, real estate developers and rural customers. Our clinker customers are primarily cement grinding plants. Our products are also used in key national projects such as Beijing-Shanghai high-speed railway, Central Railway and Qingdao Bridge. In 2010, revenue derived from our five and ten largest customers accounted for 4.9% and 7.0% of our total revenue, respectively, and revenue derived from our largest customer accounted for 1.7% of our total revenue during the same period. As of December 31, 2010, 82.6% of our customers are located in Shandong province.

## ***Pricing***

The prices of our products vary from region to region, depending on local market conditions. Our central sales department in Jinan sets the prices of our products for a certain region based on our production costs, the prices of competing products, our market position and end-user feedback we collect through our local sales personnel, and reviews and adjusts our product pricing periodically based on these factors. We typically require full payment of the contract price before delivery of products.

## ***Transportation***

A majority of our raw materials and coal are delivered directly to us by our suppliers. We outsource the delivery of some of our clinker and limestone to third-party delivery companies. The delivery of our raw materials, coal and clinker is primarily conducted through road and railway transportation. We have maintained long-term relationships with most of these delivery companies. We typically enter into one-year renewable transportation agreements with pricing terms negotiated annually based on prevailing market prices.

## **Research and Development**

Our research and development efforts concentrate on designing production facilities and lowering production costs. Our ability to design production facilities has significantly lowered our production costs. We have a research and development center at our headquarters in Jinan, which employed 57 research and development personnel as of December 31, 2010, the majority of whom have undergraduate or higher degrees.

## **Intellectual Property**

We rely on a combination of patents, trademarks, domain name registrations and contractual restrictions to establish and protect our intellectual property rights. We sell most of our products under the “Shanshui Dongyue” (山水東岳) and “Shanshui Gongyuan” brand names. We have also registered our corporate logo “” in Hong Kong. As of April 13, 2011, we have been granted eleven patents by the State Intellectual Property Office of China. All of our patents relate to process technologies used in our production.

Any unauthorized use of our brand names, trademarks and other intellectual property rights could adversely affect our business, reputation and market position. In an effort to prevent infringements of our intellectual property, we have, among other things, established a committee to focus on intellectual property infringement issues and implemented policies and procedures to address such issues. These policies and procedures include, among other things, using an authenticity code on the package of our products that can be easily identified by our customers. However, any measures we take to protect our intellectual property rights may not be sufficient.

Each of our research and development personnel has entered into a standard annually renewable employment contract with us, which includes confidentiality undertakings and an acknowledgement and agreement that all inventions, designs, trade secrets, works of authorship, developments and other processes developed or generated by them on our behalf are our property, assigning to us any ownership rights that they may claim in those works. Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may materially and adversely affect our business, financial condition, results of operations and prospects. See “Risk factors – Risks Relating to Our Business – Any unauthorized use of our brand names, trademarks and other intellectual property rights may adversely affect our business.”

## Competition

China's cement industry is highly fragmented and competitive. According to Digital Cement, a website maintained by China Cement Association, as of December 31, 2010, there were approximately 331, 193, 141 and 165 cement producers based in Shandong province, Liaoning province, Shanxi province and Shaanxi province, respectively. Due to cement's low value-to-weight ratio, the cement industry is localized in nature, with a maximum economically feasible product transportation radius of 300 kilometers. Therefore, we primarily compete against those companies with a presence in or near Shandong and Liaoning provinces. Our major competitors include China United Cement Company Limited in Shandong province and Jidong Cement Company Limited in Liaoning province. We also compete with a large number of small-scale regional cement producers in the low-grade cement product markets in Shandong and Liaoning provinces. We compete primarily on the basis of product quality, variety of product offerings, technology, location of production facilities, access to resources, sales and marketing network and brand image.

In such new markets we are developing as Inner Mongolia and Xingjiang, we believe we are the pioneer and are subject to less intense competition as opposed to Shandong and Liaoning provinces. Moreover, in line with the state policy of phasing out outdated enterprises and encouraging industry consolidation initiated by large enterprises, the entry barrier has grown higher for new market entrants.

## Employees

As of December 31, 2008, 2009 and 2010, we had 12,388, 13,190 and 14,714 employees, respectively. The following table sets forth the number of our full-time employees by function as of December 31, 2010.

<b>Employee Type</b>	<b>Number of Employees</b>
Production .....	9,506
Sales .....	1,363
Technical.....	589
Finance .....	495
Administrative and management.....	1,365
Others <sup>(1)</sup> .....	1,396
Total .....	<u>14,714</u>

(1) Other mainly include security guards, drivers, gardeners and interns.

## Occupational Health and Safety

The Production Safety Law of the PRC is the fundamental law to strengthen the supervision and administration of production safety and labor protection. See "Regulation – Safety and Labor Protection" in this document. To ensure compliance with relevant PRC regulatory requirements, we have implemented a number of safety measures and established a safety supervision department that is responsible for formulation and implementation of such safety measures. Our safety supervision department conducts inspections of our production facilities on a monthly basis to ensure that all of our operations are in compliance with existing laws and regulations. Our safety supervision department also conducts regular training sessions for employees on accident prevention and management. The safety measures we adopted include measures for personnel safety protection, vehicle operation safety and reward and penalty system for safe production. Such safety measures lay out the potential safety hazards, responsible personnel for safety matters, emergency reaction plans and periodic inspection procedures. We also conduct investigations should accidents occur during our production process, studying the reasons of the accidents, recommending remedial measures and analyzing methods to avoid similar incidents in the future.

We are committed to further reducing our fatality or personal injury rates and maintaining high safety standards at our production facilities in the future by enhancing the implementation of various safety measures, inspecting production facilities for potential problems and increasing the safety awareness of the employees by providing trainings on a regular basis. We also provide various healthcare benefits to our employees in accordance with applicable laws and regulations. To prevent potential future risks, we have also adopted various emergency action plans for limestone mining accidents, special equipment failure accidents, coal storage facility fire accidents and other accidents. Such plans set forth the responsible personnel and procedures to control and minimize the damages under emergency situations.

## **Social Insurance**

As required by applicable PRC laws and regulations, we participate in various employee benefit plans, such as pension contribution plans, medical insurance plans, work-related injury insurance plans, unemployment insurance plans and housing funds for our employees. We are required under PRC laws to make contributions to the employee benefit plans at specified percentages of the salaries, bonuses and certain allowances of our employees, up to a maximum amount specified by the local government from time to time. Members of the retirement plan are entitled to a pension equal to a fixed proportion of the salary prevailing at the member's retirement date.

## **Insurance**

We maintain an all-risks property insurance policy covering our equipment and facilities for loss due to fire or natural disasters, excluding earthquakes and floods. As of December 31, 2010, the aggregate amount covered by this policy was RMB9,972.3 million. We also maintain public liability insurance, profit loss insurance, machinery break-down insurance and product liability insurance. We do not maintain key employee insurance. We believe our insurance coverage is customary and standard with respect to type and scope of coverage for companies of comparable size in comparable industries in China.

## **Environmental Compliance**

The cement industry is categorized as a polluting industry under PRC laws. Our production processes generate noise, waste water, gaseous wastes and other industrial wastes. Our production facilities are subject to various environmental laws and regulations promulgated by national and local governments with respect to noise and air pollution and the disposal of waste and hazardous materials. The State Environmental Protection Administration sets national discharge standards for various pollutants and local environmental protection bureaus may set stricter local standards. Enterprises are required to comply with the stricter of the two applicable standards. The central and local governments provide schedules of base-level discharge fees for various polluting substances and if such levels are exceeded, the polluting entity will be required to pay excess discharge fees. Local governments are also authorized to issue orders to stop or reduce discharges in excess of the base levels. Each of our production plants, prior to its construction, is required to be evaluated for its environmental impact and when constructed, is required to be tested and approved by local environmental agencies, and is subject to continuous government monitoring thereafter. See "Regulations – Environmental Protection."

We have established a pollution control system and installed various equipment to process and dispose of our industrial waste and hazardous materials to minimize the impact on the environment. We also plan to actively rehabilitate the mining areas where the environment is affected by the mining activities and install more RHR generators to save energy. Most of our subsidiaries have met the ISO 14001 environmental management standards, except for the subsidiaries that we recently acquired and they are in the process of applying for such certification. Our personnel in charge of environmental compliance all have bachelor's degrees in environmental engineering and are experienced in this area.

Based on the legal opinion of our PRC legal advisers, we have fully complied with the relevant environmental rules and regulations and have, except for the production facilities that we have recently acquired, which are in the process of obtaining relevant environmental permits and approvals. We have not encountered material environmental claims or been subject to any material sanctions or fines for environmental violations in the past. In 2008, 2009 and 2010, our annual expenses for complying with applicable environmental laws and regulations, including water treatment costs, amounted to RMB9.6 million, RMB18.2 million and RMB25.0 million, respectively. As the PRC environmental protection regulations continue to evolve, we may be required to make significant expenditures to upgrade our production facilities to comply with environmental regulations that may be adopted or imposed in the future.

### **Mining Rights**

We have obtained limestone mining rights from the relevant land bureaus. These mining rights are valid for a period of 2 to 13 years and generally renewable upon expiration. The limestone mines are located in Shandong, Liaoning and Shanxi provinces and Inner Mongolia. As of December 31, 2010, the ownership certificates for certain limestone mining rights with a carrying amount of RMB123.5 million have not been obtained. To the extent we are ordered by the relevant authorities to cease excavation of the mines pending ownership certificates, we may be subject to fines and disgorge profits obtained from the relevant mines.

### **Property**

Our headquarters are located in Jinan, Shandong province. We own approximately 980 buildings and units in Shandong and Liaoning provinces and Inner Mongolia, with an aggregate area of approximately 716,000,000 square meters and lease approximately 950 square meters for use as production facilities, offices, warehouses and other business purposes. We have not obtained certain land use rights and building ownership certificates in relation to approximately 360,000 square meters of land, which relate to land for certain production facilities we recently acquired. We are in the process of obtaining title certificates for such properties.

### **Legal and Administrative Proceedings**

From time to time, we may be involved in legal proceedings, investigations and claims, both as plaintiff and as defendant, that arise in the ordinary course of our business. We are currently not a party to, and we are not aware of any threat of, any legal, arbitral or administrative proceedings, which, in the opinion of our management, is likely to have a material and adverse effect on our business, financial condition or results of operations.

## MANAGEMENT

Our articles of association provide that each of our directors serves three years for each term they are elected, unless the office of a director is vacated for reasons set forth in our articles of association. The chairman is elected by and from our board. Our board is responsible for the management of our business. The following table sets forth certain information with respect to our directors and executive officers as of the date of this document.

Name	Age	Position
Caikui Zhang (張才奎) .....	60	Chairman and Executive Director
Bin Zhang (張斌) .....	32	Vice Chairman, Executive Director and General Manager
Chengtian Dong (董承田) ...	53	Executive Director, Deputy General Manager
Yuchuan Yu (于玉川) .....	52	Executive Director, Deputy General Manager and Chief Engineer
Homer Sun (孫弘) .....	39	Non-Executive Director
Shuge Jiao (焦樹閣) .....	45	Non-Executive Director
Jianguo Sun (孫建國) .....	56	Independent Non-Executive Director
Yanmou Wang (王燕謀) .....	78	Independent Non-Executive Director
Jian Wang (王堅) .....	55	Independent Non-Executive Director
Bin Zhang (張斌) .....	32	Joint Company Secretary
Cheung Hung Li (李長虹) ...	60	Joint Company Secretary, Qualified Accountant

### Directors

#### *Executive Directors*

**Caikui Zhang (張才奎)** is our founder and has served as our chairman and executive director since September 2007, primarily responsible for our overall strategic planning and management. Mr. Zhang has 42 years of experience in the cement industry, and was appointed as the head of Shandong Cement Plant (the predecessor of Shandong Cement Factory Co., Ltd.) in 1990. He has been the executive director and general manager of Shandong Shanshui, our subsidiary, since August 2001. Mr. Zhang has won numerous honorary titles, including head of the Jinan Municipal Bureau (Association) of Building Materials (“Jinan Building Materials Bureau”) from November 1995 to August 2004; deputy head of the China Cement Association since October 2002 and vice president of China Building Material Industry Association since June 2007. He was a deputy to the Tenth and Eleventh National People’s Congress and a member of the Jinan Municipal Party Committee. He graduated from the Nankai University with a master’s degree in business administration in December 2005. Mr. Zhang was also our General Manager from our inception until October 2010, which position has been assumed by Mr. Bin Zhang. Mr. Caikui Zhang is the father of Mr. Bin Zhang, our vice chairman, executive director and general manager.

**Bin Zhang (張斌)** has served as our vice chairman and executive director since September 2010 and as our general manager since October 2010. He is in charge of the management of our daily production and operation as well as our operation in capital market. Mr. Zhang joined us in March 2006. He worked at Sinoma International Engineering Company Limited from December 2004 to March 2006. After joining us, Mr. Zhang was responsible for the preparatory work for our listing on the Hong Kong Stock Exchange in 2008, establishing our sourcing and supply center, overseeing our department of securities affairs and the sourcing and supply center, and concurrently held the position as the general manager of Pingyin Branch Corporation Pingyin Shanshui Cement Co., Ltd., our subsidiary. Mr. Zhang graduated from Shandong University of Science and Technology in July 2003 with a bachelor’s degree. He graduated from Nankai University in September 2008 with a master’s degree in business administration.

**Chengtian Dong (董承田)** has served as our executive director and deputy general manager since July 2008, primarily responsible for our strategic planning and management of our business in Northeast China. Mr. Dong has nearly 30 years of experience in the cement industry, and joined Shandong Cement Plant in 1982. Mr. Dong was appointed as the chief engineer and deputy head of Shandong Cement Plant in

1996, and also served as head of its research and development department in 1997. He has been the deputy general manager of Shandong Shanshui since 2001 and is primarily responsible for our production management. In September 2007, Mr. Dong was designated to oversee our strategic planning and management in Liaoning province. In addition, Mr. Dong served as the honorary deputy head of the Jinan Building Materials Bureau from March 2000 to August 2004. Mr. Dong graduated from Shanghai Tongji University in January 1982 with a bachelor's degree in cement technologies.

**Yuchuan Yu (于玉川)** has served as our executive director, deputy general manager and chief engineer since July 2008, primarily responsible for production management. He has nearly 30 years of experience in cement technology and engineering. Mr. Yu joined Shandong Cement Plant in 1983, and was appointed as its chief engineer in 1995. He has been the deputy general manager and chief engineer of Shandong Shanshui since August 2001. Mr. Yu is currently the vice president of the New Type Dry-Process Cement Association (a division under the Chinese Cement Association) and a visiting professor of the University of Jinan.

#### ***Non-Executive Directors***

**Homer Sun (孫弘)** has served as our non-executive director since July 2008. He is currently a managing director of the private equity division of Morgan Stanley Asia Limited and commands the private equity division of Morgan Stanley Asia Limited for its investment in China. He is currently a non-executive director of Sihuan Pharmaceutical Holdings Group Ltd., a Hong Kong Stock Exchange-listed company, and China Flooring Holding Co. Ltd. Mr. Sun has held office in Morgan Stanley Asia Limited since April 2000, and worked on various mergers and acquisitions in Greater China in the investment banking division prior to joining the private equity division of Morgan Stanley Asia Limited. From September 1996 to March 2000, he was a corporate attorney with Simpson Thacher & Bartlett in New York and Hong Kong, specializing in mergers and acquisitions. Mr. Sun received a bachelor's degree in chemical engineering with honors from the University of Michigan in 1993 and a J.D with honors from the University of Michigan Law School in 1996.

**Shu Ge Jiao, aka Zhen Jiao, (焦樹閣)** has served as our non-executive director since July 2008. He joined us in November 2005. He is currently a managing director of CDH China Fund L.P., and is also a non-executive director of China Yurun Food Group Company Limited and China Mengniu Dairy Company Limited, both being Hong Kong Stock Exchange-listed companies. From December 1995 to August 2002, Mr. Jiao was a deputy general manager of the direct investment department of China International Capital Corporation Limited, a Chinese investment bank. From September 1989 to January 1995, he was a researcher with the Beijing Information and Control Research Institute. In addition to his directorships in listed companies, Mr. Jiao has also been a director of various private companies. Mr. Jiao received a bachelor's degree in mathematics from Shandong University in 1986 and a master's degree in engineering from the Ministry of Space Industry Institute in 1989.

#### ***Independent Non-Executive Directors***

**Jianguo Sun (孫建國)** has served as our independent non-executive director since June 2008. In 1987, he was elected as a member of the standing committee of the district committee and deputy district head of Lixia District, Jinan City. In 1996, Mr. Sun was the deputy head of Jinan Municipal Construction Committee and the general manager of Jinan Urban Construction, Investment and Development Corporation and the director of Jinan Urban Construction Fund Administration Office. He was also appointed as the general manager of Shandong Shengli Company Limited in 1998, the chairman of Shandong Shengli Company Limited in 2000, and the chairman of Shandong Construction and Real Estate Development Co., Ltd. and Shandong Borun Chemical Co., Ltd. in 2005.

**Yanmou Wang (王燕謀)** has served as our independent non-executive director since June 2008. Mr. Wang currently serves on the supervisory board of Anhui Conch Cement Company Limited, Hong Kong Stock Exchange-listed company, and the Shanghai Stock Exchange, which is listed on the Shanghai Stock Exchange itself. Mr. Wang is an advisor to the expert committee of China International Construction

Consulting Company, a special advisor to China Investment Association and a senior advisor to China Cement Association. From November 1981 to April 1982, Mr. Wang was the deputy head and head of Chinese Building Materials Science Research Institute, and head of National Building Materials Industry Bureau from February 1982 to May 1994. Mr. Wang graduated from Nanjing Polytechnic Institute in 1956 with a bachelor's degree. He began his overseas study at Leningrad Architectural Engineering Institute of the former Soviet Union in 1958 and obtained an associate doctoral degree in science and technology of U.S.S.R. in 1962.

**Jian Wang (王堅)** has served as our independent non-executive director since June 2008. Mr. Wang is a senior accountant and a certified public accountant in China. From 1996 to 2000, he was the chief accountant of Shandong Shengli Company Limited, a company listed on the Shenzhen Stock Exchange. From 2000 to 2003, he was the deputy general manager of Shandong Shengli. In May 2003, Mr. Wang resigned from Shandong Shengli and joined Qilu Real Estate Company Limited, a private company, and was appointed as its general manager.

### ***Executive Officers***

**Yongkui Zhao (趙永魁)** has served as our deputy general manager and chief financial officer since November 2005, primarily responsible for overseeing the accounting and finance aspects of our operations and is in charge of our finance department. Mr. Zhao has over 29 years of experience in accounting and gained his experience from working in the cement industry and managing the finance of cement companies. Mr. Zhao joined Shandong Cement Plant as an accountant in July 1984. He was the deputy chief accountant and assistant to the head of the Shandong Cement Plant in December 1990. In December 2001, he was appointed as the assistant to our general manager and the head of our finance department. In November 2005, Mr. Zhao was appointed as our deputy general manager. Mr. Zhao became qualified as a senior accountant in 2003. Mr. Zhao graduated from the Shanghai Institute of Building Materials in July 1984.

**Liping Zhao (趙利平)** has served as our deputy general manager since July 2004, primarily responsible for the strategic planning and management of our businesses in Shaanxi province. He has 30 years of experience in the cement industry and gained his experience from working in the industry and managing cement companies. He joined Shandong Cement Plant as an engineer in July 1980. He was appointed as the deputy head and the assistant to the head of Shandong Cement Plant in June 1990. In December 2001, he was appointed as the assistant to the general manager and the general manager of the sales department of Shandong Shanshui. In July 2004, Mr. Zhao was appointed as the deputy general manager of Shandong Shanshui. He graduated from Shandong Construction Industry College in July 1980.

**Jingtian Mi (宓敬田)** has served as our deputy general manager since August 2007, primarily responsible for assisting Mr. Chengtian Dong in managing the cement business in Northeastern China. Mr. Mi has 30 years of experience in the building materials industry and gained his experience from managing several companies in the industry. Mr. Mi joined Shandong Shanshui as the assistant to the general manager in December 2001. In February 2004, he was appointed as the assistant to the general manager, the deputy secretary and the deputy manager of the party branch of the sales department. In August 2007, he was appointed as the deputy general manager and the deputy general manager of the sales department of Shandong Shanshui. Mr. Mi graduated from the Jinan Provincial Party School with a vocational diploma in June 1994.

**Zhongsheng Chen (陳仲聖)** has served as our deputy general manager since November 2007, primarily responsible for the engineering technology aspects of our operations. Mr. Chen has 16 years of experience in the cement industry and gained his experience from working in and managing several cement companies. Mr. Chen joined Shandong Cement Plant in August 1994 and has been responsible for the engineering technology aspects of our operations as the deputy chief engineer and the deputy head of our technology center. He was appointed as the deputy general manager of Shandong Shanshui in November 2007. Mr. Chen has published a number of academic essays in national journals such as the Cement Engineering Journal since 2000. He was also appointed as the vice president of the Professional Cement and

Concrete Division of the Shandong Silicate Association in March 2007. Mr. Chen graduated from the Shandong Building Materials Technical School with a bachelor's degree in silicate engineering in July 1994.

### ***Joint Company Secretaries and Qualified Accountant***

***Cheung Hung Li (李長虹)*** has served as one of our joint secretaries and our qualified accountant since June 2008. He is responsible for overseeing the information disclosure of our company due to our listing on the Hong Kong Stock Exchange, the management of investor relationship and our operation in capital markets. Mr. Li is ordinarily resident in Hong Kong and joined us in January 2006. Mr. Li has over 20 years of experience in accounting and finance. Prior to joining us, Mr. Li held various positions with a number of companies, including listed companies in Hong Kong such as the subsidiaries of Royal Dutch Shell Group in China and Hong Kong, Neo-Neon Holdings Limited and Top Form International Limited. Mr. Li holds a master's degree in business administration jointly granted by the Business School of the University of Manchester and the University of Wales. Mr. Li is a fellow member of both The Hong Kong Institute of Certified Public Accountants and the Association of International Accountants in England. He is also an associate of both the Institute of Chartered Secretaries & Administrators and The Hong Kong Institute of Chartered Secretaries.

***Bin Zhang (張斌)*** is one of our joint secretaries. See “– Directors – Executive Directors” above for his biographical details.

### **Board Committees**

#### ***Audit Committee***

We have established the audit committee under our board of directors. The audit committee's primary duty is to monitor the independence and work efficiency of external auditors, the financial reporting procedures and the efficiency of our internal control system, in order to assist our board of directors in its work. It reviews the external auditor's management letter and any questions raised by the auditor to the management and the management's response. The audit committee is a standing committee under our board and accountable to our board. Our audit committee consists of Mr. Yanmou Wang, Mr. Jianguo Sun and Mr. Jian Wang. Mr. Yanmou Wang is the chairman of our audit committee.

#### ***Remuneration Committee***

We have established the remuneration committee under our board of directors. The remuneration committee is principally responsible for formulating the remuneration policy for our executive directors and senior management and determining the remuneration proposal for the above people. The remuneration committee is a standing committee under our board and accountable to our board. The remuneration committee consists of Mr. Jianguo Sun, Mr. Yanmou Wang and Mr. Jian Wang. Mr. Sun is the chairman of our remuneration committee.

#### ***Execution Committee***

We have established an execution committee in August 2010 in order to enhance our corporate governance structure. The execution committee is charged with power granted by our board of directors to manage and develop our overall business and to assist our board of directors in performing its duties. The execution committee is a standing committee under our board of directors and accountable to our board. The execution committee consists of Mr. Caikui Zhang, Mr. Bin Zhang, Mr. Chengtian Dong and Mr. Yuchuan Yu. Mr. Caikui Zhang is the chairman of the execution committee.

### *Nomination Committee*

We have established a nomination committee in August 2010 in order to enhance our corporate governance structure. The nomination committee's principal duties include (i) reviewing the structure, size and composition of our board of directors on a regular basis; (ii) considering the succession arrangement of our Directors and other senior management members; (iii) where necessary, identifying suitable candidates to fill the vacancy of our board of directors and recommend such candidates to our board for approval; (iv) reviewing the length of time that non-executive directors are required to contribute and the independence of each independent non-executive director; and (v) making recommendations to our board in respect of the appointment and re-appointment of directors. The nomination committee is a standing committee under our board of directors and is accountable to our board. The nomination committee consists of Mr. Caikui Zhang, Mr. Yanmou Wang and Mr. Jianguo Sun. Mr. Caikui Zhang is the chairman of the nomination committee.

### *Service Contracts of Directors*

Each of Mr. Caikui Zhang, Mr. Chengtian Dong and Mr. Yuchuan Yu, our executive directors, has entered into a service contract with us on June 14, 2008 for a term of three years commencing on July 1, 2008, subject to termination before expiry by either party by giving not less than three months' notice in writing to the other, provided that such termination shall not occur during the first 12 months of the relevant contract. Under these service contracts, each of Mr. Caikui Zhang, Mr. Chengtian Zhang and Mr. Yuchuan Yu will receive an annual salary (including any director's fees) of RMB5 million, RMB3 million and RMB2.8 million, respectively. Such annual salary is subject to annual review by our board of directors and our remuneration committee. In the case of Mr. Caikui Zhang, the amount of his management bonus is calculated with reference to the pre-set performance target of our company, calculated based on our audited consolidated profits after taxation and non-controlling interests but before extraordinary items) as our board may approve and shall be equal to 10% of the excess of our audited consolidated profits over the pre-set performance target of our company in any given year.

Mr. Bin Zhang, our executive director, has entered into a service contract with us for an initial term of three years commencing on September 10, 2010, subject to retirement by rotation and reelection in accordance with our articles of association. Under the service contract, Mr. Zhang will be entitled to receive an annual salary (including any director's fees) of RMB1,500,000. Mr. Zhang's remuneration (including any bonus) is determined by our board with reference to his performance, position and duties with our company and its subsidiaries.

With respect to the service contracts above, the relevant executive director must abstain from voting, and not be counted in the quorum, in respect of any resolution of our board approving the determination of the salary, bonus and other benefits payable to him.

Each of Mr. Homer Sun and Mr. Shuge Jiao, our non-executive directors, has entered into a letter of appointment with us on June 14, 2008. Each letter of appointment is for an initial term of one year commencing from July 1, 2008, and thereafter shall be renewed for a maximum of three years provided it can be terminated by either party by giving at least one month's notice in writing. Non-executive directors will not receive any remuneration from our company.

Each of Mr. Jianguo Sun, Mr. Yanmou Wang and Mr. Jian Wang, our independent non-executive directors, has entered into a letter of appointment with us on June 14, 2008. Each letter of appointment is for an initial term of one year commencing from July 1, 2008, and thereafter shall be renewed for a maximum of three years provided it can be terminated by either party by giving at least one month's notice in writing. The annual fee for each Independent Non-executive Director is RMB100,000.

Except as disclosed above, none of our directors has or is proposed to enter into any service contract with our company, including our subsidiaries.

## **Compensation of Directors and Senior Management**

Our chairman, executive directors, non-executive directors and independent non-executive directors received aggregate remuneration and benefits in kind from us of approximately RMB37.0 million, nil and RMB300,000 for the year ended December 31, 2010, respectively.

## **Employees**

See “Business – Employees.” The aggregate remuneration of our employees for year ended December 31, 2010 amounted to RMB571.7 million.

For the year ended December 31, 2010, we made pension payments for our employees in the amount of RMB62.7 million.

We are required to make contributions to the housing provident fund for employees based on a certain percentage of their salaries pursuant to the relevant regulations of the PRC government. Except for this, we have no other obligation nor any plan for providing housing benefits to the staff. For the year ended December 31, 2010, we made total contributions of approximately RMB16.8 million to the housing provident fund.

## SUBSTANTIAL SHAREHOLDERS

As of May 31, 2011, the interests and short positions of persons (other than directors and chief executives of our company) in our issued shares and underlying shares, which would be required to be disclosed to us pursuant to Divisions 2 and 3 of Part XV of the Securities and Futures Ordinance of Hong Kong (the “SFO”), or which were recorded in the register required to be kept by us under Section 336 of the SFO, were as follows:

Name	Capacity	Number of shares held	Percentage of our company's issued share capital <sup>(1)</sup>	Long/Short position
China Shanshui Investment Company Limited <sup>(2)(3)</sup>	Beneficial Owner	859,736,400	30.11	Long
Hillhouse Capital Management, Ltd. <sup>(4)</sup>	Investment manager	242,759,000	8.62	Long
Gaoling Fund, L.P. <sup>(4)</sup>	Beneficial owner	242,305,000	8.60	Long
CCBI Cement Private Equity Limited <sup>(3)(5)</sup>	Nominee for another person	194,000,000	6.89	Long
CCB International Asset Management Limited <sup>(3)(5)</sup>	Investment manager	195,786,084	6.95	Long
CCB International Assets Management (Cayman) Limited <sup>(3)(5)</sup>	Interest in controlled corporations	195,786,084	6.95	Long
CCB International (Holdings) Limited <sup>(3)(5)</sup>	Beneficial owner	195,786,084	6.95	Long
CCB Financial Holdings Limited <sup>(3)(5)</sup>	Interest in controlled corporations	195,786,084	6.95	Long
CCB International Group Holdings Limited <sup>(3)(5)</sup>	Interest in controlled corporations	195,786,084	6.95	Long
China Construction Bank Corporation <sup>(3)(5)</sup>	Interest in controlled corporations	195,786,084	6.95	Long
Central Huijin Investment Limited <sup>(3)(5)</sup>	Interest in controlled corporations	217,828,084	7.77	Long

(1) Calculated based on 2,815,950,200 shares issued as of May 31, 2011.

(2) China Shanshui Investment is held as to approximately 65.55% by the discretionary trustee of the Zhang trust whose beneficiaries include employees of our company, as to approximately 16.19% by the discretionary trustee of the Li Trust whose beneficiaries include employees of our company, as to approximately 4.18% by Mr. Chengtian Dong, as to approximately 1.53% by Mr. Maohuan Li, as to approximately 4.35% by Mr. Yuchuan Yu, as to approximately 3.05% by Mr. Liping Zhao, as to approximately 2.77% by Mr. Yongkui Zhao, as to approximately 1.56% by Mr. Jingtian Mi and as to approximately 0.82% by Mr. Yongping Wang. These individuals are current or former directors or executive officers of our company. Mr Caikui Zhang as the discretionary trustee may vote and administer the shares of China Shanshui Investment for the benefit of the relevant beneficiaries as mentioned above. As Mr. Caikui Zhang is in control of more than 50% of the shares of China Shanshui Investment as discretionary trustee, he is deemed under the SFO to be interested in all the shares in our company registered in the name of China Shanshui Investment.

(3) On September 28, 2010, China Shanshui Investment Company Limited (“Shanshui Investment”) and Wing Lung Bank Limited (“Wing Lung Bank”) entered into a new two-year-term loan agreement, pursuant to which, Shanshui Investment pledged 169,000,000 of our shares to Wing Lung Bank. In compliance with all terms of the loan agreement, Shanshui Investment is still entitled to all rights attaching to such shares. On September 28, 2009, Shanshui Investment and UOB Kay Hian Finance Limited (“UOB Kay Hian”) entered into a one-year-term loan agreement, The loan were repaid in full on September 28, 2010. On September 30, 2009, Shanshui Investment and CCBI Cement Private Equity Limited (“CCBI Cement”) entered into a two-year-term loan agreement, pursuant to which, Shanshui Investment pledged 194,000,000 of our shares to CCBI Cement. In compliance with the terms of the loan agreement, Shanshui Investment is still entitled to all rights attaching to such shares. In addition, CCBI has an option to purchase 23,828,084 of our shares from Shanshui Investments. CCBI Cement exercised the option to purchase 12,000,000 shares on March 30, 2010. CCBI also exercised the option to purchase 11,828,084 shares, which transfer was completed on May 6, 2011.

- (4) Hillhouse Capital Management, Ltd., is a limited liability company incorporated in the Cayman Islands, controlling Gaoling Fund, L.P., a fund whose controlling shareholder is Hillhouse Capital Management, Ltd. Hillhouse Capital Management, Ltd. is also a shareholder of YHG Investment, L.P., which owned 454,000 of our shares.
- (5) As stated in the form of disclosure of shareholder's interests submitted by Central Huijin Investment Limited on October 5, 2009 (the date of the relevant event set out in the form was September 30, 2009), these shares were beneficially held by CCBI Cement, and CCBI Cement was in turn held directly or indirectly by CCB International Asset Management Limited, CCB International Assets Management (Cayman) Limited, CCB International (Holdings) Limited, CCB Financial Holdings Limited, CCB International Group Holdings Limited, China Construction Bank Corporation and Central Huijin Investment Limited. Each of the these companies is deemed to be interested in the shares held by CCBI Cement.

## RELATED PARTY TRANSACTIONS

The following is a summary of material transactions we have engaged in with our direct and indirect shareholders, affiliates of our shareholders and other related parties, including those in which we or our management has a significant equity interest. We believe each of these arrangements as described below have been entered into on arm's length terms or on terms that we believe have been at least as favorable to us as similar transactions with non-related parties. For a further discussion of related party transactions, see note 37 to our audited consolidated financial statements for the year ended December 31, 2010, note 36 to our audited consolidated financial statements for the year ended December 31, 2009, each of which is included elsewhere in this document.

### Sales and Purchase of Goods and Services with Related Parties

From time to time, we engage in the sale and purchase of goods and services with certain related parties of our company and the following sets forth the material related party transactions with these related parties:

For the years ended December 31, 2008, 2009 and 2010, we had sales of clinkers to Tianjin Tianhui Cement Co. Ltd. ("Tianjin Tianhui"), a company under common control of one of our ultimate shareholders, amounting to approximately RMB55.4 million, RMB39.3 million and RMB11.5 million, respectively. On April 10, 2010, Tianjin Tianhui became our wholly owned subsidiary and its transactions with our company since April 10, 2010 had been eliminated. For the years ended December 31, 2008, 2009 and 2010, we had sales of clinkers to Shanshui Stanford New Building Materials ("Stanford"), a company under common control of one of our ultimate shareholders, amounting to approximately nil, RMB0.7 million and nil.

We signed a tenancy agreement with Stanford for a term of eighteen years commencing on January 14, 2008 and expiring on December 31, 2022 for an annual rent of RMB558,500. For the years ended December 31, 2008, 2009 and 2010, we had income of RMB558,500, RMB558,500 and RMB279,250, respectively, from Stanford. Since the transfer of all interests of Jinan Shanshui Group Co. Ltd. ("Jinan Shanshui") to US Stanford Capital Limited ("USA Stanford") pursuant to the equity transfer agreement between Jinan Shanshui and USA Shanshui dated July 12, 2010, Stanford has ceased to be our related party. In addition, for the years ended December 31, 2008, 2009 and 2010, we had rental income of RMB135,000, RMB135,000 and RMB135,000, respectively, from Shanshui Jinzhu Powder Co. Ltd, a company under common control of one of our ultimate shareholders pursuant to a tenancy agreement executed in June 2008.

For the years ended December 31, 2008, 2009 and 2010, we had brand royalty income, amounting to approximately RMB418,000, RMB379,000 and RMB49,000, respectively, from Tianjin Tianhui pursuant to our trademark agreement that allows Tianjin Tianhui to use the "Shanshui Dongyue" brand (山水東岳) for a trademark fee of RMB1 yuan per ton of cement it produced. For the same periods, Tianjin Tianhui produced 417,648 tons, 378,568 tons and 48,977 tons of cement, respectively.

For the years ended December 31, 2008, 2009 and 2010, we had management fee income, amounting to approximately RMB218,000, RMB384,000 and RMB25,000, respectively, from Tianjin Tianhui pursuant to a management agreement between Tianjin Tianhui and Shandong Shanshui, who is entitled to an annual management fee of RMB100,000 plus 5% share of the annual gross profits of Tianjin Tianhui.

For the years ended December 31, 2008, 2009 and 2010, we had management fee income, amounting to approximately nil, RMB610,000 and RMB610,000, respectively, from Shandong Jinzhu Powder Co. Ltd., a company under common control of one of our ultimate shareholders, for our provision of property management services at our property which Shandong Jinzhu Powder rented from us.

For the years ended December 31, 2008, we paid loan service fees, amounting to approximately RMB4.6 million, to International Finance Corporation ("IFC"), one of our shareholders, pursuant to loan agreements between Anqiu Shanshui and Pinyin Shanshui one part and IFC on the other. Pursuant to these loan agreements, the total principal is US\$50 million, bearing interest at LIBOR plus 2% per annum and repayable biannually from 2008 to 2014.

## **Other Transactions with Related Parties**

For the year ended December 31, 2008, we had advances of approximately RMB36.8 million to China Shanshui Investment Company (“China Shanshui Investment”), our shareholder, in connection with our loan to China Shanshui Investment which carried interest at 2.7% per annum, RMB36.1 million of principal and interests had been fully repaid in June 2008. For the year ended December 31, 2009, we had advances of approximately RMB26,000 to China Shanshui Investment, which had been fully repaid.

For the year ended December 31, 2008, we had made loans of RMB3 million to Stanford, which had been fully repaid.

For the year ended December 31, 2009, we made advances of approximately RMB1.3 million to a third party, who was our customer, for Jinan Shanshui Group Property Development Co. Ltd.

For the year ended December 31, 2010, we made loans and relevant interests receivable from Dong’e Shanshui Dongchang Cement Co. Ltd. (“Dong’e Shanshui”), an associate company, amounting to RMB74.7 million. These loans with a total principal amount of RMB74 million bear interest at one-year PRC bank loan interest rate, which was 5.31% in 2010, and the related interests receivables as of December 31, 2010 was RMB680,000.

Certain of subsidiaries entered into loan agreements with IFC with a total facility available in an amount of US\$50 million. For the year ended December 31, 2010, total principal and relevant interests amounted to RMB343.8 million. These loans bear LIBOR plus 2.75% per annum and are repayable bi-annually from 2010 to 2015. For year ended December 31, 2008, 2009 and 2010, RMB88.4 million, RMB61.8 million and RMB125.5 million, respectively, was repaid under these loans.

We borrowed loans from Jinan Shanshui which principal and relevant interests amounted to RMB1.2 million as of December 31, 2010.

## **Key Management Compensation**

See “Management – Compensation of Directors and Senior Management” and “Summary – Recent Developments – Grant of Share Options.”

## **Amounts Due from/to Related Parties**

As of December 31, 2008, 2009 and 2010, other receivables due from related parties were approximately RMB5.9 million, RMB8.1 million and RMB2.8 million, respectively.

As of December 31, 2008, 2009 and 2010, customer deposits and receipts in advance from Tianjin Tianhui were approximately RMB46,000, RMB51,000 and nil, respectively.

As of December 31, 2008, 2009 and 2010, other payable due to related parties in respect of interests payable in connection with our loans from IFC and a loan from Jinan Shanshui in 2010 from them were approximately RMB5.1 million, RMB258,000 and RMB1.8 million, respectively.

As of December 31, 2008, 2009 and 2010, loans due to IFC were approximately RMB289.2 million, RMB236.4 million and RMB454.2 million, respectively.

As of December 31, 2008, 2009 and 2010, liability portion of convertible notes due to related parties were approximately RMB89.6 million, RMB10.9 million and nil, respectively.

As of December 31, 2008, outstanding bank loans secured by Jinan Shanshui were approximately RMB44.5 million.

As of December 31, 2010, other financial assets due from Dong’e Shanshui were approximately RMB74.0 million.

## DESCRIPTION OF OTHER MATERIAL INDEBTEDNESS

### Term Loan Agreements

As of December 31, 2010, we had bank facilities of approximately and RMB7,777.5 million, for short-term and long-term bank loans, of which RMB3,944.5 million was drawn.

Certain of our PRC subsidiaries have entered into term loan agreements with various PRC financial institutions, including Industrial and Commercial Bank of China, Bank of China, China Merchants Bank, China Everbright Bank, Industrial Bank Co. Ltd., China Construction Bank, OCBC Bank, Agricultural Bank of China, Shanghai Pudong Development Bank, Nanyang Commercial Bank, Communication Bank of China, Evergrowing Bank, Minsheng Bank, Qilu Bank, Huaxia Bank, Qingdao Bank, Shenzhen Development Bank and China Bohai Bank, to finance our construction of production facilities, acquisitions and working capital requirements. These loans have terms ranging from one year to six years. As of March 31, 2011, the aggregate outstanding amount under these loans, loans from equity shareholders and corporate bonds total approximately RMB8,242.7 million, of which RMB1,287.1 million was due within one year or on demand, and RMB6,955.6 million was due in greater than one year.

### *Interest*

The principal amounts outstanding under the term loans generally bear interest at floating rates calculated by reference to the relevant bank's benchmark interest rate per annum, which in turn is generally linked to the PBOC-published rates. Floating interest rates are generally subject to review by the banks monthly, quarterly or annually, or simultaneously with the adjustment of the PBOC-published rate. Interest payments are generally payable either monthly or quarterly and must be made on each payment date as provided in the particular loan agreement. As of March 31, 2011, the interest rates on the aggregate outstanding amount of our project loans ranged 2.6% to 7.7% per annum.

### *Covenants*

Under these term loans, many of our PRC subsidiary borrowers have agreed, among other things, not to take the following actions without first notifying the lender or obtaining the lenders' prior consent:

- issue any bonds;
- create encumbrances on all or substantially all of their property or assets;
- grant guarantees to any third parties or pledge or mortgage their material assets that may adversely affect their ability to repay their loans;
- make any major changes to their corporate structures, such as entering into joint ventures, mergers and acquisitions and reorganizations; or
- reduce their registered capital.

Under several term loans, certain of our PRC subsidiaries have agreed not to distribute dividends to their shareholders or repay shareholder loans without written consent of the lenders or before having fully repaid the term loans.

### ***Financial Covenants***

Under some of our term loans, certain of our PRC subsidiaries have agreed to comply with financial covenants, including in connection with the ratio of total liabilities to total assets, the contingent liability ratio and the liquidity ratio. Certain subsidiaries did not meet their respective covenants in the relevant long-term loan agreements with Weihai City Commercial Bank, Shanghai Pudong Development Bank and Qiulu Bank, the latter two of which provided confirmations to us that the noncompliance would not accelerate repayment of these loans. We had repaid in full the loan from Weihai City Commercial Bank. As of December 31, 2010, RMB160.0 million was outstanding under these loan agreements.

### ***Events of Default***

The term loans contain certain customary events of default, including cross-default, insolvency and breaches of the terms of the loan agreements. The lenders are entitled to terminate their respective agreements or demand immediate repayment of loans upon the occurrence of an event of default.

### ***Guarantee and Security***

We and certain of our PRC subsidiaries have entered into guarantee agreements with lenders in connection with certain loans pursuant to which we and our subsidiaries have agreed to guarantee liabilities in the subsidiary borrowers under these loans. In addition, certain of our PRC subsidiaries agreed to lenders to provide security interests over their assets in connection with their loans. These assets include properties, plant and equipments.

### **Corporate bonds issued by Shandong Shanshui**

Shandong Shanshui issued domestic corporate bonds in the form of medium term notes in a principal amount of RMB1 billion and RMB900 million in October 2010 and March 2011, respectively. The tenor of the notes is three years, bearing a fixed interest rate of 4.2% per annum with the interests payable annually. The domestic corporate bonds have been rated “AA” by Chengxin, a domestic rating agency.

### **IFC Loan Agreements and Guarantee**

Weihai Shanshui, Qingdao Chuangxin, Linqu Shanshui and Zaozhuang Chuangxin entered into loan agreements with IFC, one of our principal shareholders, totaling US\$50 million in 2009. Under the loan agreements, as amended, the loans bear interest at LIBOR plus 4.75% per annum and are repayable bi-annually from 2010 to 2015. Weihai Shanshui’s loans are secured by certain property, plant and equipment, and additional security over its property is being processed. Qingdao Chuanxin, Linqu Shanshui and Zaozhuang Chuangxin have agreed to provide their respective property, assets and equipment as collateral for their respective loans. In addition, Anqiu Shanshui and Pinyin Shanshui entered into loan agreements with IFC, totaling US\$50 million in 2006. Under the loan agreements, as amended, the loans bear interest at LIBOR plus 4.0% per annum and are repayable biannually from 2008 to 2014 and are secured by certain properties, plant and equipment of the subsidiaries. These loans are guaranteed by China Shanshui Cement Group Limited. Pursuant to the guarantees, we may not incur additional debt or permit creation of any lien on our properties unless we meet certain financial covenants. As of March 31, 2011, the aggregate outstanding amount under these loan agreements was RMB449.7 million.

See “Summary – Recent Developments – 2011 Term Loans.”

## **8.5% Senior Notes due 2016**

Our US\$400 million aggregate principal amount of 8.5% Senior Notes due 2016 (the “2016 Notes”) are our senior obligations and rank at least equally in right of payment with all our other unsecured, unsubordinated indebtedness, subject to any priority rights of such unsubordinated indebtedness pursuant to applicable law. As of the date of this document, we had a total of US\$400 million principal amount of the 2016 Senior Notes outstanding.

### ***Guarantee***

Our obligations under the 2016 Notes are guaranteed by our existing subsidiaries other than those incorporated or organized in the PRC. The guarantees may be released or reduced in the event of certain asset sales and certain other circumstances. In addition, we may, subject to certain conditions, incur additional indebtedness that would be incurred on an equal and ratable basis with the 2016 Notes and related guarantees.

### ***Interest***

The 2016 Notes bear interest at 8.5% annually, payable semi-annually in arrears.

### ***Covenants***

Subject to certain conditions and exceptions, the 2016 Notes restrict us and each of our restricted subsidiaries from, among other things:

- incurring additional indebtedness and issue preferred stock;
- declaring dividends on its capital stock or purchase or redeem capital stock;
- making investments or other specified restricted payments;
- issuing or selling capital stock of restricted subsidiaries;
- guaranteeing additional indebtedness;
- selling assets;
- creating any lien;
- entering into sale and leaseback transactions;
- entering into agreements that restrict the restricted subsidiaries’ ability to pay dividends and transfer assets or make intercompany loans;
- entering into transactions with equity holders or affiliates;
- effecting a consolidation or merger; or
- engaging in different business activities.

### ***Events of Default***

The 2016 Notes contain customary events of default, including a default in the payment of principal when due, default in payment of interest that continues for 30 days. If an event of default (other than an event of default relating to certain bankruptcy events) occurs and is continuing, the trustee for the 2016 Notes or the holders of at least 25% in aggregate principal amount of the Notes then outstanding, by written notice to us (and to the Trustee if such notice is given by such holders), may, and the Trustee at the written direction of such holders may declare the principal of the 2016 Notes to be immediately due and payable. If an event of default relating to certain bankruptcy events occurs, the principal of the 2016 Notes will automatically become immediately due and payable.

### ***Change of Control***

Not later than 30 days following the occurrence of certain events of change of control, we are required to make an offer to repurchase all of the 2016 Notes outstanding at a purchase price equal to 101% of their principal amount plus any accrued and unpaid interest.

### ***Maturity and Redemption***

The maturity date of the 2016 Notes is May 25, 2016. At any time on or after May 25, 2014, we may redeem the 2016 Notes, in whole or in part, at a redemption price equal to the percentage of principal amount set forth in the table below if redeemed during each period indicated below, plus any accrued and unpaid interest to the redemption date:

<b>Period</b>	<b>Redemption Price</b>
2014.....	104.25%
2015 and thereafter .....	102.125%

Additionally, if we or a guarantor of the 2016 Notes becomes obligated to pay certain additional amounts as a result of certain changes in specified tax law, we may redeem the 2016 Notes, in whole but not in part, at a redemption price equal to 100% of the principal amount of the 2016 Notes, plus any accrued and unpaid interest, subject to certain exceptions.