



Li Ning Company Limited
(李 寧 有 限 公 司)

(Incorporated in the Cayman Islands with limited liability)

Stock code : 2331

Remarkable
Strides
Annual Report
2005





MISSION *Through sports, we inspire in people the desire and power to make breakthroughs*

VISION *A world's leading brand in the sports goods industry*

CORE VALUES *Integrity, Professionalism, Passion, Breakthroughs, Trust*

Corporate Profile

Li Ning Company Limited is one of the leading sports goods enterprises in the PRC. It has its own branding, research and development, design, manufacturing, distribution and retail capabilities. The Group's products include sports footwear, apparel and accessories for sport and leisure use which are primarily sold under its own LI-NING brand. The Group has established an extensive distribution and retail network in the PRC, of which distributors manage the franchised LI-NING retail outlets under the Group's supervision. The Group also directly manages its own LI-NING retail outlets and concessions. In addition, the Group has established a joint venture with AIGLE in 2005 under which the joint venture has been given the exclusive right by AIGLE to manufacture, market, distribute and sell for 50 years in the PRC, outdoor sports products that bear the "AIGLE" trademark registered and owned by AIGLE.

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Highlights of the Year



18 JAN

Fostered strategic alliance with NBA



19 APR

Set strategic partnership with Swarovski

01 JUN

Included as a constituent stock of MSCI China Index Series

2005

04 APR

Joined hands with NetEase



27 APR

LI-NING named as "My Favorite China Brand in 2005" organized by CCTV in the PRC



01 JUL

Launched the first 4th generation LI-NING store



17 JAN

Became a constituent stock of Hang Seng Composite Index Series and Hang Seng Freefloat Index Series

**03 JUL**

Entered into a joint venture with AIGLE, a famous outdoor sports goods brand

**17 NOV**

Awarded "The 2005 WorkChina™ Best Company to Work For"

**10 JAN**

Signed an agreement with NBA player, Damon Jones

2006**13 JUL**

Received the "Leading Sports Marketing Cases Award" from the 2005 Outstanding Sports Marketing Cases Study Award Panel

22 DEC

Became the major partner of CUBA, one of the top 3 basketball tournaments in the PRC

**07 AUG**

Li Ning Company 15th Anniversary Celebration

**16 MAR**

Cooperated with ATP as its official marketing partner



BOARD OF DIRECTORS

Executive Directors

Mr. LI Ning (李寧)

(Chairman)

Mr. ZHANG Zhi Yong (張志勇)

(Chief Executive Officer)

Mr. TAN Wee Seng (陳偉成)

(Chief Financial Officer)

Non-Executive Directors

Mr. LIM Meng Ann (林明安)

Mr. Stuart SCHONBERGER

Mr. FONG Ching, Eddy (方正)

Independent Non-Executive Directors

Mr. KOO Fook Sun, Louis (顧福身)

Ms. WANG Ya Fei, Jane (王亞非)

Mr. CHAN Chung Bun, Bunny (陳振彬)

EXECUTIVE COMMITTEE

Mr. ZHANG Zhi Yong (張志勇)

(Committee Chairman)

Mr. LI Ning (李寧)

Mr. TAN Wee Seng (陳偉成)

Ms. Tina LEH (樂淑鈺)

AUDIT COMMITTEE

Mr. KOO Fook Sun, Louis (顧福身)

(Committee Chairman)

Mr. Stuart SCHONBERGER

Ms. WANG Ya Fei, Jane (王亞非)

REMUNERATION COMMITTEE

Ms. WANG Ya Fei, Jane (王亞非)

(Committee Chairman)

Mr. LIM Meng Ann (林明安)

Mr. KOO Fook Sun, Louis (顧福身)

NOMINATION COMMITTEE

Mr. LIM Meng Ann (林明安)

(Committee Chairman)

Mr. KOO Fook Sun, Louis (顧福身)

Ms. WANG Ya Fei, Jane (王亞非)

COMPANY SECRETARY

Mr. TAN Wee Seng (陳偉成), ACMA

AUTHORISED REPRESENTATIVES

Mr. LI Ning (李寧)

Mr. TAN Wee Seng (陳偉成)

QUALIFIED ACCOUNTANT

Mr. TAN Wee Seng (陳偉成), ACMA

REGISTERED OFFICE

Century Yard
Cricket Square
Hutchins Drive
P. O. Box 2681GT
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Grand Cayman
British West Indies

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Hong Kong
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AUDITORS

PricewaterhouseCoopers
Certified Public Accountants

LEGAL ADVISORS

Hong Kong law
Baker & McKenzie

PRC law
Grandall Legal Group Shanghai Office
Beijing Haisi Law Firm
King & Wood Law Firm

PRINCIPAL BANKERS

Hong Kong
DBS Bank Ltd., Hong Kong Branch

PRC
China Construction Bank
Industrial & Commercial Bank of China
China Merchants Bank
Bank of Beijing



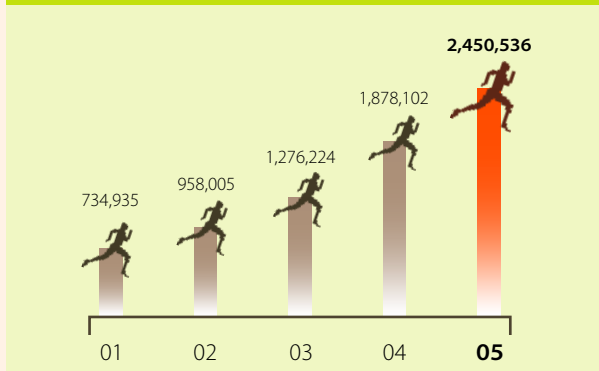
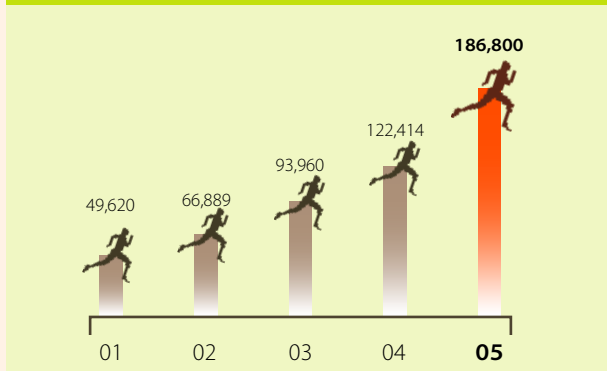
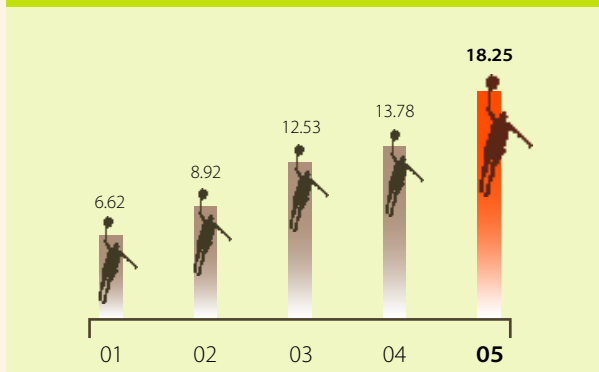
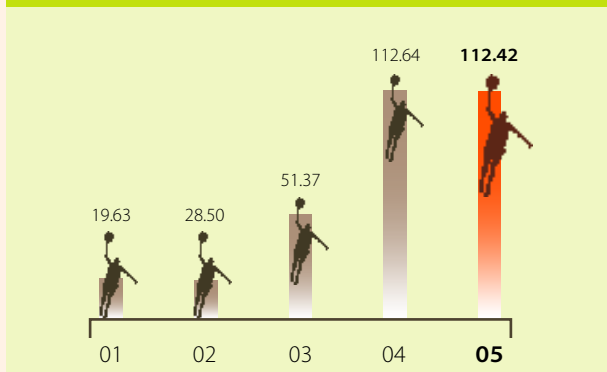
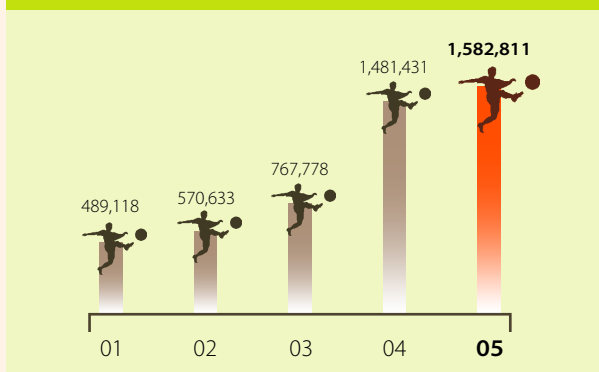
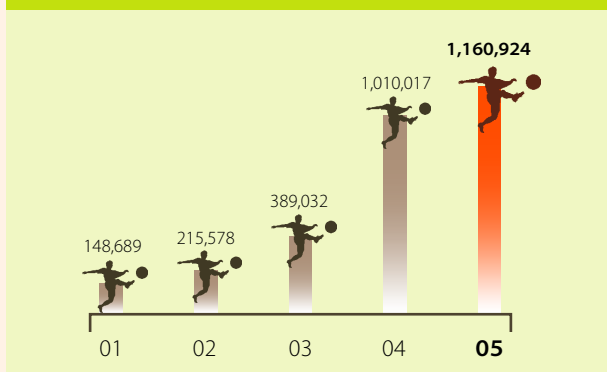
Five-year Financial Highlights

(Expressed in RMB'000 unless otherwise stated)

	2005	For the year ended 31 December			
		2004	2003	2002	2001
		(As restated – Note 1)			
Turnover	2,450,536	1,878,102	1,276,224	958,005	734,935
Operating profit	271,497	180,418	119,109	103,347	65,201
Profit before taxation	273,451	181,239	114,563	95,955	59,090
Profit attributable to equity holders	186,800	122,414	93,960	66,889	49,620
Non-current assets	119,615	102,819	89,523	86,489	91,607
Current assets	1,463,196	1,378,612	678,255	484,144	397,511
Current liabilities	404,515	454,206	362,877	337,760	324,232
Net current assets	1,058,681	924,406	315,378	146,384	73,279
Total assets	1,582,811	1,481,431	767,778	570,633	489,118
Total assets less current liabilities	1,178,296	1,027,225	404,901	232,873	164,886
Equity holders' equity	1,160,924	1,010,017	389,032	215,578	148,689
Gross profit margin (%)	47.0	46.5	47.5	44.9	39.1
Margin of profit attributable to equity holders (%)	7.6	6.5	7.4	7.0	6.8
Earnings per share – basic (RMB cents)	18.25	13.78	12.53	8.92	6.62
– diluted (RMB cents)	18.13	13.75	N/A	N/A	N/A
Return on equity holders' equity (%)	17.2	17.5	31.1	36.7	39.7
Net tangible assets per share (RMB cents)	112.42	112.64	51.37	28.50	19.63
Debt to equity holders' equity ratio (Note 2)	0.35	0.45	0.93	1.57	2.18

Notes:

- See note 2 to the accounts.
- The debt to equity holders' equity ratio is based on total liabilities divided by equity holders' equity as at 31 December.

TURNOVER (RMB'000)**PROFIT ATTRIBUTABLE TO EQUITY HOLDERS (RMB'000)****EARNINGS PER SHARE – BASIC (RMB cents)****NET TANGIBLE ASSETS PER SHARE (RMB cents)****TOTAL ASSETS (RMB'000)****EQUITY HOLDERS' EQUITY (RMB'000)**



Release
the **Power**





Mr. LI Ning, *Chairman*

Dear Shareholders,

I am delighted to report to you the encouraging annual results of Li Ning Company Limited and its subsidiaries for its second year as a publicly-listed entity.

ANOTHER YEAR OF SOLID GROWTH

Fuelled by a favourable market environment characterized by continued economic growth, rising consumer purchasing power and the growing popularity of sports activities in the PRC, the Group continued to make remarkable strides on all fronts in 2005. In solidifying our position at the forefront of the PRC's sports goods industry, we placed strong emphasis on three core areas that are crucial to our success: superior brand building and marketing strategies, inspiring product design and development capabilities, and flexible and efficient supply chain management.

Leveraging on our extensive network and resources in the PRC's sports goods industry, the Group implemented a range of high value-creating marketing initiatives that effectively increased awareness of the LI-NING brand. Our dedicated research and development efforts enriched our product offer. The diversified product range offers a wide selection for professional athletes and sports lovers, as well as consumers who are fond of fashionable sportswear. In addition, the Group implemented centralized supply chain management which helped reducing the lead time from product development to market rollout and accelerating both our response time and our time to market.

I am pleased to see that the Group's accomplishments were recognized by the investment community and reflected positively in our share price performance. Additional acknowledgement of our success was evidenced by the Company's inclusion as a constituent stock of the Hang Seng Composite Index Series and the Hang Seng Freefloat Index Series, as well as the MSCI China Index Series, during the year under review.

FINANCIAL RESULTS

For the year ended 31 December 2005, the Group's consolidated turnover rose by 30.5% to RMB2,450.5 million (2004: RMB1,878.1 million), while profit attributable to equity holders surged by 52.6% to RMB186.8 million (2004: RMB122.4 million). Basic earnings per share also increased to RMB18.25 cents (2004: RMB13.78 cents).

In view of the strong business growth and solid financial position, the Board of Directors has proposed a final dividend payment of RMB5.00 cents per ordinary share (2004: RMB4.57 cents) to Shareholders.

STRATEGIC ALLIANCES

Our core brand, LI-NING, is the cornerstone of our success. The Group embarked on multi-faceted brand building initiatives that leverage on our comprehensive network and substantial resources in the sports goods industry. The fostering of alliances with acclaimed brands also contributed to establishing a presence for the LI-NING brand in the international arena. An example of this is our three-year strategic marketing alliance with NBA, inaugurated in January 2005. To further enhance the LI-NING brand image on the world stage, the Group proudly announced an agreement with NBA star Damon Jones of the Cleveland Cavaliers in January 2006. This pivotal event established LI-NING's unique foothold as the first-ever Chinese sports goods brand to be featured in globally televised NBA league games and represented a major milestone for both the Group's and the PRC's sports goods industry as a whole. And on top of that, in March 2006, we announced a seven-year official marketing partnership with ATP, the world's premier men's professional tennis tournament association, to further strengthen our foothold in the professional tennis arena, in the PRC and internationally.



MULTI-BRANDING STRATEGY

The Group endeavours to be a leader in the PRC's sports goods industry and a premier operator and owner of sports goods brands, with a strong product portfolio. The Group's ambition is to further develop long-term relationships with reputable sports goods brands through facilitating their introduction to the rapidly growing PRC market. Our cooperation with the French outdoor sports goods brand "AIGLE" is an example of the Group's acumen in fulfilling this objective. The Group entered into a landmark 50-year agreement with AIGLE for the formation of a 50-50 joint venture which exclusively markets and distributes "AIGLE" brand products in Mainland China. Not only did this move broaden the Group's brand portfolio, but it also contributed to developing a new revenue stream.

The Group will continue to leverage on its expertise in the PRC's sports goods retailing industry to seek mutually beneficial partnerships, and ultimately develop itself into a multi-brand operator with a portfolio of superior brands.

PERFECTLY PLACED TO BENEFIT DURING THE RUN-UP TO THE BEIJING 2008 OLYMPICS

Going forward, the Beijing 2008 Olympic Games is expected to create an unprecedented wave of interest in sports. The Group is well positioned to be a beneficiary of this positive trend. With an extensive nationwide retail distribution network comprising 3,373 stores (2004: 2,622 stores) of the LI-NING brand as at 31 December 2005, and armed with a carefully planned sponsorship strategy, the Group believes that it has a solid foundation from which to capture opportunities arising during the run-up to the Beijing 2008 Olympics.

PROFESSIONALLY DESIGNED PRODUCTS PAVE THE WAY FOR FUTURE GROWTH

In realizing the motto that "Anything is Possible", the Group employs a team of highly competent research and development professionals complemented by cooperation with international partners. The consummation of these resulted in the introduction of professional calibre products featuring innovative designs that were well-received by our customers.

On the product development front, the Group will deploy resources to engineer footwear products for five major sports that offer the most attractive potential in the PRC, namely running, basketball, soccer, tennis and fitness. Catering to the needs of different customers, the Group not only offers professional products to athletes and sports lovers, but also designs and develops a range of related products in trendy styles.

STEERED BY A COMMITTED BOARD AND MANAGEMENT TEAM

The Group takes pride in its Board of Directors and senior management team, who endeavour to uphold a high level of corporate governance, provide a sound management framework to drive the Group's development, effectively manage business risks and fulfill its commitment to maximize Shareholders' value.

A WORD OF APPRECIATION

I would like to take this opportunity to express my sincere gratitude to all members of the Board for their invaluable contribution during the year. I would also like to thank our shareholders, suppliers, business partners and customers for their loyal support. I am extremely grateful for the hard work of our staff throughout the year. We could not have made such remarkable strides without all of you on our side.

I am confident that the Group will continue to deliver steady growth in the years ahead, and I look forward to sharing with our shareholders the fruits of our success.

Li Ning

Chairman

Hong Kong, 22 March 2006



Hit the Target





Mr. ZHANG Zhi Yong, Chief Executive Officer

OVERVIEW

The sports goods industry in the PRC in 2005 continued to be driven by increasing affluence and consumption power, rapid urbanization and the positive impact of the 2008 Beijing Olympics. Under such a favourable operating environment, the Group, being one of the leading sports goods enterprises in the PRC, continued to record reasonably outstanding results in 2005 by leveraging on its competitive strengths, namely its (i) strong brand image with a distinguished market positioning; (ii) enhanced product research and development capabilities leading to a diversified product range for sports and leisure use; (iii) extensive distribution and retail network; (iv) efficient supply chain management; and (v) professional management team with proactive corporate culture.

FINANCIAL REVIEW

Key financial indicators

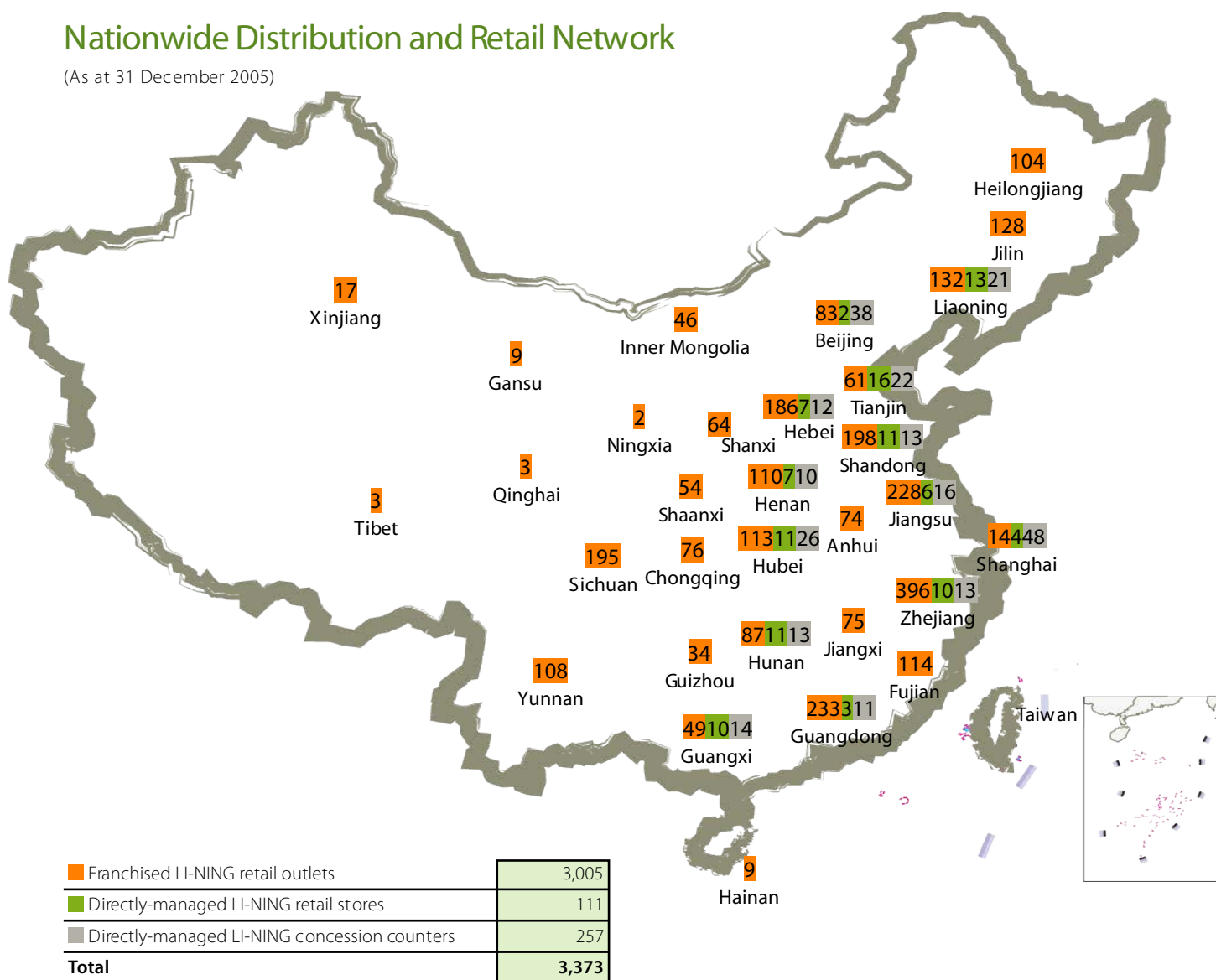
	Year ended 31 December		Year-on-year change (%)
	2005	2004 (As restated – Note 1)	
Items of income statement (audited)			
<i>(Expressed in RMB'000 unless otherwise stated)</i>			
Turnover	2,450,536	1,878,102	30.5
Gross profit	1,152,545	873,524	31.9
Operating profit	271,497	180,418	50.5
EBITDA (Note 2)	296,435	200,839	47.6
Profit attributable to equity holders	186,800	122,414	52.6
Basic earnings per share (RMB cents) (Note 3)	18.25	13.78	32.4
Selected financial ratios (audited)			
Gross profit margin (%)	47.0	46.5	
Operating profit margin (%)	11.1	9.6	
Margin of profit attributable to equity holders (%)	7.6	6.5	
Effective tax rate (%)	31.1	31.7	
Return on equity holders' equity (%)	17.2	17.5	
Debt to equity holders' equity ratio (Note 4)	0.35	0.45	
Average inventory turnover (days) (Note 5)	86	112	
Average accounts receivable turnover (days) (Note 6)	44	33	
Average trade payables turnover (days) (Note 7)	68	77	

Notes:

1. See note 2 to the accounts.
2. EBITDA refers to earnings before interest, tax, depreciation and amortization.
3. The calculation of basic earnings per share is based on the profit attributable to equity holders for the year ended 31 December 2005 of RMB186,800,000 (2004: RMB122,414,000) and the weighted average of 1,023,827,000 ordinary shares in issue (2004: 888,392,000 shares) during the year.
4. The debt to equity holders' equity ratio is based on total liabilities divided by equity holders' equity as at 31 December.
5. The calculation of average inventory turnover (days) is based on the average of opening and closing inventory balances divided by the cost of sales and multiplied by 365 days.
6. The calculation of average accounts receivable turnover (days) is based on the average of opening and closing balances of accounts and notes receivable divided by turnover and multiplied by 365 days.
7. The calculation of average trade payables turnover (days) is based on the average of opening and closing balances of trade payables divided by total purchases and multiplied by 365 days.

Nationwide Distribution and Retail Network

(As at 31 December 2005)



Turnover

For the year ended 31 December 2005, the Group's turnover reached RMB2,450,536,000, an increase of 30.5% as compared to 2004. The satisfactory growth was attributable to (i) distinct and well-defined brand marketing strategies; (ii) successful development of new product series catering to the needs of consumers; (iii) constant enhancement in supply chain management; and (iv) continued expansion of sales channels and network coverage.

Breakdown of turnover by product category

	Year ended 31 December				Year-on-year change (%)
	2005		2004		
	RMB'000	% of total turnover	RMB'000	% of total turnover	
Footwear	866,697	35.4	562,889	30.0	54.0
Apparel	1,365,802	55.7	1,083,130	57.7	26.1
Accessories	218,037	8.9	232,083	12.3	-6.1
Total	2,450,536	100.0	1,878,102	100.0	30.5

The Group continued to enrich its product portfolio with series of new products for popular sports activities, such as running, basketball, soccer, tennis and fitness. The broadened product range boosted the sales of footwear and apparel products. Significant improvements in designs, optimum pricing of key products and reinforced marketing efforts resulted in a strong growth of 54.0% in footwear sales as compared with 2004. The sales of apparel products increased by 26.1%. Sales of accessories however decreased by 6.1% as compared to 2004 due to our reduced emphasis for better retail sales efficiency.

Percentage of turnover by product category in 2005

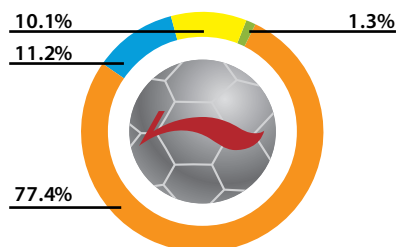


- Apparel
- Footwear
- Accessories

Percentage of turnover by sales channel

	Year ended 31 December	
	2005	2004
	% of total turnover	% of total turnover
PRC market		
Sales by franchised distributors	77.4	75.0
Sales by directly-managed retail stores	11.2	10.6
Sales by directly-managed concession counters	10.1	12.0
International markets	1.3	2.4
Total	100.0	100.0

Percentage of turnover by sales channel in 2005



- PRC market (Sales by franchised distributors)
- PRC market (Sales by directly-managed retail stores)
- PRC market (Sales by directly-managed concession counters)
- International markets

Percentage of turnover by geographical location

		Year ended 31 December	
		2005 % of total turnover	2004 % of total turnover
Note			
LI-NING brand			
PRC market			
Beijing and Shanghai		6.9	9.9
Central region	1	11.7	12.4
Eastern region	2	23.3	21.9
Southern region	3	12.8	11.0
Southwestern region	4	8.5	8.2
Northern region	5	16.4	13.8
Northeastern region	6	12.5	12.5
Northwestern region	7	1.9	2.3
International markets		1.3	2.4
KAPPA brand (sold in August 2005)			
PRC market		4.7	5.6
Total		100.0	100.0

Notes:

1. Central region includes Hubei, Hunan and Jiangxi.
2. Eastern region includes Zhejiang, Jiangsu and Anhui.
3. Southern region includes Guangdong, Guangxi, Fujian and Hainan.
4. Southwestern region includes Sichuan, Chongqing, Guizhou, Yunnan and Tibet.
5. Northern region includes Shandong, Hebei, Henan, Tianjin, Shanxi and Inner Mongolia.
6. Northeastern region includes Liaoning, Jilin and Heilongjiang.
7. Northwestern region includes Shaanxi, Xinjiang, Gansu, Qinghai and Ningxia.

The Group operates a balanced nationwide distribution network that covers all major cities of the PRC. In terms of market potential, second and third-tier cities, where the Group has a strong presence, are expected to be the mainstream markets for future growth.

Cost of sales and gross profit

For the year ended 31 December 2005, cost of sales of the Group amounted to approximately RMB1,297,991,000 (2004: RMB1,004,578,000). The overall gross profit margin in 2005 was maintained at a satisfactory level of 47.0% (2004: 46.5%). The modest margin expansion was mainly due to an optimization of our pricing strategy and enhancement in product design and research and development that enabled us to command a premium in retail price.

Gross profit margin of product categories

	Year ended 31 December	
	2005 Gross profit margin (%)	2004 Gross profit margin (%)
Overall	47.0	46.5
Footwear	46.4	43.7
Apparel	47.3	47.5
Accessories	47.8	48.7

Other income

For the year ended 31 December 2005, other income of the Group amounted to approximately RMB32,626,000 (2004: RMB17,399,000), mainly comprising government subsidies and investment gain from the disposal of a subsidiary.





Mr. TAN Wee Seng (left), *Chief Financial Officer*

Distribution and administrative expenses

For the year ended 31 December 2005, distribution expenses amounted to approximately RMB690,527,000 (2004: RMB549,771,000), mainly comprising advertising and promotional expenses, salaries and benefits of sales staff, rental and renovation expenses of retail stores, transportation and logistics expenses, sponsorship and other marketing-related expenses. Distribution expenses accounted for 28.2% of the Group's total turnover, representing a decline of 1.1% against 29.3% in 2004. The decrease was a reflection of (i) stable human resources expenses; (ii) effectively controlled store opening expenses and reduced renovation costs per square meter; and (iii) overall improvement in cost management.

Administrative expenses of approximately RMB223,147,000 (2004: RMB160,734,000) for the year ended 31 December 2005 mainly comprised staff costs, consulting expenses, office rentals, depreciation of office premises and other general expenses. Administrative expenses as a percentage of turnover increased from 8.6% in 2004 to 9.1% in 2005 as a result of the need to make provision for the non-cash stock option costs in compliance with the new IFRS 2 requirement. Excluding the non-cash share-based stock option costs adjustment, administrative expenses as a percentage of turnover represented 8.3% in 2005 against 8.2% in 2004.

Operating profit

For the year ended 31 December 2005, operating profit of the Group was RMB271,497,000, representing an increase of 50.5% from RMB180,418,000 in 2004. Operating profit margin for the year was approximately 11.1%, representing an increase of 1.5% from 2004. The increase was primarily resulted from the combined effect of a rise in gross profit margin and decrease in total distribution and administrative expenses as a percentage of total turnover of the Group.

Finance income and taxation

For the year ended 31 December 2005, the finance income of the Group amounted to RMB1,954,000 (2004: an income of RMB821,000), which was mainly due to (i) decrease in interest expenses on bank borrowings as a result of nil bank borrowings; (ii) interest income derived from the investments in relation to the cash and other financial assets of the Group; but was partially offset by (iii) the increase in exchange loss as a result of fluctuation of foreign exchange rates in the second half of the year.

For the year ended 31 December 2005, tax expenses amounted to approximately RMB85,106,000 (2004: RMB57,486,000). The effective tax rate was 31.1% (2004: 31.7%).

Profit attributable to equity holders

Profit attributable to equity holders for the year ended 31 December 2005 was approximately RMB186,800,000, an increase of 52.6% from RMB122,414,000 in 2004. Net profit margin attributable to equity holders for the year was 7.6%, representing an increase of 1.1% compared to 6.5% in 2004.

Basic earnings per share amounted to RMB18.25 cents (2004: RMB13.78 cents). Excluding the effect of the adjustments made in respect of IFRS 2 "Share-based Payment", basic earnings per share would be RMB20.94 cents (2004: RMB15.02 cents).

Provision for inventories

Inventories of the Group are stated at the lower of cost and net realizable value. In the event that net realizable value falls below cost, the difference is taken as a provision for inventories.

Accumulated provision for inventories as at 31 December 2005 and 31 December 2004 amounted to approximately RMB14,227,000 and RMB10,228,000, respectively.

Provision for doubtful debts

The Group's policy in respect of provision for doubtful debts in 2005 remained the same as that in 2004.

Accumulated provision for doubtful debts as at 31 December 2005 and 31 December 2004 amounted to approximately RMB3,716,000 and RMB10,020,000, respectively.

BUSINESS REVIEW

During the year ended 31 December 2005, the Group continued to focus on the following key development strategies: (i) reinforcing brand awareness and brand loyalty; (ii) infusing professional and trendy elements in the brand image; (iii) strengthening product design, research and development; (iv) expanding sales channels and network; (v) improving supply chain management; and (vi) embarking on a multi-brand expansion plan.

Brand promotion and sponsorships

Our brand building has been supported by a comprehensive marketing plan. In 2005, the Group implemented a multi-faceted marketing program. Through a diversity of brand building activities, the Group effectively raised its brand awareness, enhanced its brand influence and enlarged its customer loyalty.

NBA – China official marketing partner

In January 2005, Beijing Li Ning, a wholly-owned subsidiary of the Group entered into an official marketing cooperation agreement with NBA, a world-renowned sports games organizer. Pursuant to the agreement, the Group will utilize the abundant marketing experience and media resources of NBA in the PRC market to promote the LI-NING brand. Beijing Li Ning also successfully entered into an agreement with NBA player, Damon Jones in January 2006. Pursuant to the agreement, Damon Jones will wear LI-NING professional basketball shoes in his future NBA league games. This is expected to reinforce the professional image of the LI-NING brand in the basketball sector. This partnership marked a great stride for the LI-NING brand towards achieving its goal of becoming a top world-class sports goods brand. It also represents a major breakthrough in the development of the PRC sports goods industry.

Netease – "LI-NING Netease Sports Channel"

In April 2005, the Group entered into a three-year cooperation agreement with Netease, a leading internet technology venture in the PRC, whereby the two parties agreed to work in close collaboration to launch the "LI-NING Netease Sports Channel" (李寧網易體育頻道). Through a series of joint promotional activities, marketing resources and corporate culture development initiatives, the two parties joined hands to establish an information exchange platform featuring professional and comprehensive coverage of sports news and promoting the motto of "Anything is Possible" amongst the Internet users. Meanwhile, the official strategic marketing alliance between LI-NING and NBA is expected to enhance the depth and influence of NBA reports. Coverage of the medal-winning national sports teams will also be featured, with emphasis on in-depth reports on the diving team, the table tennis team, the gymnastics team and the shooting team.

Swarovski – LI-NING ladies' sports goods with crystals

In April 2005, the Group announced a partnership with Swarovski, the world-leading manufacturer of crystal jewellery and decorations, pursuant to which Swarovski crystal inlays would be featured on LI-NING ladies' tennis wear, fitness wear and fitness footwear. This initiative accelerated pace of the Group to offer fashionable sports goods.

CUBA – Sponsorship for one of the top three basketball associations in the PRC

In December 2005, the Group announced its partnership agreement with the China University Basketball Association ("CUBA"), one of the top three basketball associations in the PRC. In the PRC basketball sector, CUBA is the top association in terms of geographical coverage, participation and cultural sophistication. Securing the role as the on-site equipment sponsor of CUBA will further reinforce the professional image of the LI-NING brand in the basketball sector, thereby enabling the Group to leverage on the relevant promotional resources in markets at university level. Moreover, the cooperation also represents a long-term marketing platform for the Group in the basketball sector.

ATP – Official marketing partner

On 16 March 2006, the Group announced an official marketing partnership agreement with ATP, the world's premier men's professional tennis tournament association. During the seven-year period as specified in the agreement, the Company will be authorized the exclusive right for the manufacture, sale and marketing of tennis products including apparel, footwear and accessories co-branded by LI-NING and ATP. These co-branded products will appear in ATP events as a part of the promotion campaign. ATP and the Company will also co-host the LI-NING ATP Challenger Series and the LI-NING ATP Smash Tennis tournaments, which are expected to offer young tennis athletes plenty of development opportunities. In addition, ATP will also assist the Company to identify and sign up tennis players for endorsement purposes.

The Group successfully improved the public awareness of its new sports products (such as running, basketball, soccer, tennis and fitness products) with effective advertising strategies. "Anything is Possible", the philosophy strongly advocated by the Group, has become a popular catchphrase in daily life in the PRC. According to an online poll conducted by a PRC publisher in 2005, LI-NING brand was elected by Internet users as one of the top three favorite brands in the sportswear category in the PRC. Moreover, LI-NING brand was the only sports goods brand elected as "My Favorite China Brand in 2005" in a campaign organized by CCTV in the PRC.





Product development

The Group has a team of highly competent product development and design professionals in place. During the year under review, in addition to the in-house team, the Group fostered extensive cooperation with international partners in a bid to develop professional and fashionable products of world-class quality.

In 2004, the Group began to launch different types of specialized footwear series (including running, basketball, soccer, tennis and fitness footwear) and received encouraging market response. In Spring 2005, the Company launched "RUN FREE" ultra-light air-flow running footwear series in the PRC, which featured world-class air permeability and was made with ultra-light materials developed in-house and high-quality imported leather material using a new design and manufacturing technique. In addition, the "TOP GUN" series of basketball shoes launched in Fall 2005 was also well received by consumers.

The Group's design and research and development centre in Hong Kong continued to concentrate its effort on establishing the overall design philosophy and formulating brand-building concepts and strategies for the LI-NING branded products. The centre also cooperated with Hong Kong and international institutions and universities with a view to enhancing its technical capability in designing products with high-tech functions.

Distribution and retail network

The Group has established an extensive distribution and retail network with sales outlets throughout the PRC. Adopting a diversified retail model that comprises franchised retail outlets, directly-managed retail stores and concession counters, the Group continued to expand its sales channels during the year. As at 31 December 2005, the domestic distribution and retail network of the Group under the LI-NING brand comprised:

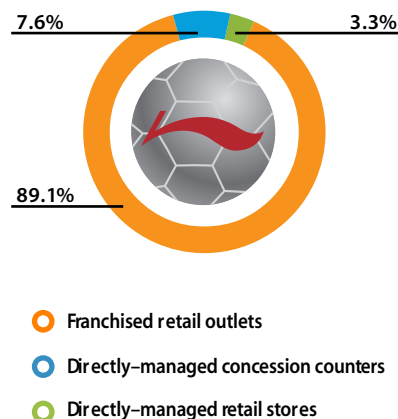
- over 260 distributors operating 3,005 franchised retail outlets across the country; and
- a total of 111 directly-managed retail stores and 257 concession counters in Beijing, Shanghai and 12 provinces in the PRC.

Number of franchised and directly-managed retail stores

	As at 31 December 2005	As at 31 December 2004	Change (%)
Franchised retail outlets	3,005	2,272	32.3
Directly-managed retail stores	111	117	-5.1
Directly-managed concession counters	257	233	10.3
Total	3,373	2,622	28.6

There was a net increase of 751 new stores during the year, bringing the total number of stores of the Group under the LI-NING brand to 3,373. With an aim of enhancing store image and efficiency, the Group launched the 4th generation store image standards in the second half of 2005. During the year under review, there were a total of 98 new and modified stores using the 4th generation standards of which 46 were new stores and 52 were modified existing stores. Furthermore, the Group's brand image and awareness were greatly enhanced with the opening of spacious flagship stores featuring stylish decorations at prime locations in major PRC cities. The newly opened flagship stores included the 1,600 square metre store at Jie Fang Road in Wuhan, the 880 square metre store at Zhong Shan Road in Xiamen and the 436 square metre store at East Main Street in Xi'an.

Percentage of franchised and directly-managed retail stores in 2005



- Franchised retail outlets
- Directly-managed concession counters
- Directly-managed retail stores

Supply chain management

A standardized supply chain management system has been implemented for all franchised and directly-managed retail outlets under the Group to provide centralized procurement, inventory and logistics support. As a result of effective supply chain management, the Group managed to respond to market changes in a more efficient and flexible manner as highlighted below:

- four large-scale sales fairs for distributors (2004: three) were organized to shorten the cycle from product development to order placements;
- average inventory turnover was substantially improved to 86 days from 112 days in 2004 as a result of enhanced inventory management;
- average accounts receivable turnover was maintained at a satisfactory level of 44 days, as compared to 33 days in 2004; and
- average trade payable turnover decreased by 9 days to 68 days from 77 days in 2004.

Multi-brand business development strategy

On 30 June 2005, Hong Kong Li Ning, an indirect wholly-owned subsidiary of the Company, entered into an agreement with AIGLE to establish a joint venture in Hong Kong, of which Hong Kong Li Ning and AIGLE each owns 50%. Pursuant to the agreement, the joint venture has set up a wholly foreign-owned enterprise in the PRC, which has been granted for a term of 50 years the exclusive right by AIGLE to manufacture, market, distribute and sell apparel and footwear products for outdoor leisure activities and extreme sports with the AIGLE trademarks in the PRC (excluding Hong Kong, Taiwan and Macau).

AIGLE is a world-renowned company that specializes in the business of apparel and footwear products for outdoor leisure activities. The Group believes that the long-term strategic joint venture is conducive to its objective of developing a multi-brand business and enhancing its overall competitive strengths. By joining forces with AIGLE to develop the PRC market, the Company is set to benefit from the combination of AIGLE's worldwide reputation and extensive experience in designing apparel and footwear products for outdoor leisure activities and the Group's vast sales network and leading position in the PRC market. As of March 2006, three AIGLE stores have commenced operation in the PRC.

The Group will continue to seek mutually beneficial partnerships, facilitating the entry of international brands into the PRC market and developing itself into a multi-brand operator with a portfolio of reputable brands.

FINANCIAL POSITION

Net asset value

As at 31 December 2005, the Group's total net asset value was RMB1,178,296,000 (31 December 2004: RMB1,027,225,000). Net asset value per share was RMB115.09 cents (31 December 2004: RMB115.63 cents).

Liquidity and capital resources

For the year ended 31 December 2005, the Group's net cash inflow from operating activities amounted to RMB138,605,000, as compared with net cash inflow of RMB134,417,000 for 2004.

Net cash (cash and cash equivalents less bank borrowings) as at 31 December 2005 amounted to RMB378,368,000, representing an increase of RMB95,800,000 compared with the net cash position as at 31 December 2004. The increase represented the aforesaid cash inflow from operating activities of RMB138,605,000, proceeds from the issue of new shares upon exercise of share options by Directors and employees of RMB5,952,000, interest income received of RMB13,047,000 and net return on fixed deposit of RMB77,364,000, less dividend payment of RMB69,402,000, net capital expenses of RMB51,152,000, net cash outflow from disposal of a subsidiary amounting to RMB14,737,000, interest expenses paid amounting to RMB1,102,000 and net cash reduction of RMB2,775,000 due to exchange rate fluctuation.

As at 31 December 2005, the Group's cash and cash equivalents amounted to RMB378,368,000 (31 December 2004: RMB322,568,000). There were no outstanding bank borrowings (31 December 2004: RMB40,000,000). Equity holders' equity amounted to RMB1,160,924,000 (31 December 2004: RMB1,010,017,000). The debt to equity holders' equity ratio, expressed in total outstanding bank borrowings as a percentage of equity holders' equity was zero (31 December 2004: 4.0%).

As at 31 December 2005, the Group had not entered into any interest rate swaps to hedge against interest rate risks.





Pledge of assets

As at 31 December 2005, no asset of the Group was pledged to secure bank borrowings or for any other purposes.

Contingent liabilities

As at 31 December 2005, the Group had no material contingent liabilities.

Foreign exchange risk

The Group mainly operated in the PRC with most transactions settled in Renminbi, the lawful currency of the PRC.

Proceeds from the initial public offering of the Company in June 2004 were denominated in Hong Kong dollars, part of which has been invested in fixed deposits denominated in US dollars or Hong Kong dollars. The Company also pays dividends in Hong Kong dollars.

The Group may be exposed to foreign exchange fluctuation in relation to its deposits.

CORPORATE RESTRUCTURING

During the year ended 31 December 2005, the Group conducted a corporate restructuring (the "Restructuring") in respect of Beijing Li Ning, its wholly-owned subsidiary, which is mainly engaged in the sales of LI-NING brand products. Prior to the Restructuring, Beijing Li Ning was a domestic company established in the PRC with limited liability, owned as to 80% by 上海悦奥體育用品有限公司 (Shanghai Yue Ao Sports Goods Co., Ltd.) ("Shanghai Yue Ao") and 20% by 佛山李寧體操學校服務有限公司 (Foshan Li Ning Gymnastics School Services Company Limited), wholly-owned subsidiaries of the Company in the PRC. After the Restructuring, Beijing Li Ning was converted into a sino-foreign equity joint venture held as to approximately 75% by Shanghai Li Ning, a wholly-owned subsidiary of the Company in the PRC, and approximately 25% by Hong Kong Li Ning, a wholly-owned subsidiary of the Company in Hong Kong.

The purpose of the Restructuring was to rationalize the shareholding structure of the Group in order to improve management and operational efficiency. The Group will continue to review and implement further restructuring as and when appropriate.

DISPOSAL OF INTERESTS IN KAPPA BRAND BUSINESS

On 30 June 2005, Shanghai Yue Ao, a subsidiary of the Company, agreed to transfer its entire 80% equity interest in Beijing Dong Xiang, a subsidiary of the Company to 上海泰坦體育用品有限公司 (Shanghai Tai Tan Sporting Goods Co., Ltd.) ("Shanghai Tai Tan") for a consideration of RMB8,614,000 (the "Disposal"). Shanghai Tai Tan is a company owned as to 93% by Mr. Chen Yi Hong, an executive director of the Company before his resignation on 1 September 2005, and his spouse. Shanghai Tai Tan is therefore a connected person of the Company under the Listing Rules.

Concurrent with the Disposal, Shanghai Li Ning, a subsidiary of the Company, agreed to assign all its rights in the outstanding debts of RMB36,200,000 owed to it by Beijing Dong Xiang to Shanghai Tai Tan for a consideration of RMB36,200,000 (the "Assignment").

Beijing Dong Xiang is primarily engaged in the development, manufacturing, sale and distribution of all products related to, named or associated with the KAPPA brand. The KAPPA brand originates from Italy and is currently owned by the BasicNet Group of Italy. Pursuant to the franchised distribution agreement and the technology license agreement between the BasicNet Group and Beijing Dong Xiang (the "KAPPA License Agreements"), Beijing Dong Xiang has been granted the exclusive right to distribute KAPPA brand products in the PRC (including Macau but excluding Hong Kong and Taiwan) until 31 December 2007.

As the KAPPA License Agreements represent only short-term arrangements between the Group and the BasicNet Group and will expire on 31 December 2007, the Company will not be able to enjoy the benefits of growth in value of the KAPPA brand fostered by the Company and funded with its resources in developing KAPPA's business in the long run. The Disposal was therefore consistent with the Group's strategic repositioning to redirect its resources to focus primarily on the development of the Company's own brands, and on the acquisition of or long-term joint venture with international brands, such as the joint venture with AIGLE.

The Directors believed that the Disposal was beneficial to the business development of the Group and in the interest of the Company and its shareholders as a whole. The transaction was approved by independent shareholders of the Company at the extraordinary general meeting held on 11 August 2005 and has been completed. Since the completion of the Disposal and the Assignment, Beijing Dong Xiang has ceased to be a subsidiary of the Company.

OUTLOOK AND DEVELOPMENT STRATEGIES

The increasing average disposable income of the general public of the PRC and the rapid urbanization in the PRC have together been the engines driving the rapid growth of consumption of sports goods in the PRC. Along with changes in lifestyle and increased health awareness, sports have become one of the most popular leisure activities. Moreover, major sports events such as the 2006 World Cup and 2008 Beijing Olympics have also generated a strong passion for and interest in sports within the PRC. As a result, demand for sports goods has been on the rise. The sports goods industry in the PRC is anticipated to offer immense growth potential, particularly in the second and third-tier markets. The Group, which owns a renowned sports goods brand in the PRC and with a solid business and financial position, is well positioned to benefit from this positive trend.

To cope with keen competition in the PRC sports goods market, the Group will raise its core competitive edge to maintain high growth. It will continue to strengthen brand building and marketing, reinforce product design and development and improve supply chain management capabilities to build up its competitiveness in the international arena by 2008.

The Group will continue to focus on developing the two major product lines, namely sports footwear and apparel. We will increase our product appeal to international markets and enhance the professional standards of the LI-NING brand by improving product quality through innovative designs and technological improvements. The Group will also continue with its efforts to increase brand awareness by implementing comprehensive marketing strategies to increase customer loyalty and their preference for our products. Paving way for future development, the Group will further expand its retail network, improve our store display and decoration with a view to further promoting our brand image and store efficiency.

Apart from developing its own brands, the Group will also continue to seek opportunities for long-term cooperation with reputable brands, so as to further enhance its competitive edge and boost future growth.

The Group has an experienced and professional management team to implement its overall corporate planning and strategies, brand building, business development, capital allocation and financial management plans. As our business expands, the management team has been growing with new recruits with strong marketing, retail and sales management experience of multi-national background which further enhance our management and execution capability. By leveraging on our competitive strengths, the Group's management is committed to launching premium sports goods for customers, offering job satisfaction and commitment for its employees and generating attractive returns for Shareholders and investors as a whole.





Exploit
the ***Speed***







The Board of Directors recognizes their mission of creating values and maximizing returns to the Shareholders, while at the same time fulfilling their corporate responsibilities. To this end, we strive to promote and uphold the highest standard of corporate governance.

The Hong Kong Stock Exchange has promulgated a new Code on Corporate Governance Practices (the "Corporate Governance Code") which came into effect in January 2005. The Company has put in place corporate governance practices to comply with all the provisions and most of the recommended best practices of the Corporate Governance Code in 2005.

BOARD OF DIRECTORS

Accountable to the Shareholders, the Board of Directors is collectively responsible for formulating the strategic business direction of the Group and setting objectives for management, overseeing its performance and assessing the effectiveness of management strategies.

The Directors

Currently, the Board comprises nine Directors, including the Chairman and two other Executive Directors, three Non-Executive Directors and three Independent Non-Executive Directors. The biographical details of the Directors are set out on pages 48 to 50 of this annual report. The composition of the Board is well balanced with each Director having sound knowledge, experience and/or expertise relevant to the business operations and development of the Group. All Directors are aware of their collective and individual responsibilities to the Shareholders and have exercised their duties with care, skill and diligence, contributing to the successful performance of the Group.

Each of the Non-Executive and Independent Non-Executive Directors has entered into a service contract with the Company for a term of three years commencing on 28 June 2004 and thereafter shall continue from year to year until terminated by either party giving the other party one month's notice in writing.

All Directors should be subject to retirement by rotation at least once every three years, but are eligible for re-election. A new Director appointed by the Board is subject to election by Shareholders at the general meeting immediately after his or her appointment.

The Company has received from each of the Independent Non-Executive Directors an annual confirmation of his or her independence as required under the Listing Rules. The Company considers all Independent Non-Executive Directors to be independent.

The Company has arranged appropriate insurance cover in respect of legal actions against its Directors and officers with the extent of this insurance being reviewed each year.

Responsibilities of the Board

The Board reviews the performance of the operating divisions against their agreed targets and budgets on a regular basis and also exercises a number of reserved powers, including:

- formulating long-term strategy;
- approving annual budget;
- approving public announcements including the interim and annual financial statements;
- setting dividend policy;
- approving material borrowings and treasury policy; and
- committing to major acquisitions, disposal, formation of joint ventures and capital transactions.

The Directors are responsible for the preparation of the financial accounts of the Company for each financial year and ensuring that these accounts give a true and fair view of the state of affairs of the Group, its results and cash flows for that period. The Directors are also responsible for ensuring that proper accounting records of the Company which disclose the financial position of the Group are kept at all times.

To ensure a balance of power and authority, the role of the Chairman and the Chief Executive Officer is segregated. The Chairman of the Board is Mr. Li Ning. The Chief Executive Officer of the Company is Mr. Zhang Zhi Yong. There is a clear distinction between the Chairman's responsibility for the management of the Board of Directors and the Chief Executive Officer's responsibility for the management of the day-to-day operations of the Group's business.

Board meetings

Board meetings are scheduled in advance to facilitate maximum attendance of Directors. The meeting agenda is set after consulting with members of the Board. The Board held six meetings in 2005. Individual attendance of each Director at the meetings is set out below:

Member of the Board	Number of Board meetings attended	Attendance rate
<i>Executive Directors</i>		
Li Ning	6 out of 6	100%
Zhang Zhi Yong	6 out of 6	100%
Tan Wee Seng	6 out of 6	100%
<i>Non-Executive Directors</i>		
Lim Meng Ann	3 out of 6	50%
Stuart Schonberger	6 out of 6	100%
Fong Ching, Eddy	5 out of 6	83%
<i>Independent Non-Executive Directors</i>		
Koo Fook Sun, Louis	6 out of 6	100%
Wang Ya Fei, Jane	6 out of 6	100%
Chan Chung Bun, Bunny	5 out of 6	83%

EXECUTIVE COMMITTEE

The Board has established the Executive Committee to enhance management efficiency. The Executive Committee comprises three Executive Directors, namely, Mr. Zhang Zhi Yong (Chairman of the Committee), Mr. Li Ning, Mr. Tan Wee Seng and Ms. Tina Leh, the General Manager of the LI-NING brand. The Executive Committee is delegated by the Board of Directors to perform mainly the following duties:

- formulate the Group's overall operational and financial plans for the approval by the Board;
- examine and approve strategic business directions at the subsidiary level;
- examine and approve financial arrangements of the companies of the Group within a limit approved by the Board; and
- decide on the appointment and removal of the senior management staff of subsidiary companies.

The Board of Directors reviews the terms of reference of the Executive Committee annually to ensure the proper and appropriate delegation of authority is in place.

In furtherance of good corporate governance, the Board has set up a number of other committees, including the Audit Committee, the Remuneration Committee and the Nomination Committee. Each of these Committees reports regularly to the Board, addressing major issues and findings with valuable recommendations for the decision making of the Board. The particulars of each of these Committees are set out hereunder.

AUDIT COMMITTEE

The Audit Committee is responsible for reviewing the Group's financial information, overseeing the Group's financial reporting systems and internal control procedures, making recommendation to the Board on the appointment, re-appointment and removal of the external auditor, and approving the remuneration and terms of engagement of the external auditor. The Audit Committee comprises its Chairman, Mr. Koo Fook Sun, Louis, an Independent Non-Executive Director and two other members, namely, Mr. Stuart Schonberger, a Non-Executive Director and Ms. Wang Ya Fei, Jane, an Independent Non-Executive Director. All Audit Committee members possess appropriate professional qualifications or accounting or related financial management expertise in discharging their responsibilities of being a member of the Audit Committee.

The terms of reference of the Audit Committee, which are available on the Company's website www.lining.com, follow the guidelines set out by the Hong Kong Institute of Certified Public Accountants and have been revised in 2005 to comply with the Corporate Governance Code.

The Audit Committee held three meetings in 2005 and had attended to the following matters:

- review the internal and external audit findings, the accounting principles and practices adopted by the Group, Listing Rules and statutory compliance in relation to financial reporting; and
- discuss auditing, internal controls, risk management and financial reporting matters including the interim and annual accounts, before recommending them to the Board for approval.

The external auditors, the Chief Executive Officer, the Chief Financial Officer and the manager of the Internal Audit Department also attended these meetings. Individual attendance of each Audit Committee member at the meetings is set out as follows:

Member of the Audit Committee	Number of Committee meetings attended	Attendance rate
Koo Fook Sun, Louis	3 out of 3	100%
Stuart Schonberger	2 out of 3	67%
Wang Ya Fei, Jane	3 out of 3	100%

NOMINATION COMMITTEE

The Nomination Committee was established in June 2005 and is chaired by Mr. Lim Meng Ann, a Non-Executive Director, with Mr. Koo Fook Sun, Louis and Ms. Wang Ya Fei, Jane as the other two members, both being Independent Non-Executive Directors.

The Nomination Committee adopts the recommended terms of reference as set out in the Corporate Governance Code as its terms of reference which are also published on the Company's website. Its main role is to evaluate the composition of the Board, make recommendations to the Board on the appointment and succession of Directors by reference to pre-set guidelines including appropriate professional knowledge and industry experience, personal ethics, integrity and skills and time commitment of Directors to the Board. The Nomination Committee carries out the process of selecting and recommending candidates for directorship including consideration of referrals and engagement of professional recruitment consultants when necessary.

The Nomination Committee met once in 2005 with full attendance of its members. At that meeting, the Committee reviewed the structure, size and composition (including the skills, knowledge and experience) of the Board and concluded that the current Board comprises a sufficient number of directors and is well balanced with each Director having sound knowledge, experience and/or expertise relevant to the business operations and development of the Group.

REMUNERATION COMMITTEE

The Remuneration Committee is chaired by Ms. Wang Ya Fei, Jane, an Independent Non-Executive Director and with two other members, Mr. Lim Meng Ann, a Non-Executive Director and Mr. Koo Fook Sun, Louis, an Independent Non-Executive Director.

The primary role of the Remuneration Committee is to regularly review human resources management policies, make recommendations on the compensation and benefit plans of Directors and senior executives, and set performance goals for senior executives of the Group.

The Remuneration Committee has revised its terms of reference in 2005 to comply with the Corporate Governance Code. The current terms of reference of the Remuneration Committee are published on the Company's website.

The Remuneration Committee met four times in 2005 and had attended to the following:

- review and approve Directors' and senior executives' remuneration including, among others, granting of share options and annual bonus;
- discuss and consider the financial impact of expensing share options in the Company's income statement; and
- review remuneration policy and set key performance indicators for senior management.

In discharge of its functions, the Remuneration Committee consulted and sought advice from external consultants, the Chairman, the Chief Executive Officer and the director of Human Resources of the Company.

Individual attendance of each of its members at the Remuneration Committee meetings is set out as follows:

Member of the Remuneration Committee	Number of Committee meetings attended	Attendance rate
Wang Ya Fei, Jane	4 out of 4	100%
Lim Meng Ann	4 out of 4	100%
Koo Fook Sun, Louis	3 out of 4	75%

The primary goal of the Group's remuneration policy for Executive Directors is to enable the Company to retain and motivate Executive Directors by linking their compensation with their individual performance as measured against the corporate objectives and the Group's operating results, taking into accounts also of the comparable market conditions.

The principal elements of the remuneration package of an Executive Director include director's fee, basic salary, discretionary bonus and share options.

Remuneration of a Non-Executive Director includes mainly the director's fee which is a matter for the Board to decide.

The Company reimburses reasonable out-of-pocket expenses incurred by Directors in the course of performing their duties as Directors.

Directors do not participate in decisions or meetings approving their own remuneration.

The emoluments paid to each Director for the year ended 31 December 2005 are set out in note 7 to the accounts.

EXTERNAL AUDITORS

For the year ended 31 December 2005, the total remuneration for the audit services provided by the external auditors amounted to RMB2,788,000. The audit fee was approved by the Audit Committee.

For the year ended 31 December 2005, the total remuneration for the permissible non-audit services provided by the external auditors (including any entity under common control, ownership or management with the auditors) amounted to RMB1,000,000. The non-audit services mainly comprised tax compliance and other tax advisory services. The Audit Committee had been briefed in respect of the non-audit services and related fees and was satisfied that such services did not (in terms of the nature of services and the amount of fees charged) affect the independence of the external auditors.

The re-appointment of PricewaterhouseCoopers as auditors of the Company has been recommended by the Audit Committee and endorsed by the Board and is subject to approval by the Shareholders at the forthcoming annual general meeting.

INTERNAL CONTROL

Internal control system

The Board has the overall responsibility for the Company's system of internal control and evaluation of its effectiveness through the review by the Audit Committee. The Company's system of internal control plays a key role in the management of risks that are significant to the fulfillment of its business objectives. Procedures have been designed for safeguarding assets against unauthorized use or disposition; maintaining proper accounting records and the reliability of financial information used within the business or for publication. The procedures provide reasonable but not absolute assurance against material errors, losses or fraud. Procedures have also been designed for compliance with applicable laws, rules and regulations.

During the year of 2005, the Company engaged external professional advisers and initiated a project to review and standardize internal control manuals for its financial, operational and compliance controls and risk management functions for the Group with a view to further enhancing the effectiveness of the Group's internal control system.

A review of the effectiveness of the Company's internal control system covering all material control, including financial, operational and compliance controls and risk management functions, is conducted annually. The review is conducted by reference to the COSO (The Committee of Sponsoring Organization) internal control framework, which assesses the Group's internal control system against the five elements of control environment, risk assessment, control activities, communication and monitoring. The results of the review for the year ended 31 December 2005 were reported to the Audit Committee and the Board.

The Board confirms that systems and procedures are in place to identify, control and report on significant risks involved in achieving the Company's strategic objectives. Exposures to these risks are monitored by the Board with the support of various committees and senior management. No material deficiencies had been identified so far and there were no significant areas of concern. The Board considered that the Company's internal control system is adequate and effective and the Company has complied with the provisions on internal control of the Corporate Governance Code.

With respect to procedures and internal controls for the handling and dissemination of price-sensitive information, the Company is fully aware of its obligations under the Listing Rules and the overriding principle that price-sensitive information should be announced immediately when it is the subject of a decision. The Company's policy has included a strict prohibition on the unauthorized use of confidential or insider information and has established and implemented procedures for responding to external enquiries about the Group's affairs. The Chief Financial Officer, the Chief Executive Officer and the Chairman are identified and authorized to act as the Company's spokespersons to respond to enquiries made about the Group's affairs.

Internal audit

The Group has an Internal Audit Department which plays an important role in the Group's internal control framework. The tasks of the Department include regular review and audit of the practices, procedures and internal control systems on those areas of the Group's activities with the greatest perceived risks and special review of areas of concern identified by management or the Audit Committee. The Internal Audit Department reports directly to the Chief Financial Officer and has direct access to refer matters to the Audit Committee.

The annual work plan of internal audit is reviewed and endorsed by the Audit Committee and a summary of major audit findings is reported regularly to the Audit Committee. During the year of 2005, the Internal Audit Department reviewed the key operations of the Group, identified areas of concern and held constructive communications with the Audit Committee.

DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") contained in Appendix 10 of the Listing Rules as the Company's code of conduct regarding securities transactions by its Directors. Having made specific and reasonable enquiries of all Directors, the Company is satisfied that all Directors complied with their obligations under the Model Code regarding their securities transactions during the year.

Specified employees who are likely to be in possession of unpublished price-sensitive information of the Group are also subject to compliance with guidelines on no less exacting terms than the Model Code. No incident of non-compliance was noted by the Company in 2005.

SHAREHOLDERS' RIGHTS

Under the Company's articles of association, any one or more Shareholders holding not less than one-tenth of the paid up capital of the Company carrying the right of voting at general meetings of the Company shall at all times have the right, by written requisition to the Board to require an extraordinary general meeting to be called by the Board for the transaction of any business specified in such requisition.

To safeguard Shareholders' rights, the Company adopts the policy of voting by poll for all resolutions put forward at any Shareholders' meetings.

Shareholders may send their enquiries requiring the Board's attention to the Company Secretary at the Company's principal place of business in Hong Kong. Other general enquiries can be directed to the Company through its Investor Relations Manager, whose contact information is published on the Company's website.

INVESTOR RELATIONS

The Company believes that effective communication with the investment community is essential for enhancing investors' knowledge and understanding of the Company's business performance and strategies. To achieve this, the Company pursues a proactive policy of promoting investor relations and communications. The main purpose of the Company's investor relations policy, therefore, is to enable investors to have access, on a fair and timely basis, to information that is reasonably required for making the best investment decisions.

In 2005, as part of the regular program of investor relations, the Chief Financial Officer and the Investor Relations team of the Company held regular briefings, attended investor forums and participated in road shows with institutional investors and financial analysts in the PRC, Hong Kong and other overseas countries to keep them abreast of the Company's development and promote two-way communications. When the Company announced its interim and annual results, the Chairman, the Chief Executive Officer and the Chief Financial Officer conducted briefings with analysts and the press to apprise them of the Group's operating results as well as business strategies and outlook. The public could access details of these events and the relevant presentation materials through the Company's websites.

The Company believes that Shareholders' meeting is an important channel and the best opportunity for face-to-face dialogue with Shareholders. At the last annual general meeting held on 12 May 2005, all Executive Directors and most of the Non-Executive Directors and Independent Non-Executive Directors were present at the meeting to address or provide explanation to Shareholders on questions raised in respect of the Group's business strategies and financial results.

During the year of 2005, investors continued to have access to up-to-date corporate information of the Group through the corporate websites of www.lining.com and www.irasia.com/listco/hk/lining. These websites enable the public to obtain information on the Group's establishment, financial performance and latest business developments. Financial calendar for Shareholders are set out on page 122 of this annual report. Shareholders may also find the relevant information on the Company's websites.

By order of the Board

ZHANG Zhi Yong

Executive Director & Chief Executive Officer

TAN Wee Seng

Executive Director & Chief Financial Officer

Hong Kong, 22 March 2006





Perform
the ***Skill***

DIRECTORS

Executive Directors

Mr. LI Ning (李寧), aged 43, is the founder of the LI-NING brand and the Group's Chairman and an Executive Director. He is primarily responsible for the Group's overall corporate strategies, planning and business development.

Mr. Li Ning is one of the most outstanding athletes in the 20th century. In the 6th World Cup Competition in 1982, Mr. Li won six gold medals for men's artistic gymnastics and was named “體操王子” (the “Prince of Gymnastics”) in the PRC. In the 23rd Los Angeles Olympic Games in 1984, Mr. Li won three gold, two silver and one bronze medals, making him the athlete winning the most medals of that Olympic Games. In 1987, Mr. Li became the only Asian member of Athlete's Commission of the International Olympic Committee. From 1993 to 2000, Mr. Li served as a member of the Men's Artistic Gymnastics Technical Committee of the Federation Internationale De Gymnastique. In 1999, Mr. Li was voted one of the “World's Most Excellent Athletes in the 20th Century” by the World Sports Correspondent Association.

After retiring in 1989 from his athlete career, Mr. Li Ning initiated the idea of the LI-NING brand with the goal of creating the first national sports goods brand in the PRC. He has dedicated the past 16 years to expanding and promoting the Group's business, as well as developing the PRC's sports goods industry. Mr. Li has a bachelor's degree in law from Peking University (北京大學) and completed the executive M.B.A. program of Guanghua School of Management of Peking University (北京大學光華管理學院).

Mr. ZHANG Zhi Yong (張志勇), aged 37, is the Chief Executive Officer and an Executive Director. Mr. Zhang joined the Group in December 1992 as a finance manager of Beijing Li Ning, became the financial controller of Beijing Li Ning in April 1999 and was the general manager of Beijing Li Ning from March 2001 to December 2005. Mr. Zhang is primarily responsible for the overall development, sale and marketing of the Group's products. Mr. Zhang has over 10 years of experience in financial and marketing management. He has a bachelor's degree from Beijing College of Economics (北京經濟學院) and completed the executive M.B.A. program of Guanghua School of Management of Peking University (北京大學光華管理學院).

Mr. TAN Wee Seng (陳偉成), aged 50, is the Chief Financial Officer, an Executive Director, Qualified Accountant and the Company Secretary. Mr. Tan joined the Group in January 2003. He is primarily responsible for the Group's overall financial management, capital planning and allocation, corporate secretarial affairs and investor relations. He has over 28 years of experience in the fields of financial, business, acquisition and post-acquisition management. Prior to joining the Group, Mr. Tan held various senior management positions in a number of multinational corporations. From 1999 to 2002, Mr. Tan has been the senior vice president of the China, Mongolia and North Korea regions and Head of Information and Trading Systems of Reuters China. Prior to that, he was the managing director of a Reuters Hong Kong subsidiary, AFE Computer Services Limited (a major domestic equity and financial information services company branded under the Stock Market Channel), and a director of its Australia subsidiary, Infocast Pty Limited. Mr. Tan was also the Reuters East Asia regional finance manager. Mr. Tan is a member of the Chartered Institute of Management Accountants in the United Kingdom.

Non-Executive Directors

Mr. LIM Meng Ann (林明安), aged 42, is a Non-Executive Director, Chairman of the Nomination Committee and a member of the Remuneration Committee. Mr. Lim joined the Group in July 2003. Mr. Lim is the senior vice president of, and is responsible for the investment activities in Greater China for GIC Special Investments Pte. Ltd., the private equity arm of Government of Singapore Investment Corporation Pte. Ltd., which he joined in 1997. Prior to that, he was an investment officer of International Finance Corporation, the private sector investment arm of the World Bank group, from 1993 to 1997. Mr. Lim has a B.Eng degree (first class honours) from University College of London and a MBA degree from University of Strathclyde. He is also a Chartered Financial Analyst.

Mr. Stuart SCHONBERGER, aged 47, is a Non-Executive Director and a member of the Audit Committee. Mr. Schonberger joined the Group in January 2003. Mr. Schonberger is a managing director of CDH China Management Company Limited, the management company for CDH China Fund, L.P., which is a private equity fund focused on investments in the PRC. Prior to joining CDH China Management Company Limited, Mr. Schonberger worked in the private equity group of China International Capital Corporation from 1998 to 2002. Prior to that, Mr. Schonberger worked for the First National Bank of Chicago in New York City. Mr. Schonberger received his M.B.A. degree from New York University's Graduate School of Business and B.A. degree from Wesleyan University. He is currently a director of GEM Services Inc. and eBIS Company Limited.

Mr. FONG Ching, Eddy (方正), aged 59, is a Non-Executive Director. Mr. Fong joined the Group in June 2004. Mr. Fong is a certified public accountant and was formerly a senior partner of PricewaterhouseCoopers, an international accounting firm. Apart from pursuing his professional career, Mr. Fong is active in public and community services in Hong Kong. He was appointed as Justice of Peace in 1996 and awarded Silver Bauhinia Star medal in 2000 by the Hong Kong Government. Mr. Fong is currently a non-executive director of the Securities and Futures Commission and the Hong Kong Applied Science and Technology Research Institute Company Limited and a council member of the Open University of Hong Kong. Mr. Fong is also an independent non-executive director of China Resources Power Holdings Company Limited, Parkson Retail Group Limited, Tradelink Electronic Commerce Limited (listed on the Main Board of the Hong Kong Stock Exchange) and SUNeVision Holdings Limited (listed on the Growth Enterprise Market of the Hong Kong Stock Exchange). Mr. Fong graduated from the University of Kent in the United Kingdom and was also conferred as Honorary Doctor of Civil Law.

Independent Non-Executive Directors

Mr. KOO Fook Sun, Louis (顧福身), aged 49, is an Independent Non-Executive Director, Chairman of the Audit Committee and a member of the Remuneration Committee and the Nomination Committee. Mr. Koo joined the Group in June 2004. Mr. Koo is the managing director of Hercules Capital Limited, a corporate finance advisory firm. He was the managing director and head of the corporate finance department of a major international bank, a director and chief executive officer of a company listed on the Main Board of the Hong Kong Stock Exchange. He currently also serves as an independent non-executive director of Weichai Power Company Limited, Midland Holdings Limited and Good Friend International Holdings Inc. (listed on the Main Board of the Hong Kong Stock Exchange), and EVI Education Asia Limited (listed on the Growth Enterprise Market of the Hong Kong Stock Exchange). Mr. Koo graduated with a bachelor's degree in business administration from the University of California at Berkeley and is a certified public accountant.

Ms. WANG Ya Fei (王亞非), aged 50, is an Independent Non-Executive Director, Chairman of the Remuneration Committee and a member of the Audit Committee and the Nomination Committee. Ms. Wang joined the Group in January 2003. Ms. Wang has 14 years of experience in management and corporate finance matters. Ms. Wang has been the director and deputy general manager of Beijing Investment Consultants Inc. since 1996. She has also been an associate professor in Guanghua School of Management of Peking University (北京大學光華管理學院) since 1995. She has a bachelor's degree in international politics from Fudan University (復旦大學) in Shanghai and was an exchange scholar in Maryland University, College Park in the United States. Ms. Wang also has a M.B.A. degree from the University of Lancaster in the United Kingdom.

Mr. CHAN Chung Bun, Bunny (陳振彬), aged 48, is an Independent Non-Executive Director. Mr. Chan joined the Group in June 2004. Mr. Chan has more than 25 years of experience in the garment industry and is currently the chairman of Prospective Holdings Ltd. Mr. Chan is active in community affairs. He is currently the chairman of Kwun Tong District Council. In 2002, Mr. Chan was appointed as Justice of Peace. In 2003, Mr. Chan took up chairmanship of the Pok Oi Hospital Board of Directors. In 2004, Mr. Chan was awarded the Bronze Bauhinia Star medal by the Hong Kong Government.

SENIOR MANAGEMENT

LI-NING brand

Ms. Tina LEH (樂淑鈺), aged 42, is a member of the Executive Committee of the Board of Directors and the General Manager of the LI-NING brand. She joined the Group in December 2005. Ms. Leh is primarily responsible for the overall management of the business operation of the LI-NING brand. She has 20 years of experience in brand management of multinational company. Prior to joining the Group, she held senior management positions in the PRC subsidiaries of various multinational companies. Ms. Leh has a bachelor's degree of Media in Taiwan Shixin University (臺灣世新大學), and is currently participating in an executive M.B.A. program of Fudan University (復旦大學) in Shanghai.

Mr. WU Xian Yong (伍賢勇), aged 34, is the Deputy General Manager of marketing of the LI-NING brand. He joined the Group in February 2004. Mr. Wu is primarily responsible for branding, marketing and product strategies of the LI-NING brand. Mr. Wu has 9 years of experience in marketing and brand management. Prior to joining the Group, he held various positions in various PRC subsidiaries of a multinational consumer goods company. He has a bachelor's degree from Xi'an Jiao Tong University (西安交通大學) and a bachelor's degree in international commerce from Renmin University of China (中國人民大學).

Mr. GUO Jian Xin (郭建新), aged 36, is the Deputy General Manager of operation of the LI-NING brand. He joined the Group in October 1997. Mr. Guo is primarily responsible for the procurement, manufacturing, quality control and logistics management of the LI-NING brand products. Mr. Guo has over 7 years of experience in logistics and procurement management. He graduated from South China Normal University (華南師範大學) majoring in mathematics.

Mr. YE Xue Feng (葉學鋒), aged 42, is the Deputy General Manager of sales of the LI-NING brand. He joined the Group in July 2004. Mr. Ye is primarily responsible for the formulation and implementation of the nationwide sales plan of the LI-NING brand, the overall management of the sales subsidiaries and the sports fashion department, the establishment of the Group's sales channels, the formulation and implementation of customer development strategy. Before joining the Group, Mr. Ye worked for the PRC subsidiaries of various multinational companies. He has more than 11 years of experience in sales management. He graduated from Fujian College of Traditional Chinese Medicine (福建中醫學院) with a bachelor's degree in medical science, and completed an executive M.B.A program of Ross Business School of British Leicester University.

Mr. WU Wei Guo (吳偉國), aged 46, is the Deputy General Manager of the LI-NING brand footwear products. He joined the Group in January 2005. Mr. Wu is primarily responsible for the development and management of the LI-NING brand footwear products, including planning, research and development and design. Prior to joining the Group, Mr. Wu worked in the PRC subsidiaries of various multinational companies and was in charge of marketing and product management functions. He has a bachelor's degree in business administration from University of Wisconsin of the United States.

“AIGLE” brand

Mr. LIU Da Jun (劉達君), aged 37, is the General Manager of the “AIGLE” brand. Mr. Liu joined the Group in August 2005. He is primarily responsible for the overall operation management of the “AIGLE” brand. Prior to joining the Group, Mr. Liu held senior management positions in the PRC subsidiaries of various multinational companies and has over 10 years of experience in marketing and product development. Mr. Liu graduated from Dan Jiang University (淡江大學) and has a bachelor’s degree in statistics. He is currently participating in an executive M.B.A. program of China Europe International Business School (中歐國際工商學院).

Manufacturing and others

Mr. LIANG Yong Gen (梁永根), aged 40, is the Deputy General Manager of Guangdong Li Ning Sports Development Co., Ltd. He joined the Group in February 1992. Mr. Liang is primarily responsible for the management of the apparel manufacturing operations in Sanshui, the PRC. Mr. Liang has over 14 years and 6 years of experience in accounting and operations management, respectively. He graduated from Jinan University (暨南大學).

Mr. XIE Tie Hua (謝鐵華), aged 45, is the Director of operations of Foshan Li Ning Gymnastics School Service Co., Ltd. He joined the Group in May 1992. Mr. Xie is primarily responsible for managing the Group’s gymnastics training school. Prior to joining the Group, Mr. Xie was a member of the Chinese National Gymnastics Team from 1979 to 1985 and the coach of Japan’s Osaka Gymnastics Club from 1989 to 1990. He graduated from Jilin Gymnastics University (吉林體操大學).

Functional divisions

Mr. ZHANG Hui (張輝), aged 35, is the Director of Strategic Development. Mr. Zhang joined the Group in November 2000. Mr. Zhang is primarily responsible for corporate strategic planning and supervision, new business development and management. Mr. Zhang has a bachelor’s degree from Financial and Banking Institute of China (中國金融學院). He graduated from Tsinghua University (清華大學) with a master’s degree in international commerce management.

Ms. DAI Qian (戴倩), aged 34, is the Director of Human Resources. Ms. Dai joined the Group in June 1997. Ms. Dai is primarily responsible for establishing the strategic human resources system, human resources echelon cultivation system, building up compensation, benefit system and legal compliance system, and human resources administration and management. She has over 8 years of experience in human resources management and administration. Ms. Dai has a bachelor’s degree from the Beijing University of Science and Technology (北京科技大學) and a master’s degree in international commerce management from Renmin University of China (中國人民大學).

Mr. ZHANG Jun (張峻), aged 37, is the Director of Information Technology. He joined the Group in July 2005. Mr. Zhang is primarily responsible for building up the IT system of the Group, including strategic planning, project implementation, information operation and resource management. Prior to joining the Group, he worked in a reputable IT group in the PRC. Mr. Zhang has a bachelor's degree from Beijing University of Posts and Telecommunications (北京郵電大學), and is currently participating in an executive M.B.A. course in Peking University (北京大學).

Mr. ZHANG Xiao Yan (張小岩), aged 43, is the Director of Governmental and Public Relationship. He joined the Group in January 2004. Mr. Zhang is primarily responsible for governmental and public relationship matters in relation to the Company. Mr. Zhang has 13 years of experience in marketing and management. Prior to joining the Group, he held marketing positions in the PRC subsidiaries of various multinational consumer goods companies. Mr. Zhang has a bachelor's degree and a master's degree from Beijing Diplomatic College (北京外交學院).

Mr. XU Wei Jun (徐偉軍), aged 37, is an assistant to the Chief Executive Officer. Mr. Xu is primarily responsible for corporate strategy analysis and project management. He joined the Group in August 2001. Prior to joining the Group, he worked in the PRC subsidiaries of various multinational consumer goods companies. Mr. Xu has a bachelor's degree from Zhongshan University (中山大學).



A DISTINCTIVE CORPORATE CULTURE

We believe that a good corporate culture is an indispensable element for nurturing high-calibre employees. Being a professional sports goods enterprise, we advocate sports and the spirit of sports. We endeavour to achieving our mission of “Through sports, we inspire people the desire and power to make breakthroughs”. We look forward to fulfilling our vision of becoming “A world’s leading brand in the sports goods industry”. We believe in “Integrity, professionalism, passion, breakthroughs and trust” as our core values. With these core believes, the Group has strengthened itself over the years, and so has its workforce. We deeply believe that talent is an invaluable asset to the Company and we are pleased to see that our combined efforts in offering a good working environment, a wide range of training and personal development programs, as well as an attractive remuneration package, have enabled us to retain a team of talented workforce that fully appreciates the Group’s corporate culture.

The Group organizes an array of activities so that each and every individual staff can effectively experience the culture advocated by the Company. The theme activities held during the year under review included 2005 Corporate Games, 15th Anniversary Celebration, Product Culture Festival, Christmas family activities and Innovation Contest. As a result of these activities, we develop mutual trust among staff and generate the enthusiasm and conviction to motivate all staff to contributing towards a

common goal. In addition, the Group has set up 15 staff clubs throughout the PRC with sports facilities for soccer, basketball, tennis, running, gymnasium exercises, table tennis, badminton, golf, swimming and other outdoor activities. These clubs enabled our employees to experience the spirit of sports and the passion and power of sports activities. They provide the drive and motivation for the staff, bringing the potential of individuals and teams into full play. We take pride to announce that these efforts had earned us two major recognitions:

- on 17 November 2005, the Company was honored as “The 2005 WorkChina™ Best Company to Work For” in a survey jointly organized by Watson Wyatt and Fortune Magazine (Chinese Edition) on employees commitment to the enterprises they work for in the PRC; and
- the Company was also nominated as a “二零零五年度最佳雇主”(“2005 Best Employer”) in a survey organized by the Economic Channel of CCTV in the PRC.

EMPLOYEES AND REMUNERATION POLICY

As at 31 December 2005, the Group had about 2,890 employees (31 December 2004: 4,402 employees). The decrease in the number of employees was mainly due to the outsourcing of sales activities which led to a reduction in sales staff during the year under review.

The Group endeavours to motivate staff with a performance-based remuneration system. On top of basic salary, staff with outstanding performances are rewarded with bonuses in the form of cash, share options, honorary awards, or a combination of these. These effectively align the benefits of the staff with the growth of the Group.

In addition, the Company entered into cooperation with internationally acclaimed human resources management consultants such as Watson Wyatt, Mercer Human Resource Consulting and Towers Perrin, in respect of long-term enhancement of the Group's incentive system. We are confident that our remuneration system is competitive in retaining quality staff.

COMPREHENSIVE LEARNING AND DEVELOPMENT SYSTEM

The Group has always positioned itself as an organization that advocates lifetime learning. While a good corporate culture provides employees with good working environment and atmosphere, a comprehensive learning and development system provides the staff with paths and opportunities for further development.

During the year under review the Group implemented an all-round internal learning and development system that encompassed various trainings including leadership and management skills, job-related professional skills and personal development. A total of 1,627.1 days of training in connection with the adaptation of corporate culture, leadership and management skills were provided to the Group's core management members. On the basis of a core management team of 204 staff, the average training time per capita was 8.0 days. On the other hand, a total of 5,172.3 days of training in connection with the adaptation of corporate culture, professional knowledge and skills were provided to the Group's management and technical staff. On the basis of 690 staff in this group, the average training time per capita was 7.5 days.

SOCIAL RESPONSIBILITY

In the course of its relentless pursuit for brand excellence, the Group is also committed to undertaking responsibilities and obligations as a member of the community by contributing to the society.

The Group has been actively involved in sports welfare activities since its inception. Resources have been deployed to promote the following three major types of activities:

- sports and sports-related activities;
- educational activities; and
- activities that promote a green environment.

Internally, as a socially responsible corporate citizen, the Company has used its best endeavour in realizing the ideal of a "Green Earth" by strongly advocating the use of environmental-friendly materials to reduce and avoid pollution.

Externally, the Company has been a keen supporter for the setting up of 中華體育基金會 (China Sports Foundation). It started participating in the charitable "Lifeline Express" and construction of 李寧希望小學 (Li Ning Hope Primary School) in 2003 and 2005, respectively. The Company will further deploy resources on sports welfare and youth development charitable activities. The Company will continue to play an active role in the participation, and promote staff voluntary participation, in various other charitable and fund-raising activities. On-site visits will also be arranged for our employees with an aim of cultivating their sense of social responsibility and fulfilling the obligations of the Company as a corporate member of the community. The sense of social responsibility of our staff can be reflected in their voluntary participation in bone marrow and blood donation in 2005.

The Company took part in the following charitable events in 2005:

- In January 2005, the Company's staff made donations to the tsunami victims in Southeast Asia through the National Headquarters of the Red Cross Society of China;
- In July 2005, to mark its 15th Anniversary, the Company sponsored all the clothes of the 西藏光明行 (Tibet Sunlight Tour) campaign with four of its staff joining the program as a gesture of its compassion for the community;
- In August 2005, the Company successfully raised RMB260,000 from its staff through an internal fund-raising campaign for 李寧希望小學 (Li Ning Hope Primary School). The funds raised will be used for improving facilities of 李寧希望小學 (Li Ning Hope Primary School) in Hebei and Guangxi;
- In November 2005, the Company donated sportswear, footwear and athletic equipment to 黃庄小學 (Huangzhuang Primary School), a school attended by children of workers in Beijing, to help realize their athletic dreams; and
- In December 2005, the Company made donations in kind of over RMB13 million to areas suffering from disasters and poverty through the National Headquarters of the Red Cross Society of China.

The Group will continue to deploy resources in supporting welfare activities and commit to contributing towards developing a harmonious society.

Report of the Directors

The Directors have pleasure in presenting their report together with the audited financial statements of the Company and of the Group for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. The principal activities of its subsidiaries are brand development, design, manufacturing, sale and distribution of sports-related footwear, apparel and accessories sold mainly in the PRC under the Group's own LI-NING brand.

Particulars of the Company's subsidiaries and its interest in a jointly controlled entity as at 31 December 2005 are set out in notes 17 and 18, respectively, to the accounts.

RESULTS AND DIVIDENDS

The results of the Group for the year ended 31 December 2005 and the state of the Company's and the Group's affairs as at that date are set out in the financial statements on pages 74 to 121 of this annual report.

An interim dividend of RMB2.30 cents (equivalent to HK2.21 cents) per ordinary share, totalling RMB22,649,000 was paid on 30 September 2005. The Directors recommend the payment of a final dividend of RMB5.00 cents (equivalent to HK4.81 cents) (2004: RMB4.57 cents, equivalent to HK4.30 cents) per ordinary share in respect of the year ended 31 December 2005. The translation of RMB into Hong Kong dollars is made at the exchange rate of HK\$1.00=RMB1.0403 as at 31 December 2005 for illustration purpose only. The actual translation rate for the purpose of dividend payment in Hong Kong dollars will be based on the official exchange rate of RMB against Hong Kong dollars as quoted by the People's Bank of China on 12 May 2006, being the date of the annual general meeting on which the final dividend is proposed to the Shareholders for approval.

Subject to the approval of the Directors' recommendation by the Shareholders at the annual general meeting to be held on 12 May 2006, the final dividend will be paid on or about 22 May 2006 to the Shareholders whose names appear on the registers of members of the Company on 12 May 2006. The registers of members of the Company will be closed from Tuesday, 9 May 2006 to Friday, 12 May 2006 (both days inclusive). In order to qualify for the above mentioned proposed final dividend, all transfers accompanied by the relevant share certificates must be lodged with the Company's Hong Kong branch share registrar and transfer office, Computershare Hong Kong Investor Services Limited at Shops 1712 – 1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:00 p.m. on Monday, 8 May 2006.

RESERVES

As at 31 December 2005, distributable reserves of the Company amounted to RMB480,137,000 (2004: RMB555,780,000). Movements in the reserves of the Group during the year are set out in note 26 to the accounts.

Report of the Directors

MAJOR CUSTOMERS AND SUPPLIERS

Sales and purchases of the Group attributable to its major customers and suppliers respectively in the financial year were as follows:

	Year ended 31 December	
	2005	2004
	% of total turnover	% of total turnover
Five largest customers	16.6	13.1
The largest customer	5.6	3.9
<hr/>		
	% of total purchases	% of total purchases
Five largest suppliers	40.8	30.2
The largest supplier	14.2	9.1

All of the above five largest customers and suppliers of the Group are independent third parties. To the best knowledge and belief of the Directors, none of the Directors, their associates or any Shareholder owning more than 5% of the issued share capital of the Company, has any interest in any of the Group's five largest customers or suppliers as disclosed above.

BANK LOANS AND OTHER BORROWINGS

Particulars of bank loans and other borrowings of the Company and the Group as at 31 December 2005 are set out in note 24 to the accounts.

DONATIONS

Charitable and other donations made by the Group during the year amounted to RMB13,535,000 (2004: RMB75,000).

PROPERTY, PLANT AND EQUIPMENT

Movements in the Group's property, plant and equipment during the year are set out in note 12 to the accounts.

SHARE CAPITAL

Movements in the share capital of the Company during the year are set out in note 25 to the accounts.

FIVE-YEAR FINANCIAL HIGHLIGHTS

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on pages 6 and 7 of this annual report.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's articles of association or the laws of Cayman Islands where the Company is incorporated.

DIRECTORS

The Directors of the Company during the year and up to the date of this report are as follows:

Executive Directors

Mr. Li Ning

Mr. Zhang Zhi Yong

Mr. Tan Wee Seng

Mr. Chen Yi Hong (re-elected on 12 May 2005 and resigned on 1 September 2005)

Non-Executive Directors

Mr. Lim Meng Ann

Mr. Stuart Schonberger (re-elected on 12 May 2005)

Mr. Fong Ching, Eddy

Independent Non-Executive Directors

Mr. Koo Fook Sun, Louis

Ms. Wang Ya Fei, Jane

Mr. Chan Chung Bun, Bunny (re-elected on 12 May 2005)

In accordance with article 87 of the Company's articles of association, Mr. Tan Wee Seng, Mr. Fong Ching, Eddy and Ms. Wang Ya Fei, Jane shall retire from the office and, being eligible, offer themselves for re-election as Directors at the forthcoming annual general meeting.

DIRECTORS' SERVICE CONTRACTS

Each of the Non-Executive and Independent Non-Executive Directors has entered into a service contract with the Company for a term of three years commencing on 28 June 2004 and shall continue thereafter from year to year until terminated by either party giving one month's notice in writing to the other party.

None of the Directors proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not determinable by the Company or its subsidiaries within one year without payment of compensation (other than statutory compensation).

Report of the Directors

DIRECTORS' INTEREST IN CONTRACTS

Save as disclosed in this report, no contracts of significance in relation to the Company's business to which the Company or its subsidiaries was a party and in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or any time during the year.

BIOGRAPHIES OF DIRECTORS AND SENIOR MANAGEMENT

Biographies of Directors and senior management are set out on pages 48 to 53 of this annual report.

PENSION SCHEMES

In the PRC, the Group contributes on a monthly basis to various defined contribution retirement benefit plans established and operated by relevant Chinese municipal and provincial governments (the "Pension Schemes"). The municipal and provincial governments have undertaken to assume the obligations to pay all the retirement benefits accrued to employees under these Pension Schemes upon their retirement. The Group has no further obligation for payment of post-retirement benefits to employees beyond the contributions made by the Group to these Pension Schemes.

The Group also participates in the provident fund plans mandated by the Hong Kong Government (the "MPF Schemes") which is a defined contribution retirement benefit plan. Contributions to these plans are expensed as incurred.

None of the Pension Schemes or the MPF Schemes has provision for the forfeiture of contributions made to the provident fund.

The Group's contributions to retirement benefit schemes charged to the consolidated income statement for the year ended 31 December 2005 were RMB14,011,000.

MANAGEMENT CONTRACTS

No contract concerning the management and administration of the whole or any substantial part of the business of the Company was entered into or existed during the year.

SHARE OPTION SCHEMES

Share Purchase Scheme

As part of the reorganization of the Group prior to the listing of the Company's shares on the Hong Kong Stock Exchange in June 2004, Mr. Li Ning, a substantial shareholder and Chairman of the Company has, through Alpha Talent, established the Share Purchase Scheme. Under the Share Purchase Scheme, Mr. Li transferred 35,250,000 of the Company's shares beneficially owned by him to Alpha Talent. The objective of the Share Purchase Scheme is to provide for the grant of rights to purchase the Company's shares beneficially owned by Mr. Li Ning through Alpha Talent to key individuals who have contributed to the economic achievement of the Group.

The Share Purchase Scheme was adopted by Alpha Talent on 5 June 2004 and shall be valid and effective for a period of 10 years from that date. A committee established by the board of directors of Alpha Talent shall determine, among other things, the Directors and employees of the Group who shall be selected to receive options, the exercise price, the terms and conditions of the options.

Options to purchase for 25,230,000 Shares and 4,602,500 Shares held by Alpha Talent were granted to certain Directors and key employees under the Share Purchase Scheme on 8 June 2004 and 11 November 2005, respectively. Details of the movements of the share options granted under the Share Purchase Scheme for the year ended 31 December 2005 are set out in note 27 to the accounts.

Pre-IPO Share Option Scheme

The Company has adopted the Pre-IPO Share Option Scheme for the purposes of giving the participants an opportunity to have a personal stake in the Company and recognizing the contribution of, and providing an incentive to Directors and eligible employees of the Group who, in the sole discretion of the Board of Directors, have contributed or will contribute to the success of the Company. The Pre-IPO Share Option Scheme was adopted on 5 June 2004. Options to subscribe for 16,219,000 Shares were granted to certain Directors and eligible employees on 5 June 2004 and the exercise price per Share is HK\$1.8275, being 15% discount to the price for each Share upon the initial public offering of the Company's shares on the Hong Kong Stock Exchange in June 2004. HK\$1 was payable by the grantee who accepted the grant of an option. The option period of all options granted does not exceed 10 years. No further options will be offered or granted pursuant to the Pre-IPO Share Option Scheme.

Report of the Directors

upon the listing of the shares of the Company on the Hong Kong Stock Exchange on 28 June 2004. Details of the movements of the share options under the Pre-IPO Share Option Scheme for the year ended 31 December 2005 were as follows:

	as at 01/01/2005	Number of share options exercised during the year	lapsed during the year	as at 31/12/2005	Exercise price HK\$
Executive Directors					
Zhang Zhi Yong	1,597,000	–	–	1,597,000	1.8275
Tan Wee Seng	1,287,000	(75,000)*	–	1,212,000	1.8275
Employees of the Group					
In aggregate	12,757,000	(3,053,667)#	(1,000,333)	8,703,000	1.8275
	15,641,000	(3,128,667)	(1,000,333)	11,512,000	

* Closing price per Share immediately before the date of exercise of the options is HK\$5.60.

Weighted average closing price per Share immediately before the dates of exercise of the options is HK\$4.38.

All options referred to above are subject to vesting schedules and exercise periods as follows:

% of the options granted	Vesting date	Exercise period
33.3	28/06/2005	28/06/2005 – 05/06/2010
33.3	28/06/2006	28/06/2006 – 05/06/2010
33.4	28/06/2007	28/06/2007 – 05/06/2010

Post-IPO Share Option Scheme

The Company adopted the Post-IPO Share Option Scheme on 5 June 2004. The Post-IPO Share Option Scheme will remain in force for a period of 10 years from 5 June 2004.

The purpose of the Post-IPO Share Option Scheme is to provide the Group with a means of retaining, incentivising, rewarding, remunerating, compensating high-calibre individuals who have demonstrated high level of performance, loyalty and dedication and have made valuable contribution towards the success of the Group. Eligible participants are Directors, employees, officers, agents, consultants or representatives of any member of the Group who, as the Board of Directors may determine in its absolute discretion, have made valuable contribution to the business of the Group based on their performance and/or years of service, or are regarded as valuable human resources of the Group based on their work experience, knowledge in the industry and other relevant factors.

Eligible participants of the Post-IPO Share Option Scheme are required to pay HK\$1 for each option granted upon acceptance of the grant. The exercise price of the option is determined by the Directors and being not less than the highest of: (a) the closing price of the shares of the Company as stated in the Hong Kong Stock Exchange's daily quotations sheets on the date of the grant of the option; (b) the average closing price of the shares of the Company as stated in the Hong Kong Stock Exchange's daily quotation sheets for the five business days immediately preceding the date of the grant of the option; and (c) the nominal value of the shares of the Company.

The maximum number of shares of the Company available for issue upon exercise of all options granted and yet to be exercised under the Post-IPO Share Option Scheme and other share option schemes in aggregate shall not exceed 30% of the number of issued shares of the Company from time to time. In addition, subject as provided under the Listing Rules, the total number of shares of the Company which may be available for issue upon exercise of all options to be granted under the Post-IPO Share Option Scheme, together with all options to be granted under any other share option schemes of any member of the Group, must not represent more than 10% of the nominal amount of all the issued shares of the Company as at 28 June 2004, being the date of the listing of the shares of the Company on the Hong Kong Stock Exchange. Therefore, as at the date of this report, the Company may grant options in respect of up to 98,606,200 shares of the Company (or such numbers of shares as shall result from a sub-division or a consolidation of such 98,606,200 Shares from time to time) to participants under the Post-IPO Share Option Scheme. The total number of shares of the Company issued and which may be issued upon exercise of all options (whether exercised, cancelled or outstanding) granted in any 12-month period to each participant must not exceed 1% of the number of shares of the Company in issue.

An option may be exercised in accordance with the terms of the Post-IPO Share Option Scheme at any time during a period to be notified by the Board of Directors, which must not be more than 10 years from the date of grant.

Any shares of the Company allotted and issued on the exercise of options will rank *pari passu* with other shares of the Company in issue on the date of allotment.

Report of the Directors

On 4 July 2005, options to subscribe for 15,921,000 Shares have been granted to Directors and eligible employees under the Post-IPO Share Option Scheme. Details of the movements of the share options under the Post-IPO Share Option Scheme for the year ended 31 December 2005 were as follows:

	Number of share options			Exercise price
	granted on 04/07/2005	lapsed during the year	as at 31/12/2005	HK\$
Executive Directors				
Zhang Zhi Yong	832,000	–	832,000	3.685
Tan Wee Seng	728,000	–	728,000	3.685
Non-Executive Directors				
Lim Meng Ann	246,000	–	246,000	3.685
Stuart Schonberger	246,000	–	246,000	3.685
Fong Ching, Eddy	246,000	–	246,000	3.685
Independent Non-Executive Directors				
Koo Fook Sun, Louis	246,000	–	246,000	3.685
Wang Ya Fei, Jane	246,000	–	246,000	3.685
Employees of the Group				
In aggregate	13,131,000	(416,000)	12,715,000	3.685
	15,921,000*	(416,000)	15,505,000	

* The closing market price per Share immediately before the date on which the options were granted as quoted in the Hong Kong Stock Exchange's daily quotation sheets was HK\$3.70.

All options referred to above are subject to vesting schedules and exercise periods as follows:

% of the options granted	Vesting date	Exercise period
33.3	04/07/2006	04/07/2006 – 04/07/2011
33.3	04/07/2007	04/07/2007 – 04/07/2011
33.4	04/07/2008	04/07/2008 – 04/07/2011

Valuations of the options granted under the Share Purchase Scheme, the Pre-IPO Share Option Scheme and the Post-IPO Share Option Scheme are set out in note 27 to the accounts.

Save as disclosed above, at no time during the year was the Company or its subsidiaries a party to any arrangement to enable the Directors or any of their spouses or children under 18 years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2005, the interests and short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")), as recorded in the register required to be kept under Section 352 of the SFO or as notified to the Company and the Hong Kong Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") contained in the Listing Rules of the Hong Kong Stock Exchange, were as follows:

Name of Director	Number of Shares/ underlying shares held	Capacity	% of issued share capital*
Li Ning	379,761,000 (note 1) (long position)	Interests of controlled corporations	37.01
	20,369,500 (note 1(c)) (short position)	Interests of controlled corporation	1.99
Zhang Zhi Yong	14,879,000 (note 2) (long position)	Personal	1.45
Tan Wee Seng	4,715,000 (note 3) (long position)	Personal	0.46
Lim Meng Ann	246,000 (note 4) (long position)	Personal	0.02
Stuart Schonberger	246,000 (note 4) (long position)	Personal	0.02
Fong Ching, Eddy	246,000 (note 4) (long position)	Personal	0.02
Koo Fook Sun, Louis	246,000 (note 4) (long position)	Personal	0.02
Wang Ya Fei, Jane	246,000 (note 4) (long position)	Personal	0.02

* The percentages have been calculated based on 1,026,166,667 shares of the Company in issue as at 31 December 2005.

Report of the Directors

Notes:

1. Mr. Li Ning is taken to be interested in an aggregate of 379,761,000 Shares held by Victory Mind Assets Limited, Champion Link Capital Limited and Alpha Talent, respectively, as follows:
 - (a) 203,374,000 Shares are held by Victory Mind Assets Limited which is owned as to 62.106% by Mr. Li Ning and 37.894% by Mr. Li Chun, the brother of Mr. Li Ning. Mr. Li Ning is taken to be interested in 203,374,000 Shares that Victory Mind Assets Limited is interested. Mr. Li Ning is a director of Victory Mind Assets Limited.
 - (b) 150,000,000 Shares are held by Champion Link Capital Limited. The entire interest in Champion Link Capital Limited is held by Dragon City Management Limited in its capacity as trustee of the Three-River Unit Trust, which is a unit trust, the units of which are owned as to 60% by Cititrust (Cayman) Limited as trustee of the Palm Trust and as to 40% by Cititrust (Cayman) Limited as trustee of the Gingko Trust. Both of the Palm Trust and the Gingko Trust are irrevocable discretionary trusts, the objects of which include the respective family members of Mr. Li Ning and his brother, Mr. Li Chun. Mr. Li Ning is the settlor of the Palm Trust and is taken to be interested in 150,000,000 Shares that Champion Link Capital Limited is interested. Mr. Li Ning is a director of Champion Link Capital Limited and Dragon City Management Limited.
 - (c) 26,387,000 Shares are held by Alpha Talent, which is established and solely owned by Mr. Li Ning for the purpose of holding the relevant Shares under the Share Purchase Scheme. Mr. Li Ning is taken to be interested in 26,387,000 Shares that Alpha Talent is interested. Mr. Li Ning is a director of Alpha Talent.

Mr. Li Ning is taken to have a short position in 20,369,500 Shares, among the total of 26,387,000 Shares, held by Alpha Talent in the Company. When the Share Purchase Scheme was first set up in June 2004, 35,250,000 Shares were held by Alpha Talent. As at 31 December 2005, Alpha Talent had granted options to purchase 29,832,500 Shares pursuant to the Share Purchase Scheme, among which options to purchase for 600,000 Shares have been lapsed due to resignation of an employee and options to purchase 8,863,000 Shares have been exercised. The total number of outstanding options as at 31 December 2005 is 20,369,500 Shares. Mr. Li Ning is the sole shareholder of Alpha Talent, a controlled corporation of Mr. Li Ning, he is thus taken to have a short position in the 20,369,500 Shares.
2. Mr. Zhang Zhi Yong is interested in 2,700,000 Shares held and is also taken to be interested as a grantee of options to purchase 9,750,000 Shares under the Share Purchase Scheme, options to subscribe for 1,597,000 Shares under the Pre-IPO Share Option Scheme and options to subscribe for 832,000 Shares under the Post-IPO Share Option Scheme.
3. Mr. Tan Wee Seng is interested in 75,000 Shares held and is also taken to be interested as a grantee of options to purchase 2,700,000 Shares under the Share Purchase Scheme, options to subscribe for 1,212,000 Shares under the Pre-IPO Share Option Scheme and options to subscribe for 728,000 Shares under the Post-IPO Share Option Scheme.
4. The respective Director is taken to be interested as a grantee of options to subscribe for 246,000 Shares each under the Post-IPO Share Option Scheme.

Save as disclosed above, so far as was known to any Director, as at 31 December 2005, none of the Directors or chief executive of the Company had, pursuant to Divisions 7 and 8 of Part XV of the SFO, nor were they taken to or deemed to have under such provisions of the SFO, any interests or short positions in any shares or underlying shares or interests in debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Hong Kong Stock Exchange, or any interests which were required, pursuant to Section 352 of the SFO, to be entered into the register referred to therein, or any interests which were required, pursuant to the Model Code, to be notified to the Company and the Hong Kong Stock Exchange.

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31 December 2005, the register of substantial shareholders maintained under section 336 of the SFO shows that the Company had been notified of the following substantial shareholders' interests and short positions, representing 5% or more of the Company's issued share capital:

Name of shareholder	Number of Shares held	Capacity	% of issued share capital*
Li Ning (Note 1)	379,761,000 (Long position)	Interest of controlled corporations	37.01
	20,369,500 (Short position)	Interest of controlled corporations	1.99
Li Chun (Note 2)	353,374,000 (Long position)	Interest of controlled corporations	34.44
Victory Mind Assets Limited (Note 2(a))	203,374,000 (Long position)	Beneficial owner	19.82
Champion Link Capital Limited (Note 2(b))	150,000,000 (Long position)	Beneficial owner	14.62
Dragon City Management Limited (Note 2(b))	150,000,000 (Long position)	Trustee	14.62
Cititrust (Cayman) Limited (Note 2(b))	150,000,000 (Long position)	Trustee	14.62
Tetrad Ventures Pte. Ltd. (Note 3)	113,055,500 (Long position)	Beneficial owner	11.02
Government of Singapore Investment Corporation (Ventures) Pte. Ltd. (Note 3)	113,055,500 (Long position)	Interest of controlled corporation	11.02
GIC Special Investments Pte. Ltd. (Note 3)	113,055,500 (Long position)	Interest of controlled corporation	11.02

Report of the Directors

Name of shareholder	Number of Shares held	Capacity	% of issued share capital*
Government of Singapore Investment Corporation Pte. Ltd. (Note 3)	113,055,500 (Long position)	Interest of controlled corporations	11.02
Minister of Finance (Incorporated) (Note 3)	113,055,500 (Long position)	Interest of controlled corporations	11.02
Fidelity International Limited	61,518,000 (Long position)	Investment manager	5.99
Matthews International Capital Management, LLC	51,317,000 (Long position)	Investment manager	5.00

* The percentages have been calculated based on 1,026,166,667 shares of the Company in issue as at 31 December 2005.

Notes:

- See note 1 under "Directors' and Chief Executive's Interests and Short Positions in Shares, Underlying Shares and Debentures".
- Mr. Li Chun is taken to be interested in an aggregate of 353,374,000 Shares held by Victory Mind Assets Limited and Champion Link Capital Limited, respectively, as follows:
 - 203,374,000 Shares are held by Victory Mind Assets Limited which is owned as to 37.894% by Mr. Li Chun, and 62.106% by Mr. Li Ning, the brother of Mr. Li Chun. Mr. Li Chun is taken to be interested in the 203,374,000 Shares that Victory Mind Assets Limited is interested in; and
 - 150,000,000 Shares are held by Champion Link Capital Limited. The entire interest in Champion Link Capital Limited is held by Dragon City Management Limited in its capacity as trustee of the Three-River Unit Trust, which is a unit trust, the units of which are owned as to 60% by Cititrust (Cayman) Limited as trustee of the Palm Trust and as to 40% by Cititrust (Cayman) Limited as trustee of the Gingko Trust. Both of the Palm Trust and the Gingko Trust are irrevocable discretionary trusts, the objects of which include the respective family members of Mr. Li Chun and his brother, Mr. Li Ning. Mr. Li Chun is the settler of the Gingko Trust and is taken to be interested in the 150,000,000 Shares that Champion Link Capital Limited is interested in.
- 113,055,500 Shares are held by Tetrad Ventures Pte. Ltd., a wholly-owned subsidiary of Government of Singapore Investment Corporation (Ventures) Pte. Ltd., which in turn is a wholly-owned subsidiary of Minister of Finance (Incorporated). Tetrad Ventures Pte. Ltd. is also an investment vehicle managed by GIC Special Investments Pte. Ltd., the private equity investment arm of Government of Singapore Investment Corporation Pte. Ltd., which in turn is a wholly-owned subsidiary of Minister of Finance (Incorporated).

Save as disclosed above, as at 31 December 2005, the Company had not been notified by any person (other than a Director or chief executive of the Company or their respective associate(s)) of any interests and short positions in the shares and underlying shares of the Company which were required to be recorded in the register kept under Section 336 of the SFO.

CONNECTED TRANSACTION

On 30 June 2005, Shanghai Yue Ao, a subsidiary of the Company, agreed to transfer its entire 80% equity interest in Beijing Dong Xiang to Shanghai Tai Tan for a consideration of RMB8,614,000 (the "Disposal"). Shanghai Tai Tan is a company owned as to 93% by Mr. Chen Yi Hong (an Executive Director of the Company before his resignation on 1 September 2005) and his spouse and is therefore a connected person of the Company under the Listing Rules. Concurrent with the Disposal, Shanghai Li Ning, a subsidiary of the Company, agreed to assign all its rights in the outstanding debts in the sum of RMB36,200,000 owed to it by Beijing Dong Xiang to Shanghai Tai Tan for a consideration of RMB36,200,000 (the "Assignment"). The Disposal and the Assignment constituted connected and discloseable transaction of the Company under the Listing Rules.

The transaction was approved by independent shareholders of the Company at the extraordinary general meeting held on 11 August 2005 and has been completed. Since the completion of the Disposal and the Assignment, Beijing Dong Xiang has ceased to be a subsidiary of the Company. More information of the Disposal is set out on pages 31 and 32 of this annual report under the section headed "Disposal of interests in KAPPA brand business".

CONTINUING CONNECTED TRANSACTIONS

During the year under review, the Group had the following transactions which constituted continuing connected transactions under the Listing Rules:

1. *Sports organizing and promotion framework agreement ("Sports Organizing Agreement") between Beijing Li Ning and 北京一動體育發展有限公司 (Beijing Edo Sports Development Co., Ltd.) ("Beijing Edo Sports")*

Beijing Edo Sports is a limited company established in the PRC, which is owned as to 80% by 上海寧晟企業管理有限公司 (Shanghai Ning Sheng Corporate Management Co., Ltd.) ("Shanghai Ning Sheng"). By reason of the interests of Mr. Li Ning (an Executive Director and Chairman of the Company) and his family members in Shanghai Ning Sheng, Beijing Edo Sports is an associate of Mr. Li Ning and, hence, a connected person of the Company for the purposes of the Listing Rules.

Beijing Li Ning entered into the Sports Organizing Agreement dated 1 January 2004 with Beijing Edo Sports for a term of three years commencing from 1 January 2004, under which Beijing Li Ning engaged Beijing Edo Sports to carry out joint promotion of sports events in return for organizing fees payable to Beijing Edo Sports.

Payments from Beijing Li Ning to Beijing Edo Sports for the year ended 31 December 2005 amounted to an aggregate of RMB3,250,000, which was below the relevant annual cap approved by the Hong Kong Stock Exchange as disclosed in the Company's listing prospectus dated 15 June 2004 ("Listing Prospectus").

Report of the Directors

2. *Non-exclusive distributorship arrangement of KAPPA brand products by 北京動感九六體育用品有限公司 (Beijing Dong Gan Jiu Liu Sporting Goods Co., Ltd.) ("Dong Gan Jiu Liu")*

Dong Gan Jiu Liu is a limited company established in the PRC, which is owned as to 70% by Mr. Chen Yi Liang (a brother of Mr. Chen Yi Hong, an Executive Director of the Company before his resignation on 1 September 2005) and as to 30% by a company beneficially owned by the family members of Mr. Chen Yi Hong. Dong Gan Jiu Liu is an associate of Mr. Chen Yi Hong and, hence, a connected person of the Company for the purposes of the Listing Rules.

On 1 January 2004, Beijing Dong Xiang (as supplier) and Dong Gan Jiu Liu (as non-exclusive distributor) entered into a non-exclusive distributorship framework agreement for the sale of KAPPA brand products for a term of three years commencing from 1 January 2004. In August 2005, the Group disposed its entire 80% interest in Beijing Dong Xiang to a company controlled by Mr. Chen Yi Hong and Beijing Dong Xiang has ceased to be a subsidiary of the Company as a result of the disposal.

Transaction value for the distribution of licensed products between Beijing Dong Xiang and Dong Gan Jiu Liu for the year ended 31 December 2005 amounted to an aggregate of RMB9,663,000, which was below the relevant annual cap approved by the Hong Kong Stock Exchange as disclosed in the Listing Prospectus.

3. *Non-exclusive distributorship arrangement of LI-NING brand products by 北京動感競技經貿有限公司 (Beijing Dong Gan Jing Ji Trading Co., Ltd.) ("Dong Gan Jing Ji")*

Dong Gan Jing Ji is a limited liability company established in the PRC, which is owned as to 60% by Mr. Chen Yi Liang and 40% by Mr. Chen Yi Yong. Both of Mr. Chen Yi Liang and Mr. Chen Yi Yong are brothers of Mr. Chen Yi Hong, an Executive Director of the Company before his resignation on 1 September 2005. Dong Gan Jing Ji is an associate of Mr. Chen Yi Hong and, hence, a connected person of the Company for the purposes of the Listing Rules.

On 1 January 2004, Beijing Li Ning (as supplier) and Dong Gan Jing Ji (as non-exclusive distributor) have entered into a non-exclusive distributorship agreement for the sale of LI-NING brand products at a retail shop in Beijing for a term of three years commencing from 1 January 2004.

Transaction value for the distribution of products between Beijing Li Ning and Dong Gan Jing Ji for the year ended 31 December 2005 amounted to an aggregate of RMB345,000, which was below the relevant annual cap approved by the Hong Kong Stock Exchange as disclosed in the Listing Prospectus.

The Directors, including the Independent Non-Executive Directors, have reviewed the above continuing connected transactions made during the year ended 31 December 2005 and confirmed that these transactions were entered into:

- (1) in the ordinary and usual course of business of the Group;
- (2) on normal commercial terms or on terms no less favourable to the Company than terms available to or from independent third parties; and
- (3) in accordance with each of the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

PricewaterhouseCoopers, the auditors of the Company, has confirmed to the Board of Directors in writing that the continuing connected transactions made during the year ended 31 December 2005:

- (1) have received the approval of the Board of Directors of the Company;
- (2) are in accordance with the pricing policies of the Group;
- (3) have been entered into in accordance with the relevant agreements governing the transactions; and
- (4) have not exceeded the annual cap as disclosed in the Listing Prospectus.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S SHARES

The Company had not redeemed any of its listed shares during the year ended 31 December 2005. Neither the Company nor any of its subsidiaries had purchased or sold any of the Company's shares during the year.

SUFFICIENCY OF PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the Directors, throughout the year ended 31 December 2005 and up to the date of this report, the Company has maintained a sufficient public float of more than 25% of the Company's issued shares as required under the Listing Rules.

Report of the Directors

CORPORATE GOVERNANCE

The Company has complied with the corporate governance practices as set out in Appendix 14 of the Listing Rules which came into effect on 1 January 2005. Principal corporate governance practices adopted by the Company are set out in the Corporate Governance Report on pages 36 to 45 of this annual report.

AUDITORS

PricewaterhouseCoopers will retire as auditors of the Company and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of PricewaterhouseCoopers as auditors of the Company is to be proposed at the forthcoming annual general meeting.

By order of the Board

LI Ning

Chairman

Hong Kong, 22 March 2006

Report of the Auditors

TO THE EQUITY HOLDERS OF LI NING COMPANY LIMITED

(Incorporated in the Cayman Islands with limited liability)

We have audited the accompanying balance sheet of Li Ning Company Limited (the "Company") and the consolidated balance sheet of the Company and its subsidiaries (hereinafter collectively referred to as the "Group") as at 31 December 2005, and the related consolidated income statement, consolidated cash flow statement and consolidated statement of changes in equity for the year then ended. The financial statements set out on pages 74 to 121 are the responsibility of the directors. Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial positions of the Company and of the Group as at 31 December 2005, and the results of operations of the Group and its cash flows for the year then ended in accordance with International Financial Reporting Standards, and comply with the disclosure requirements of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, 22 March 2006

Consolidated Income Statement

For the year ended 31 December 2005
(Expressed in RMB'000 unless otherwise stated)

	Note	2005	2004 (As restated – Note 2)
Turnover	4	2,450,536	1,878,102
Cost of sales		(1,297,991)	(1,004,578)
Gross profit		1,152,545	873,524
Distribution expenses		(690,527)	(549,771)
Administrative expenses		(223,147)	(160,734)
Other income	5	32,626	17,399
Operating profit		271,497	180,418
Finance income, net	8	1,954	821
Profit before taxation		273,451	181,239
Taxation	9	(85,106)	(57,486)
Profit for the year		188,345	123,753
Attributable to:			
Equity holders of the Company		186,800	122,414
Minority interests		1,545	1,339
		188,345	123,753
Dividends	10	73,957	86,753
Earnings per share for equity holders of the Company (RMB cents)	11		
– Basic		18.25	13.78
– Diluted		18.13	13.75

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Balance Sheet

As at 31 December 2005

(Expressed in RMB'000 unless otherwise stated)

	Note	2005	2004 (As restated – Note 2)
ASSETS			
Non-current assets			
Property, plant and equipment	12	95,796	89,399
Land use rights	13	3,857	4,057
Intangible assets	14	9,960	9,363
Deposit paid for land use right	15	10,002	–
		119,615	102,819
Current assets			
Inventories	16	290,617	318,326
Accounts and notes receivable	19	373,226	217,574
Other receivables and prepayments	20	67,824	81,424
Pledged bank deposits	21	–	66,212
Fixed deposits held at banks	21	353,161	372,508
Cash at banks and in hand	21	378,368	322,568
		1,463,196	1,378,612
Total assets		1,582,811	1,481,431
EQUITY			
Capital and reserves attributable to the equity holders of the Company			
Share capital	25	108,889	108,563
Reserves	26	1,052,035	901,454
		1,160,924	1,010,017
Minority interests		17,372	17,208
Total equity		1,178,296	1,027,225
LIABILITIES			
Current liabilities			
Trade payables	22	214,162	260,997
Other payables and accruals	23	161,196	138,102
Short-term borrowings	24	–	40,000
Taxation payable		29,157	15,107
		404,515	454,206
Total liabilities		404,515	454,206
Total equity and liabilities		1,582,811	1,481,431

The accompanying notes are an integral part of these consolidated financial statements.

Approved by the Board of Directors on 22 March 2006.

ZHANG Zhi Yong

Executive Director & Chief Executive Officer

TAN Wee Seng

Executive Director & Chief Financial Officer

Balance Sheet

As at 31 December 2005

(Expressed in RMB'000 unless otherwise stated)

	Note	2005	2004 (As restated – Note 2)
ASSETS			
Non-current assets			
Investment in subsidiaries	17	234,656	79,568
Current assets			
Other receivables and prepayments	20	3,713	2,550
Pledged bank deposits	21	–	66,212
Fixed deposits held at banks	21	345,284	372,508
Cash at banks and in hand	21	8,837	153,137
		357,834	594,407
Total assets		592,490	673,975
EQUITY			
Capital and reserves attributable to the equity holders of the Company			
Share capital	25	108,889	108,563
Reserves	26	480,137	555,780
Total equity		589,026	664,343
LIABILITIES			
Current liabilities			
Other payables and accruals	23	3,464	9,632
Total equity and liabilities		592,490	673,975

The accompanying notes are an integral part of this financial statement.

Approved by the Board of Directors on 22 March 2006.

ZHANG Zhi Yong

Executive Director & Chief Executive Officer

TAN Wee Seng

Executive Director & Chief Financial Officer

Consolidated Statement of Changes in Equity

For the year ended 31 December 2005
(Expressed in RMB'000 unless otherwise stated)

	Note	Attributable to equity holders of the Company	Minority interests	Total equity
Balance as at 1 January 2004,				
– as previously reported as equity		389,032	–	389,032
Balance as at 1 January 2004,				
– as previously separately reported as minority interests	2	–	15,869	15,869
Balance as at 1 January 2004, as restated		389,032	15,869	404,901
Profit for the year		122,414	1,339	123,753
Dividends paid	10	(105,772)	–	(105,772)
Share options granted for services provided	27	11,025	–	11,025
Proceeds from issuance of shares of the Company, net of expenses		593,318	–	593,318
Balance as at 31 December 2004		1,010,017	17,208	1,027,225
Balance as at 1 January 2005,				
– as previously reported as equity		1,010,017	–	1,010,017
Balance as at 1 January 2005,				
– as previously separately reported as minority interests		–	17,208	17,208
Balance as at 1 January 2005, as restated		1,010,017	17,208	1,027,225
Profit for the year		186,800	1,545	188,345
Dividends paid	10	(69,402)	–	(69,402)
Share options granted for services provided	27	27,557	–	27,557
Proceeds from exercise of share options		5,952	–	5,952
Disposal of a subsidiary		–	(1,381)	(1,381)
Balance as at 31 December 2005		1,160,924	17,372	1,178,296

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December 2005
(Expressed in RMB'000 unless otherwise stated)

	Note	2005	2004
Cash flows from operating activities			
Cash inflow generated from operations	28(a)	206,562	191,484
Income tax paid		(67,957)	(57,067)
Net cash generated from operating activities		138,605	134,417
Cash flows from investing activities			
Purchase of property, plant and equipment		(38,546)	(31,145)
Deposit paid for land use right		(10,002)	–
Purchase of intangible assets		(3,375)	(7,655)
Proceeds from disposals of property, plant and equipment, land use right and intangible assets		771	175
Decrease/(increase) in fixed deposits at banks		11,152	(371,277)
Interest received		13,047	1,356
Net cash outflow from disposal of a subsidiary	28(b)	(14,737)	–
Net cash used in investing activities		(41,690)	(408,546)
Cash flows from financing activities			
Proceeds from issuance of shares of the Company		5,952	622,918
Share issuance cost paid		–	(29,600)
Proceeds from borrowings		50,000	90,000
Repayment of borrowings		(90,000)	(135,000)
Decrease/(increase) in pledged bank deposits		66,212	(66,212)
Dividends paid		(69,402)	(105,772)
Interest paid		(1,102)	(4,369)
Net cash (used in)/generated from financing activities		(38,340)	371,965
Increase in cash and cash equivalents		58,575	97,836
Cash and cash equivalents at beginning of the year		322,568	224,488
Exchange difference		(2,775)	244
Cash and cash equivalents at end of the year		378,368	322,568

The accompanying notes are an integral part of these consolidated financial statements.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

1 Basis of presentation and principal activities

Li Ning Company Limited (the "Company") and its subsidiaries (together the "Group") have its own brand and are principally engaged in brand development, design, manufacturing, sales and distribution of sports-related footwear, apparel and accessories in the People's Republic of China (the "PRC").

The Company was incorporated on 26 February 2004 in the Cayman Islands as an exempted company with limited liability under the Company Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. Pursuant to a reorganisation dated 5 June 2004, the Company acquired the entire issued share capital of RealSports Pte. Ltd. ("RealSports"), the then holding company of the other companies comprising the Group and became the holding company of the Group. The reorganisation has been accounted for in a manner similar to pooling-of-interests, under which the consolidated income statement and cash flow statement for the year ended 31 December 2004 included the results of operations and cash flows of the companies comprising the Group from 1 January 2004 or since their dates of incorporation or dates of becoming members of the Group, whichever is later, to 31 December 2004. The balance sheets as at 31 December 2004 have been prepared to present the financial positions of the Company and the Group as if the current group structure had been in existence since 1 January 2004.

The address of registered office is Century Yard, Cricket Square, Hutchins Drive, P.O. Box 2681GT, George Town, Grand Cayman, British West Indies.

The Company's shares were listed on The Stock Exchange of Hong Kong Limited on 28 June 2004.

2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The consolidated financial statements have been prepared under the historical cost convention.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

2 Summary of significant accounting policies (Continued)

(a) Basis of preparation (Continued)

Standards and amendments to published standards effective in 2005

In 2005, the Group adopted the following new/revised IFRS that are relevant to the operations of the Group. The 2004 comparatives have been amended as required, in accordance with the relevant requirements.

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events after the Balance Sheet Date
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 24	Related Party Disclosures
IAS 27	Consolidated and Separate Financial Statements
IAS 32	Financial Instruments: Disclosure and Presentation
IAS 33	Earnings per Share
IAS 39	Financial Instruments: Recognition and Measurement
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations

The adoption of IFRS 2 has resulted in a change in the accounting policy for share-based payments. Until 31 December 2004, the provision of share options to directors and employees did not result in an expense in the income statement. Effective on 1 January 2005, the Group expenses the cost of share options in the income statement. In accordance with IFRS 2, the cost of share options granted after 7 November 2002 and not yet vested on 1 January 2005 was expensed retrospectively in the income statements of the respective periods.

The main impact of IFRS 2 on the Group is the expensing of share options granted under the Share Purchase Scheme, the Pre-IPO Share Option Scheme and the Share Option Scheme. Refer to Note 27 for details of such schemes. The effect of the change of policy has decreased the Group's profit for the year ended 31 December 2005 by RMB27,557,000 (2004: RMB11,025,000) as a result of increased staff costs, and a corresponding increase in other reserves. In addition, such change of policy has decreased basic earnings per share by RMB2.69 cents for the year ended 31 December 2005 (2004: decrease by RMB1.24 cents).

The adoption of the other standards as mentioned above, being IAS 1, 2, 8, 10, 16, 17, 21, 24, 27, 32, 33, 39, and IFRS 3 and 5 did not result in substantial changes to the Group's accounting policies, except that IAS 1 has affected the presentation of minority interests and other disclosure. Also in accordance with IAS 21, the functional currency of each of the companies comprising the Group has been re-evaluated based on the guidance under the revised standard.

2 Summary of significant accounting policies (Continued)

(a) Basis of preparation (Continued)

Standards, amendments and interpretations to published standards that are not effective in 2005

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2006, which the Group has not early adopted, as follows:

IAS 19 (Amendment)	Employee Benefits
IAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
IAS 39 (Amendment)	The Fair Value Option
IAS 39 and IFRS 4 (Amendment)	Financial Guarantee Contracts
IFRS 1 (Amendment)	First-time Adoption of IFRS
IFRS 6 (Amendment)	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRIC 4	Determining whether an arrangement contains a lease
IFRIC 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6	Liabilities arising from Participation in a Specific Market – Waste Electrical and Electronic Equipment

The directors have assessed the impact of these new standards, amendments and interpretations to existing standards and have concluded that IAS 19, IFRS 1, IFRS 6, IFRIC 5 and IFRIC 6 are not relevant to the Group's situations. The Group is currently assessing the impact of the remaining standards or interpretations and will adopt them as appropriate in the 2006 financial statements.

(b) Consolidation

The consolidated financial statements include the financial statements of the Company and all its subsidiaries made up to 31 December.

(i) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are no longer consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet, investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

2 Summary of significant accounting policies (Continued)

(b) Consolidation (Continued)

(ii) Joint ventures

The Group's interests in jointly controlled entities ("JCE") are accounted for by proportionate consolidation. The Group combines its share of the JCE's individual income and expenses, assets and liabilities and cash flows on a line-by-line basis with similar items in the Group's financial statements. The Group recognizes the portion of gains or losses on the sale of assets by the Group to the JCE that is attributable to the other venturers. The Group does not recognize its share of profits or losses from the joint venture that result from the Group's purchase of assets from the joint venture until the Group resells the assets to an independent party. However, a loss on the transaction is recognized immediately if the loss provides evidence of a reduction in the net realisable value of current assets, or an impairment loss.

In the Company's balance sheet, investments in JCE are stated at cost less provision for impairment losses. The results of the JCE are accounted for by the Company on the basis of dividends received and receivable.

(c) Segment reporting

Business segments provide products or services that are subject to risks and returns different from those of other business segments. Geographical segments provide products or services within a particular economic environment that is subject to risks and returns different from those components operating in other economic environments.

In accordance with the Group's internal financial reporting, the Group has determined that business segment be presented as the primary reporting format. No geographical segment is presented as most of the Group's of operations and assets are located in the PRC.

Segment assets consist primarily of property, plant and equipment, land use rights, intangible assets, inventories, operating receivables and cash and cash equivalents, and mainly exclude deferred tax assets. Segment liabilities comprises operating liabilities and exclude items such as current and deferred tax liabilities. Capital expenditure mainly comprises additions to property, plant and equipment, land use rights and intangible assets.

(d) Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each entity in the Group are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Renminbi, which is the functional currency of all entities comprising the Group and the presentation currency of the Company.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in income statement.

2 Summary of significant accounting policies (Continued)

(d) Foreign currency translation (Continued)

(iii) Group companies

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (1) Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (2) Income and expenses for each income statement presented are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (3) All resulting exchange differences are recognized as a separate component of equity.

(e) Property, plant and equipment (excluding construction-in-progress)

Property, plant and equipment (excluding construction-in-progress) is stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes the purchase price of the asset and any directly attributable costs of bringing the asset to its working condition for its intended use.

Depreciation is calculated on a straight-line basis to write off the cost less impairment losses of each asset to their residual values over their estimated useful lives as follows:

Buildings	20 – 40 years
Leasehold improvements	2 years or over the lease term, whichever is shorter period
Machinery	10 -18 years
Motor vehicles and office equipment	3 – 12 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Repairs and maintenance are charged to the income statement during the financial period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits in excess of the originally assessed standard of performance of the existing asset will flow to the Group. Major renovations are depreciated over the remaining useful life of the related asset.

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in the income statement.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

2 Summary of significant accounting policies (Continued)

(f) Construction-in-progress

Construction-in-progress represents buildings, plant and/or machinery under construction and pending installation and is stated at cost less accumulated impairment losses. Cost includes the costs of construction of buildings, the costs of plant and machinery, installation, testing and other direct costs. No provision for depreciation is made on construction-in-progress until such time as the relevant assets are completed and ready for intended use. When the assets concerned are brought into use, the costs are transferred to property, plant and equipment and depreciated in accordance with the policy as stated in Note (e) of this section.

(g) Land use right

Land use right represents prepaid lease payments for the use of land in the PRC and are amortised over the lease period varying from 20 to 50 years on a straight-line basis.

(h) Intangible assets

(i) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives of 3 years. Costs associated with maintaining computer software programmes are recognised as an expense as incurred, and expenditure which enhances or extends the performance of computer software programmes beyond their original specifications is recognised as a capital improvement and added to the original cost of the software. Computer software costs recognised as assets are amortised using the straight-line method over their useful lives, not exceeding a period of 3 years.

(ii) Trademarks

Expenditure to acquire trademarks is capitalised and amortised using the straight line method over the number of years granted by the relevant jurisdiction or 10 years, whichever is a shorter period.

(i) Impairment of long lived assets

Property, plant and equipment, construction-in-progress, land use rights and intangible assets are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount which is the higher of an asset's net selling price and value in use. For the purpose of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows.

(j) Investments

The Group classifies its investments in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

2 Summary of significant accounting policies (Continued)

(j) Investments (Continued)

(i) *Financial assets at fair value through profit or loss*

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realized within 12 months of the balance sheet date. As at 31 December 2004 and 2005, the Group did not hold any investments in this category.

(ii) *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. Loans and receivables are included in accounts receivable and other receivables in the balance sheet.

(iii) *Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. As at 31 December 2004 and 2005, the Group did not hold any investments in this category.

(iv) *Available-for-sale financial assets*

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. As at 31 December 2004 and 2005, the Group did not have any investments in the category.

Purchases and sales of investments are recognized on trade-date. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Investments are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Realized and unrealized gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Unrealized gains and losses arising from changes in the fair value of non-monetary securities classified as available-for-sale are recognized in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments are included in the income statement as gains or losses from investment securities. The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

2 Summary of significant accounting policies (Continued)

(k) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(l) Accounts receivable

Accounts receivable are carried at original invoice amounts less provision made for impairment of these receivables. Such provision for impairment of accounts receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers. The amount of the provision is recognised in the income statement.

(m) Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheets at cost. For the purpose of the consolidated cash flow statements, cash and cash equivalents comprise cash on hand and deposits held at call with banks.

(n) Borrowings

Borrowings are recognised initially at the proceeds received, net of transaction costs incurred. Borrowings are stated subsequently at amortised cost using the effective yield method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings.

(o) Borrowing costs

All borrowing costs are expensed as incurred.

(p) Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

(q) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Currently enacted tax rates are used in the determination of deferred income tax.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investment in subsidiaries, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

2 Summary of significant accounting policies (Continued)

(r) Director and employee benefits

(i) Pension obligations

The Group contributes on a monthly basis to various defined contribution retirement benefit plans organised by municipal and provincial governments in the PRC, including the Hong Kong Special Administrative Region. The municipal and provincial governments undertake to assume the retirement benefit obligations payable to all existing and future retired employees under these plans and the Group has no further obligation for post-retirement benefits beyond the contributions made.

Contributions to these plans are expensed as incurred. The Company has no other post-employment obligations under the employment contracts.

(ii) Share-based payments

The Group maintains several equity-settled, share-based compensation plans. The fair value of the director and employee services received in exchange for the grant of the options is credited to other reserves and recognized as an expense over vesting period and is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the Group revises its estimate of the number of options that are expected to become exercisable. It recognizes the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity, over the remaining vesting period.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

(iii) Other benefits

Other directors and employees' obligations are recorded as a liability and charged to the income statement when the Group is contractually obliged or when there is a past practice that has created a constructive obligation.

(s) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

(t) Revenue recognition

Revenue from sale of goods is recognised when significant risks and rewards of ownership of the goods are transferred to the buyer.

Interest income is recognised on a time proportion basis, taking account of the principal outstanding and the effective rate over the period to maturity, when it is determined that such income will accrue to the Group.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

2 Summary of significant accounting policies (Continued)

(u) Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

(v) Contingent liabilities and contingent assets

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognised but are disclosed in the notes to the accounts when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognised.

(w) Government grants

A government grant is recognised when there is reasonable assurance that the Group will comply with the conditions attaching to it and that the grant will be received.

Grants relating to income are deferred and recognised in the income statement over the period necessary to match them with the costs they are intended to compensate.

(x) Dividends

Dividends are recorded in the Group's financial statements in the period in which they are approved by the board of directors. Dividends proposed or declared after the balance sheet date are disclosed as a post balance sheet event and are not recognised as a liability at the balance sheet date.

3 Financial risk management

(a) Financial risk factors

The Group's activities expose it to a variety of financial risks, including the effects of changes in foreign currency exchange rates and interest rates.

(i) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions settled in RMB.

The proceeds derived from the initial public offering of the Company in June 2004 ("IPO") are denominated in Hong Kong Dollars ("HK\$"). Certain sum has been deposited into various bank deposit accounts denominated in HK\$ or United States Dollars ("US\$"). In addition, the Company is required to pay dividends in HK\$ when dividends are declared.

Any foreign currency exchange rate fluctuations in connection with its deposits and investments may have a financial impact to the Group.

(ii) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates and the Group has no significant interest-bearing assets, other than cash at banks. The Group's exposure to changes in interest rates is mainly attributable to its short-term borrowings during the year (nil balance as at 31 December 2005). The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

(iii) Credit risk

The Group has no significant concentrations of credit risk. The carrying amount of accounts receivable included in the consolidated balance sheet represents the Group's maximum exposure to credit risk in relation to its financial assets. The Group has put in place policies to ensure that sales of products are made to customers with an appropriate credit history and the Group performs periodic credit evaluations of its customers. The Group's historical experience in collection of trade and other receivables falls within the recorded allowances and the directors are of the opinion that adequate provision for uncollectible accounts receivable has been made in the consolidated financial statements.

(b) Fair value estimation

The face values less any estimated credit adjustments for the Group's financial assets and liabilities with a maturity of less than one year, including cash at bank and in hand, time deposits, accounts and notes receivable and other receivables, trade payables, short-term borrowings and other payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

4 Turnover and segment information

Turnover comprises the invoiced value for the sale of goods net of value added tax ("VAT"), rebates and discount.

Primary reporting format – business segment

The Group has its own brand; it operates in one business segment which is the brand development, design, manufacturing, sale and distribution of sports-related footwear, apparel and accessories.

Secondary reporting format – geographical segment

Substantially all assets and operations of the Group during the two years ended 31 December 2004 and 2005 were located in the PRC. No geographical segments analysis is presented as less than 5% of the Group's turnover and contribution to operating profit is attributable to markets outside the PRC.

5 Other income

	2005	2004
Subsidies from local governments (note a)	29,535	17,399
Net gain on disposal of a subsidiary (note b)	3,091	–
	32,626	17,399

Notes:

- (a) During the year, the Group received subsidies from various local governments in the PRC amounting to RMB29,535,000 (2004: RMB17,399,000).
- (b) During the year, the Group disposed of Beijing Dong Xiang Sports Development Co., Ltd. ("Beijing Dong Xiang"), a company incorporated in the PRC which is principally engaged in sales of "KAPPA" branded products, to Shanghai Tai Tan Sporting Goods Co., Ltd. ("Shanghai Tai Tan"), a company incorporated in the PRC in which Mr. Chen Yi Hong, a former director, has a beneficial interest, and recognized gain on disposal of RMB3,091,000.

6 Expenses by nature

	2005	2004
Costs of inventories recognized as expenses included in cost of sales	1,226,719	987,622
Depreciation on property, plant and equipment	22,310	18,147
Amortization of intangible assets	2,498	2,067
Amortization of land use rights	130	207
Advertising and marketing expenses	377,667	267,769
Director and employee benefit expense (note 7)	228,620	189,605
Operating lease rentals in respect of land and buildings	98,966	80,794
Research and product development	43,703	35,895
Transportation and logistics expenses	54,942	44,730
Write-back of impairment charge of accounts receivable	(2,211)	(7,030)
Write-down of inventories to net realizable value/(reversal of write-down)	5,318	(5,201)
Auditors' remuneration	2,788	2,766
Other expenses	150,215	97,712
Total of cost of sales, distribution and administrative expenses	2,211,665	1,715,083

7 Director and employee benefit expense

	2005	2004
Wages and salaries	142,217	133,605
Contributions to retirement benefit plan	14,011	16,255
Share option costs	27,557	11,025
Staff quarters and housing benefits	4,751	3,861
Other benefits	40,084	24,859
	228,620	189,605

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

7 Director and employee benefit expense (Continued)

(a) Directors' and senior management's emoluments

The remuneration of each director for the year ended 31 December 2005 is set out below:

Name of Director	Fees	Salary	Discretionary bonuses	Inducement fees	Other benefits (i)	Employer's contribution to pension scheme	Compensation for loss of office as director	Total
Mr. Li Ning	412	1,814	1,093	–	583	109	–	4,011
Mr. Zhang Zhi Yong	412	1,120	729	–	2,385	126	–	4,772
Mr. Tan Wee Seng	412	573	662	–	1,336	–	–	2,983
Mr. Chen Yi Hong (ii)	274	582	–	–	2,996	67	1,497	5,416
Ms. Wang Ya Fei, Jane	160	–	–	–	–	–	–	160
Mr. Lim Meng Ann	160	–	–	–	–	–	–	160
Mr. Stuart Schonberger	160	–	–	–	–	–	–	160
Mr. Fong Ching, Eddy	160	–	–	–	–	–	–	160
Mr. Koo Fook Sun, Louis	160	–	–	–	–	–	–	160
Mr. Chan Chung Bun, Bunny	160	–	–	–	–	–	–	160

The remuneration of each director for the year ended 31 December 2004 is set out below:

Name of Director	Fees	Salary	Discretionary bonuses	Inducement fees	Other benefits (i)	Employer's contribution to pension scheme	Compensation for loss of office as director	Total
Mr. Li Ning	1,800	557	820	–	383	118	–	3,678
Mr. Zhang Zhi Yong	523	1,337	610	–	298	121	–	2,889
Mr. Tan Wee Seng	851	805	1,097	–	–	–	–	2,753
Mr. Chen Yi Hong (ii)	232	1,051	385	–	–	165	–	1,833
Ms. Wang Ya Fei, Jane	81	–	–	–	–	–	–	81
Mr. Lim Meng Ann	81	–	–	–	–	–	–	81
Mr. Stuart Schonberger	81	–	–	–	–	–	–	81
Mr. Fong Ching, Eddy	81	–	–	–	–	–	–	81
Mr. Koo Fook Sun, Louis	81	–	–	–	–	–	–	81
Mr. Chan Chung Bun, Bunny	81	–	–	–	–	–	–	81

7 Director and employee benefit expense (Continued)

(a) Directors' and senior management's emoluments (Continued)

- (i) Other benefits include insurance premium, housing allowance and share options granted to the respective directors under the Share Purchase Scheme and Pre-IPO Share Option Scheme which have already been exercised by them during the year (the value set out being the difference between the exercise prices and the market prices of the Company's shares on the relevant exercise dates).
- (ii) Mr. Chen Yi Hong resigned as the Company's director on 1 September 2005.
- (iii) In addition to the above, the fair value of the unexercised share options granted to the respective directors under the Share Purchase Scheme, Pre-IPO Share Option Scheme and Share Option Scheme charged to the income statement during the year is as follows:

Name of Director	2005	2004
Mr. Zhang Zhi Yong	5,368	3,077
Mr. Tan Wee Seng	1,890	1,074
Mr. Chen Yi Hong (ii)	–	205
Ms. Wang Ya Fei, Jane	81	–
Mr. Lim Meng Ann	81	–
Mr. Stuart Schonberger	81	–
Mr. Fong Ching, Eddy	81	–
Mr. Koo Fook Sun, Louis	81	–

Although the fair value of the options is calculated in accordance with IFRS 2, it does not necessarily reflect the value to the respective directors as the options have not yet been exercised and no implication is made as to whether such options will be exercised by the respective directors.

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group included four directors for the year ended 31 December 2005 (2004: four directors), and their emoluments are reflected in the analysis presented above. The aggregate amounts of emoluments paid and payable to the remaining individual whose emoluments were the highest in the Group for the year are as follows:

	2005	2004
Salaries and allowances	817	959
Other benefits	2,360	–
Contributions to retirement benefit scheme	45	47
	3,222	1,006

In addition to the above, the fair value of the unexercised share options granted to the individual under the Share Purchase Scheme, Pre-IPO Share Option Scheme and Share Option Scheme charged to the income statement for the year ended 31 December 2005 is RMB269,000 (2004: RMB493,000).

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

8 Finance income, net

	2005	2004
Interest expenses on bank borrowings wholly repayable within 5 years	1,102	4,369
Interest income on bank balances and deposits	(14,026)	(3,715)
Net foreign currency exchange loss/(gain)	10,970	(1,475)
	(1,954)	(821)

9 Taxation

	2005	2004
Current taxation		
– Hong Kong profits tax	365	430
– The PRC enterprise income tax	84,741	57,056
	85,106	57,486

(a) The Company was incorporated in the Cayman Islands. Under current laws of Cayman Islands, there are no income, estate, corporation and capital gains subject to income tax or other taxes payable by the Company. The Company's subsidiary, RealSports Pte Ltd., was established under the International Business Companies Acts of the British Virgin Islands and is exempted from British Virgin Islands income taxes.

(b) Hong Kong profits tax has been provided at the rate of 17.5% on the estimated assessable profit arising in Hong Kong for the year ended 31 December 2005 (2004: 17.5%).

9 Taxation (Continued)

- (c) Provision for the PRC enterprise income tax is calculated based on the statutory tax rate of 33% on the assessable income of each of the group companies, except that certain subsidiaries of the Company are taxed at preferential tax rates of 15% based on the relevant PRC tax rules and regulations.

The tax on the Group's profit before taxation differs from the theoretical amount that would arise using the tax rate of 33% as follows:

	2005	2004
Profit before taxation	273,451	181,239
Tax calculated at a tax rate of 33%	90,239	59,809
Effects of different tax rate in Hong Kong	(324)	(380)
Preferential tax rates on the income of certain subsidiaries	(33,684)	(42,121)
Tax losses not recognized	8,937	12,545
Expenses not deductible for tax purposes	26,719	27,921
Tax credit granted to a subsidiary	(6,483)	–
Income not subject to tax	(298)	(288)
Taxation charge	85,106	57,486

The weighted average applicable tax rate is 31.1% (2004: 31.7%).

10 Dividends

	2005	2004
Interim dividend paid of RMB2.30 cents (2004: Nil) per ordinary share (note a)	22,649	40,000
Proposed final dividend of RMB5.00 cents (2004: RMB4.57 cents) per ordinary share (note b)	51,308	46,753
	73,957	86,753

Notes:

- (a) At a board meeting held on 25 August 2005, the directors declared an interim dividend of RMB2.30 cents (equivalent to HK2.21 cents) per ordinary share, totalling RMB22,649,000 for the six months ended 30 June 2005.

The comparative figure amounting to RMB40,000,000 represents a special distribution declared by RealSports Pte Ltd., the intermediate holding company, to its then equity holders prior to the Company's IPO in Hong Kong.

- (b) At a board meeting held on 29 March 2005, the directors proposed a final dividend of RMB4.57 cents (equivalent to HK4.30 cents) per ordinary share, totalling RMB46,753,000 for the year ended 31 December 2004. The dividend was approved by and paid to shareholders in 2005.

At a board meeting held on 22 March 2006, the directors proposed a final dividend of RMB5.00 cents (equivalent to HK4.81 cents) per ordinary share, totalling RMB51,308,000 for the year ended 31 December 2005. The translation of RMB into Hong Kong dollars is made at the exchange rate as at 31 December 2005. The actual translation rate for the purpose of dividend payment in Hong Kong dollars will be based on the official exchange rate of RMB against Hong Kong dollars on 12 May 2006, being the date of the annual general meeting on which the final dividend is proposed to the shareholders for approval. This proposed dividend is not reflected as a dividend payable in the financial statements, but will be reflected as an appropriation of distributable reserves for the year ending 31 December 2006.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

11 Earnings per share

Basic

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

	2005	2004
Profit attributable to equity holders of the Company	186,800	122,414
Weighted average number of ordinary shares in issue (thousands)	1,023,827	888,392
Basic earnings per share (RMB cents)	18.25	13.78

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all potentially dilutive ordinary shares. The Company's potentially dilutive ordinary shares comprised shares which may be issued under its share option schemes. A calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options, with the difference being adjusted in arriving at the weighted average number of shares for diluted earnings per shares, of which details are as follows.

	2005	2004
Profit attributable to equity holders of the Company, used to determine diluted earnings per share	186,800	122,414
Weighted average number of ordinary shares in issue (thousands)	1,023,827	888,392
Adjustment for share options (thousands)	6,750	1,871
Weighted average number of ordinary shares for diluted earnings per share (thousands)	1,030,577	890,263
Diluted earnings per share (RMB cents)	18.13	13.75

12 Property, plant and equipment

	Buildings	Leasehold improve- ment	Machinery	Motor vehicles and office equipment	Construction -in-progress	Total
As at 1 January 2004						
Cost	70,873	11,961	11,442	38,883	–	133,159
Accumulated depreciation	(23,289)	(6,774)	(4,249)	(17,363)	–	(51,675)
Net book amount	47,584	5,187	7,193	21,520	–	81,484
Year ended 31 December 2004						
Opening net book amount	47,584	5,187	7,193	21,520	–	81,484
Additions	600	11,574	998	14,454	3,519	31,145
Disposals	(2,715)	–	(265)	(2,103)	–	(5,083)
Transfer	–	–	–	3,369	(3,369)	–
Depreciation charge	(2,812)	(6,228)	(1,996)	(7,111)	–	(18,147)
Closing net book amount	42,657	10,533	5,930	30,129	150	89,399
As at 31 December 2004						
Cost	68,759	23,535	9,527	43,339	150	145,310
Accumulated depreciation	(26,102)	(13,002)	(3,597)	(13,210)	–	(55,911)
Net book amount	42,657	10,533	5,930	30,129	150	89,399
Year ended 31 December 2005						
Opening net book amount	42,657	10,533	5,930	30,129	150	89,399
Additions	549	12,296	2,580	12,439	10,682	38,546
Disposals	–	(617)	(30)	(936)	–	(1,583)
Reclassification	(797)	797	324	(324)	–	–
Disposal of a subsidiary	–	(710)	–	(1,760)	(5,786)	(8,256)
Depreciation charge	(2,483)	(9,626)	(1,157)	(9,044)	–	(22,310)
Closing net book amount	39,926	12,673	7,647	30,504	5,046	95,796
As at 31 December 2005						
Cost	66,957	29,539	13,648	54,914	5,046	170,104
Accumulated depreciation	(27,031)	(16,866)	(6,001)	(24,410)	–	(74,308)
Net book amount	39,926	12,673	7,647	30,504	5,046	95,796

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

12 Property, plant and equipment (Continued)

Buildings are located in the PRC and are built on land for which the Group had land use rights for periods varying from 20 to 50 years.

Depreciation expense of RMB12,076,000 (2004: RMB9,882,000) has been charged in administrative expenses, RMB8,644,000 (2004: RMB5,104,000) in distribution expenses and RMB1,590,000 (2004: RMB3,161,000) in cost of inventories.

13 Land use rights

Land use rights consist of prepaid lease payments for land for period varying from 20 to 50 years.

As at 1 January 2004

Cost	5,390
Accumulated amortization	(1,126)
	<hr/>
Net book amount	4,264
	<hr/>

Year ended 31 December 2004

Opening net book amount	4,264
Amortization	(207)
	<hr/>
Closing net book amount	4,057
	<hr/>

As at 31 December 2004

Cost	5,390
Accumulated amortization	(1,333)
	<hr/>
Net book amount	4,057
	<hr/>

Year ended 31 December 2005

Opening net book amount	4,057
Disposal	(70)
Amortization	(130)
	<hr/>
Closing net book amount	3,857
	<hr/>

As at 31 December 2005

Cost	5,320
Accumulated amortization	(1,463)
	<hr/>
Net book amount	3,857
	<hr/>

Amortization charge of RMB130,000 (2004: RMB207,000) is included in administrative expenses.

14 Intangible assets

	Trademark	Computer Software	Total
As at 1 January 2004			
Cost	1,526	4,566	6,092
Accumulated amortization	(146)	(2,171)	(2,317)
Net book amount	1,380	2,395	3,775
Year ended 31 December 2004			
Opening net book amount	1,380	2,395	3,775
Additions	–	7,655	7,655
Amortization	(81)	(1,986)	(2,067)
Closing net book amount	1,299	8,064	9,363
As at 31 December 2004			
Cost	1,526	12,221	13,747
Accumulated amortization	(227)	(4,157)	(4,384)
Net book amount	1,299	8,064	9,363
Year ended 31 December 2005			
Opening net book amount	1,299	8,064	9,363
Additions	1,527	1,848	3,375
Disposal of a subsidiary	–	(278)	(278)
Disposals	–	(2)	(2)
Amortization	(158)	(2,340)	(2,498)
Closing net book amount	2,668	7,292	9,960
As at 31 December 2005			
Cost	3,053	13,441	16,494
Accumulated amortization	(385)	(6,149)	(6,534)
Net book amount	2,668	7,292	9,960

Amortization charge of RMB2,498,000 (2004: RMB2,067,000) is included in administrative expenses.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

15 Deposit paid for land use right

During the year ended 31 December 2005, the Group paid deposit amounting to RMB10,002,000 for acquisition of a land use right in Beijing, the PRC. As at 31 December 2005, the Group was still in the process of obtaining the relevant land use right certificate.

16 Inventories

	2005	2004
Raw materials	1,934	21,884
Work in progress	3,730	707
Finished goods	299,180	305,963
	304,844	328,554
Less: Provision for write-down to net realizable value	(14,227)	(10,228)
	290,617	318,326

17 Investment in subsidiaries

	Company	
	2005	2004
Investment in unlisted shares, at cost	79,568	79,568
Loan to a subsidiary	155,088	–
	234,656	79,568

Balance due from a subsidiary is unsecured, non-interest bearing and has no fixed terms of repayment.

17 Investment in subsidiaries (Continued)

The following is a list of the principal subsidiaries as at 31 December 2005:

Name	Place of operation & incorporation and date of incorporation	Issued share/paid up capital	Equity interest held by the Company	Principal activities
<i>Directly held:-</i>				
RealSports Pte Ltd.	The British Virgin Islands, 8 October 2002	US\$1,000	100%	Investment holding
<i>Indirectly held:-</i>				
Li Ning Sports Technology Development (Hong Kong) Co., Ltd. (李寧體育科技發展(香港)有限公司)	Hong Kong, 28 May 2004	HK\$1	100%	Research and development
Li Ning Sports (Hong Kong) Co., Ltd. (李寧體育(香港)有限公司)	Hong Kong, 19 March 2003	HK\$100	100%	Provision of administrative services
李寧體育(上海)有限公司 (Li Ning Sports (Shanghai) Co., Ltd.)	The PRC, 25 August 1997	US\$8,000,000	100%	Sale of sports goods
北京李寧體育用品有限公司 (Beijing Li Ning Sports Goods., Ltd.)	The PRC, 4 November 1997	RMB66,670,000	100%	Sale of sports goods
上海狐步物流有限公司 (Shanghai Hubu Logistics Co., Ltd.)	The PRC, 15 July 2004	RMB3,000,000	100%	Provision of logistics, transportation and storage service
上海狐步信息系統有限公司 (Shanghai Hubu Information System Co., Ltd.)	The PRC, 20 April 2000	RMB2,000,000	100%	Provision of technology information service
上海少昊體育用品研發有限公司 (Shanghai Shao Hao Sports Goods Research and Development Co., Ltd.)	The PRC, 18 December 2001	RMB3,000,000	100%	Product design, research and development

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

17 Investment in subsidiaries (Continued)

Name	Place of operation & incorporation and date of incorporation	Issued share/paid up capital	Equity interest held by the Company	Principal activities
上海悅奧體育用品有限公司 (Shanghai Yue Ao Sports Goods Co., Ltd.)	The PRC, 5 March 2003	RMB3,000,000	100%	Sale of sports goods
佛山李寧體操學校服務有限公司 (Foshan Li Ning Gymnastics School Services Co., Ltd.)	The PRC, 31 October 1996	RMB1,000,000	100%	Property management
廣東李寧體育發展有限公司 (Guangdong Li Ning Sports Development Co., Ltd.), formerly known as 廣東健力寶運動服裝有限公司 (Guangdong Sports Jianlibao Apparel Co., Ltd.)	The PRC, 13 December 2001	RMB8,240,000	80%	Product manufacturing
上海一動體育發展有限公司 (Shanghai Edosports Development Co., Ltd.)	The PRC, 9 July 2001	RMB10,000,000	100%	Sale of sports goods
鄭州一動體育用品銷售有限公司 (Zhengzhou Edosports Goods Sales Co., Ltd.)	The PRC, 25 June 1998	RMB2,750,000	100%	Sale of sports goods
廣州一動體育用品銷售有限公司 (Guangzhou Edosports Goods Sales Co., Ltd.)	The PRC, 6 August 1998	RMB3,200,000	100%	Sale of sports goods
瀋陽一動體育用品銷售有限公司 (Shenyang Edosports Goods Sales Co., Ltd.)	The PRC, 10 June 1999	RMB3,000,000	100%	Sale of sports goods

17 Investment in subsidiaries (Continued)

Name	Place of operation & incorporation and date of incorporation	Issued share/paid up capital	Equity interest held by the Company	Principal activities
濟南一動體育用品銷售有限公司(Jinan Edosports Goods Sales Co., Ltd.)	The PRC, 15 April 2003	RMB1,000,000	100%	Sale of sports goods
武漢一動體育用品銷售有限公司(Wuhan Edosports Goods Sales Co., Ltd.)	The PRC, 2 June 1999	RMB1,000,000	100%	Sale of sports goods
杭州一動體育用品銷售有限公司(Hangzhou Edosports Goods Sales Co., Ltd.)	The PRC, 5 August 1999	RMB3,000,000	100%	Sale of sports goods
北京李寧體育用品銷售有限公司(Beijing Li Ning Sports Goods Sales Co., Ltd.)	The PRC, 4 November 1997	RMB5,000,000	100%	Sale of sports goods
石家莊一動體育用品銷售有限公司(Shijiazhuang Edosports Goods Sales Co., Ltd.)	The PRC, 12 November 1999	RMB1,000,000	100%	Sale of sports goods
上海一動體育用品銷售有限公司(Shanghai Edosports Goods Sales Co., Ltd.)	The PRC, 8 August 2000	RMB5,000,000	100%	Sale of sports goods
天津一動體育用品銷售有限公司(Tianjin Edosports Goods Sales Co., Ltd.)	The PRC, 14 December 1999	RMB3,500,000	100%	Sale of sports goods
南京一動體育用品銷售有限公司(Nanjing Edosports Goods Sales Co., Ltd.)	The PRC, 15 April 2003	RMB1,000,000	100%	Sale of sports goods

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

17 Investment in subsidiaries (Continued)

Name	Place of operation & incorporation and date of incorporation	Issued share/paid up capital	Equity interest held by the Company	Principal activities
新疆一動體育用品銷售有限公司 (Xinjiang Edosports Goods Sales Co., Ltd.)	The PRC, 4 February 2005	RMB1,000,000	100%	Sale of sports goods
長沙一動體育用品銷售有限公司 (Changsha Edosports Goods Sales Co., Ltd.)	The PRC, 26 August 1998	RMB1,000,000	100%	Sale of sports goods
南寧一動體育用品銷售有限公司 (Nanning Edosports Goods Sales Co., Ltd.)	The PRC, 29 July 1998	RMB1,500,000	100%	Sale of sports goods

18 Interest in a jointly controlled entity

On 30 June 2005, the Group signed an agreement with Aigle International S.A., a company incorporated in France, whereby the companies agreed to the setting up of a jointly controlled entity in which the Group and Aigle International S.A. both have a 50% interest. Such jointly controlled entity, namely, Li-Ning Aigle Ventures Limited was thereafter established as a company incorporated in Hong Kong. Li-Ning Aigle Ventures Limited is an investment holding company. Its wholly owned subsidiary established in the PRC in January 2006 is principally engaged in manufacturing, marketing and distribution of AIGLE brand apparel and foot wear products. As at and for the year ended 31 December 2005, the Group's share of the assets and liabilities and operating results of the jointly controlled entity are included in the consolidated balance sheet and income statement as follows:

Current assets	5
Less: current liabilities	(63)
Net assets	(58)
Administrative expenses	(63)

As at 31 December 2005, the Group did not have any contingent liabilities in respect of its interest in the jointly controlled entity. In addition, as at 31 December 2005, the jointly controlled entity did not have any contingent liabilities.

19 Accounts and notes receivable

	2005	2004
Accounts and notes receivable	376,942	227,594
Less: provision for impairment of receivables	(3,716)	(10,020)
	373,226	217,574

Customers are normally granted credit terms of 60 days. Ageing analysis of accounts and notes receivable at the respective balance sheet dates is as follows:

	2005	2004
0 – 30 days	226,956	154,318
31 – 60 days	67,105	34,946
61 – 90 days	44,661	13,847
91 – 180 days	34,504	12,942
181 – 365 days	637	3,705
Over 365 days	3,079	7,836
	376,942	227,594

As at 31 December 2005, the largest five customers accounted for 29% of total accounts receivable balance (2004: 17%).

20 Other receivables and prepayments

	Group		Company	
	2005	2004	2005	2004
Advances to suppliers	1,856	24,905	–	–
Rental and other deposits	17,131	21,589	–	–
Prepaid rental	18,165	14,924	–	–
Others	30,672	20,006	3,713	2,550
	67,824	81,424	3,713	2,550

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

21 Cash and bank deposits

As at 31 December 2005, the Group had the following cash and bank deposits held with banks in the PRC (including Hong Kong Special Administrative Region):

	Group		Company	
	2005	2004	2005	2004
Cash at banks and in hand	378,368	322,568	8,837	153,137
Fixed deposits held at banks with maturity of more than three months	353,161	372,508	345,284	372,508
Pledged bank deposits	–	66,212	–	66,212
	731,529	761,288	354,121	591,857

The effective interest rate on the fixed deposits was 3.8% (2004: 2.0%). These deposits have an average maturity of 83 days (2004: 258 days).

An analysis of cash and bank deposits by denominated currency is as follows:

	Group		Company	
	2005	2004	2005	2004
Denominated in Renminbi	360,446	162,207	–	–
Denominated in Hong Kong Dollars	258,157	328,333	247,440	326,817
Denominated in United States Dollars	112,926	270,748	106,681	265,040
	731,529	761,288	354,121	591,857

At present, Renminbi is not a freely convertible currency in the international market. The conversion of Renminbi into foreign currencies and remittance of Renminbi out of the PRC is subject to the rules and regulations of exchange control promulgated by the PRC government. Also, the exchange rate is determined by the government of the PRC.

22 Trade payables

The normal credit period for trade payables generally ranges from 30 to 60 days. Ageing analysis of trade payables at the respective balance sheet dates is as follows:

	2005	2004
0 – 30 days	205,666	189,984
31 – 60 days	4,645	66,855
61 – 90 days	2,410	2,695
91 – 180 days	312	873
181 – 365 days	829	341
Over 365 days	300	249
	214,162	260,997

23 Other payables and accruals

	Group		Company	
	2005	2004	2005	2004
Accrued expenses	49,668	14,244	2,262	1,662
Advances from customers	8,777	23,534	–	–
Wages payable	36,633	35,382	–	–
Welfare payable	23,310	29,578	–	–
VAT and other taxes payable	16,670	10,906	–	–
Due to a related company	–	1,840	–	–
Other payables	26,138	22,618	1,202	7,970
	161,196	138,102	3,464	9,632

24 Short-term borrowings

	2005	2004
Bank loan denominated in RMB		
– secured	–	20,000
– cross guaranteed by a group company	–	20,000
	–	40,000

The weighted average effective annual interest rate of the borrowings was 3.45% for the year ended 31 December 2005 (2004: 4.57%).

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

25 Share capital

	Number of shares (Thousands)	Approximate amount HK\$'000
Authorized at HK\$0.10 each		
As at 31 December 2004 and 2005	10,000,000	1,000,000
Issued and fully paid		
Issued nil paid on incorporation, and subsequently credited as fully paid	0.1	–
Issued and credited as fully paid as consideration for acquisition of the share capital of RealSports	749,999.9	75,000
New issue through placing and public offer	273,038	27,304
As at 31 December 2004	1,023,038	102,304
Proceeds from shares issued pursuant to share option scheme (note a)	3,129	313
As at 31 December 2005	1,026,167	102,617
Equivalent to RMB'000		108,889

Note:

- (a) During the year ended 31 December 2005, the Company issued 3,129,000 shares of HK\$0.10 each to employees of the Group at issued price of HK\$1.8275 per share pursuant to the Company's Pre-IPO Share Option scheme. Refer to Note 27 for details.

26 Reserves

Group

	Share Premium	Capital reserves (a)	Statutory reserve fund (b)	Statutory staff welfare fund (b)	Retained profits	Other reserves	Total
As at 1 January 2004	–	85,634	42,376	17,334	164,120	–	309,464
Share premium on placing and public offer	564,323	–	–	–	–	–	564,323
Profit for the year	–	–	–	–	122,414	–	122,414
Share options granted for services provided	–	–	–	–	–	11,025	11,025
Appropriations to statutory reserves	–	–	5,027	92	(5,119)	–	–
2003 dividends paid	–	–	–	–	(65,772)	–	(65,772)
Special distribution declared	–	(40,000)	–	–	–	–	(40,000)
As at 31 December 2004	564,323	45,634	47,403	17,426	215,643	11,025	901,454

	Share Premium	Capital reserves (a)	Statutory reserve fund (b)	Statutory staff welfare fund (b)	Retained profits	Other reserves	Total
As at 1 January 2005, as previously reported	564,323	45,634	47,403	17,426	226,668	–	901,454
Share options granted for services provided (Note 2)	–	–	–	–	(11,025)	11,025	–
As at 1 January 2005, as restated	564,323	45,634	47,403	17,426	215,643	11,025	901,454
Profit for the year	–	–	–	–	186,800	–	186,800
Share options granted for services provided	–	–	–	–	–	27,557	27,557
Issue of new shares pursuant to exercise of share options	5,626	–	–	–	–	–	5,626
Transfer of fair value of share options exercised to share premium	15,834	–	–	–	–	(15,834)	–
Appropriations to statutory reserves	–	–	22,368	3,479	(25,847)	–	–
Dividends paid	(69,402)	–	–	–	–	–	(69,402)
As at 31 December 2005	516,381	45,634	69,771	20,905	376,596	22,748	1,052,035

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

26 Reserves (Continued)

Company

	Share premium	Accumulated losses	Other reserves	Total
As at 26 February 2004 (date of incorporation)	–	–	–	–
Shares issued at premium on placing and public offer	564,323	–	–	564,323
Share options granted for services provided	–	–	11,025	11,025
Loss for the period from 26 February 2004 (date of incorporation) to 31 December 2004	–	(19,568)	–	(19,568)
As at 31 December 2004	564,323	(19,568)	11,025	555,780

	Share premium	Accumulated losses	Other reserves	Total
As at 1 January 2005, as previously reported	564,323	(8,543)	–	555,780
Share options granted for services provided	–	(11,025)	11,025	–
As at 1 January 2005, as restated	564,323	(19,568)	11,025	555,780
Loss for the year	–	(39,424)	–	(39,424)
Share options granted for services provided	–	–	27,557	27,557
Issue of new shares pursuant to exercise of share options	5,626	–	–	5,626
Transfer of fair value of share options exercised to share premium	15,834	–	(15,834)	–
Dividends paid	(69,402)	–	–	(69,402)
As at 31 December 2005	516,381	(58,992)	22,748	480,137

(a) Capital reserves

Capital reserves comprised the aggregate of contribution by the then shareholders of the Group and the merger reserve arose during the reorganisation in preparation for listing of the Company's shares on The Stock Exchange of Hong Kong Limited (Note 1).

26 Reserves (Continued)

(b) Statutory reserves

Under the relevant PRC laws and regulations, the Company's subsidiaries in the PRC (the "PRC Companies") are required to appropriate certain percentage of their respective net profit to two statutory funds – the statutory reserve fund and the statutory staff welfare fund. Details of the two funds are as follows:

(i) Statutory reserve fund

Pursuant to applicable PRC laws and regulations, the PRC Companies are required to allocate 10% of the companies' net profit to the fund until such fund reaches 50% of the companies' registered capital. The statutory reserve fund can be utilized, upon approval by the relevant authorities, to offset accumulated losses or to increase registered capital of the companies, provided that such fund be maintained at a minimum of 25% of the companies' registered capital.

(ii) Statutory staff welfare fund

Pursuant to applicable PRC laws and regulations, the PRC Companies are required to transfer 5% to 10% of the companies' net profit to the fund. This fund can only be used to provide staff welfare facilities and other collective benefits to the companies' employees. This fund is non-distributable other than upon liquidation of the PRC Companies.

(c) Distributable reserves

Under the Company Law (revised) of the Cayman Islands, share premium of the Company is available for paying distributions or dividends to its equity holders provided that immediately following the distribution or dividend the Company is able to pay its debts as they fall due in the ordinary course of business.

As at 31 December 2005, the Company had reserves available for distribution amounting to approximately RMB480,137,000 (2004: RMB555,780,000).

27 Share option schemes

(a) Share Purchase Scheme

Alpha Talent Management Limited ("Alpha Talent") was set up in 2004 by Mr. Li Ning, a substantial shareholder and chairman of the Company, to hold 35,250,000 of the Company's shares beneficially owned by Mr. Li Ning.

The objective of the Share Purchase Scheme (the "Alpha Talent Option") is to provide for the grant of rights to purchase the Company's shares beneficially owned by Mr. Li Ning through Alpha Talent to certain key individuals who have contributed to the economic achievement of the Group.

The Alpha Talent Option was adopted by Alpha Talent on 5 June 2004 and is effective for a period of 10 years from that date. A committee established by the board of directors of Alpha Talent determines the individuals within the Group who shall be selected to receive options, the exercise price, and the terms and conditions of the options. Lapsed or cancelled options will be re-granted in accordance with the terms of the Alpha Talent Option until all shares held by Alpha Talent have been purchased pursuant to the scheme.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

27 Share option schemes (Continued)

(a) Share Purchase Scheme (Continued)

Currently granted options vest gradually after the individuals complete certain periods of service in the Group's companies ranging from 6 to 30 months.

Movement in the number of share options outstanding and their related weighted average exercise prices are as follows:

	2005 Weighted average exercise price (per share) HK\$	2005 Outstanding options (Thousands)	2004 Weighted average exercise price (per share) HK\$	2004 Outstanding options (Thousands)
As at 1 January	0.69	24,630	–	–
Granted	3.19	4,603	0.69	25,230
Exercised	2.07	(8,863)	–	–
Lapsed	–	–	0.86	(600)
As at 31 December	0.65	20,370	0.69	24,630
Exercisable as at 31 December	0.68	16,042	0.71	11,340

Share options outstanding as at the end of the years have the following expiry dates and weighted-average exercise prices:

Expiry date	2005 Weighted average exercise price (per share) HK\$	2005 Share options (Thousands)	2004 Weighted average exercise price (per share) HK\$	2004 Share options (Thousands)
8 June 2010	0.64	18,967	0.69	24,630
11 November 2011	0.86	1,403	–	–
		20,370		24,630

27 Share option schemes (Continued)

(b) Pre-IPO Share Option Scheme

The Company has adopted a pre-IPO share option scheme (the "Pre-IPO Option"). The purpose of the scheme is to give the directors and full-time employees of the Company and the Group an opportunity to have a personal stake in the Company and recognise their contribution to the Group. The Pre-IPO Share Option Scheme was adopted on 5 June 2004. HK\$1 is payable by the grantee who accepts the grant of an option.

Total number of share options subject to the Pre-IPO Option is 16,219,000 shares and they have been granted on 5 June 2004. No further share options will be granted under the Pre-IPO Option. Options granted under the Pre-IPO Option vest gradually after employees or directors complete a period of service in the Group of 12 to 36 months starting from the date of grant (5 June 2004).

Movement in the number of share options outstanding and exercise prices are as follows:

	2005	2005	2004	2004
	Exercise	Outstanding	Exercise	Outstanding
	price	options	price	options
	(per share)	(Thousands)	(per share)	(Thousands)
	HK\$		HK\$	
As at 1 January	1.8275	15,641	–	–
Granted	–	–	1.8275	16,219
Exercised	1.8275	(3,129)	–	–
Lapsed	1.8275	(1,000)	1.8275	(578)
As at 31 December	1.8275	11,512	1.8275	15,641
Exercisable as at 31 December	1.8275	2,501	–	–

Share options outstanding as at the end of the years have the following expiry date and exercise price:

	2005	2005	2004	2004
	Exercise	Share	Exercise	Share
	price	options	price	options
Expiry date	(per share)	(Thousands)	(per share)	(Thousands)
	HK\$		HK\$	
5 June 2010	1.8275	11,512	1.8275	15,641

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

27 Share option schemes (Continued)

(c) Share Option Scheme

Pursuant to a shareholders' resolution passed on 5 June 2004, the Company adopted a share option scheme (the "Post-IPO Option"). The Share Option Scheme will remain in force for a period of 10 years commencing from 5 June 2004.

The purpose of the Post-IPO Option is to provide incentives to eligible participants to contribute to the Company and to enable the Company to recruit high-calibre employees and attract human resources that are valuable to the Group. Eligible participants are any individuals being employees, officers, agents, consultants or representatives of any member of the Group who, based on the board of directors' discretion, have made valuable contribution to the business of the Group based on their performance and/or years of service, or are regarded as valuable human resources of the Group based on their work experience, knowledge in the industry and other relevant factors.

HK\$1 is payable by the participant who accepts the grant of an option. The subscription price for the shares under the option to be granted will be determined by the Company's board of directors and will be the highest of: (a) the closing price of the shares of the Company as at stated in The Hong Kong Stock Exchange Limited's daily quotations sheets on the date of the grant of the option; (b) the average closing price of the shares of the Company as stated in The Hong Kong Stock Exchange Limited's daily quotations sheets for the five business days immediately preceding the date of the grant of the option; and (c) the nominal value of the shares of the Company.

The maximum number of shares that may be granted under the Post-IPO Option and other share option schemes shall not exceed 30% of the number of issued shares of the Company from time to time. The total number of shares of the Company issued and which may be issued upon exercise of all options (whether exercised, cancelled or outstanding) granted in any 12-month period to each participant must not exceed 1% of the number of shares of the Company in issue. Lapsed or cancelled options may be re-granted in accordance with the terms of the Post-IPO Option.

An option may be exercised in accordance with the terms of the Post-IPO Option at any time during a period to be notified by the Company's board of directors, which must not be more than 10 years from the date of the grant.

Any share of the Company allotted and issued on the exercise of options will rank pari passu with the other shares of the Company in issue on the date of allotment.

27 Share option schemes (Continued)

(c) Share Option Scheme (Continued)

No Post-IPO Options were granted during the year ended 31 December 2004. Movement in the number of Post-IPO Options outstanding and their related exercise price during the year ended 31 December 2005 are as follows:

	2005	
	Exercise price (per share) HK\$	Outstanding options (Thousands)
Granted	3.685	15,921
Lapsed	3.685	(416)
As at 31 December	3.685	15,505
Exercisable as at 31 December	–	–

Share options outstanding as at the end of the year have the following expiry date and exercise price:

	2005	
Expiry date	Exercise price (per share) HK\$	Share options (Thousands)
4 July 2011	3.685	15,505

(d) Fair value of share options

The fair value of the options granted under the above three schemes during the years ended 31 December 2004 and 2005 determined using Black-Scholes valuation model were as follows:

	2005	2004
Alpha Talent Option	10,190	20,563
Pre-IPO Option	N/A	12,435
Post-IPO Option	17,368	N/A

The Group has taken advantage of the transitional provisions of IFRS 2 to apply the standard to share options granted after 7 November 2002 and not yet vested at 1 January 2005. Share options granted and vested prior to 1 January 2005 with fair value totalling RMB19,312,000 under Alpha Talent Option were not included in the calculation of the schemes' fair value.

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

27 Share option schemes (Continued)

(d) Fair value of share options (Continued)

The fair values were determined using the Black-Scholes valuation model which was performed by an independent valuer, American Appraisal China Limited. Significant inputs into the model were as follows:

	2005	2004
Alpha Talent Option		
Weighted average share price (HK\$)	4.68	2.26
Weighted average exercise price (HK\$)	3.19	0.69
Expected volatility	39.2%	40.6%
Expected option life (years)	3.11	2.39
Weighted average annual risk free interest rate	4.4%	2.4%
Expected dividend yield	2.0%	2.0%
Pre-IPO Option		
Share price (HK\$)	N/A	2.35
Exercise price (HK\$)	N/A	1.8275
Expected volatility	N/A	41.1%
Expected option life (years)	N/A	1.97
Weighted average annual risk free interest rate	N/A	2.4%
Expected dividend yield	N/A	2.0%
Post-IPO Option		
Share price (HK\$)	3.65	N/A
Exercise price (HK\$)	3.685	N/A
Expected volatility	39.2%	N/A
Expected option life (years)	4.0	N/A
Weighted average annual risk free interest rate	3.3%	N/A
Expected dividend yield	2.0%	N/A

The expected volatility is estimated based on historical stock prices of comparable companies listed on The Stock Exchange of Hong Kong Limited and/or the daily trading prices of the Company's shares since its date of listing (28 June 2004).

On 30 August 2005, the Group reduced the vesting period and exercise period of certain outstanding options under Alpha Talent Option and Pre-IPO Option. Exercisable dates of certain share options have been advanced to 1 September 2005 from 28 December 2005, 28 June 2006 and 28 June 2007. Expiry dates have been advanced to 31 December 2005 from 8 June 2010 and 5 June 2010. The incremental fair value of RMB222,000 has been expensed in the income statement for the year ended 31 December 2005. The Group used the inputs noted above to measure the fair value of the original and revised share option schemes immediately before and after the modification.

28 Cash flow statement

(a) Reconciliation of profit before taxation to net cash inflow generated from operations:

	2005	2004
Profit before taxation	273,451	181,239
Adjustments for:		
Depreciation	22,310	18,147
Amortisation	2,628	2,274
Write-back of impairment charge of accounts receivable	(2,211)	(7,030)
Write-down/(reversal of write-down) of inventories to net realisable value	5,318	(5,201)
Gain on disposal of a subsidiary	(3,091)	–
Share options charged to compensation expense	27,557	11,025
Loss on disposals of property, plant and equipment, land use right and intangible assets	884	4,908
Interest income	(14,026)	(3,715)
Interest expenses	1,102	4,369
Net foreign currency exchange loss/(gain)	10,970	(1,475)
Operating profit before working capital changes	324,892	204,541
Decrease/(increase) in inventories	11,126	(16,886)
Increase in accounts and notes receivable	(176,441)	(90,485)
Decrease/(increase) in other receivables and prepayments	7,642	(41,596)
(Decrease)/increase in trade payables	(19,951)	89,416
Increase in other payables and accruals	59,294	46,494
Cash inflow generated from operations	206,562	191,484

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

28 Cash flow statement (Continued)

(b) Disposal of a subsidiary

On 31 August 2005, the Group disposed of its 80% equity interest in Beijing Dong Xiang to Shanghai Tai Tan, a company controlled by Mr. Chen Yi Hong, a former director, for cash consideration of RMB8,614,000.

Major assets and liabilities of Beijing Dong Xiang as at 31 August 2005 are as follows:

Property, plant and equipment	8,256
Intangible assets	278
Inventories	11,265
Accounts receivable	23,000
Other receivables and prepayments	6,937
Cash at banks and in hand	23,351
	<hr/>
	73,087
	<hr/>
Trade payables	(26,884)
Due to a subsidiary of the Group	(36,200)
Taxation	(3,099)
	<hr/>
	(66,183)
	<hr/>
Net assets	6,904
	<hr/>
The Group's share (80%)	5,523
	<hr/>
Consideration	8,614
	<hr/>
Gain on disposal	3,091
	<hr/>
Analysis of cash outflow from disposal:	
Consideration in cash	8,614
Less: Cash at banks and in hand disposed	(23,351)
	<hr/>
Net cash outflow	(14,737)
	<hr/>

29 Commitments

(a) Capital commitments

As at 31 December 2005, the Group has authorised but not contracted for capital commitments of RMB98,000,000 for construction of a headquarter building in the PRC.

(b) Operating lease commitments – where a group company is the lessee:

The Group has commitments to make the following aggregate minimum payments under non-cancellable operating leases in respect of its office premises and shops:

	2005	2004
Not later than 1 year	51,776	66,934
Later than 1 year and not later than 5 years	91,893	109,829
Later than 5 years	2,880	–
	146,549	176,763

Notes to the Accounts

(Expressed in RMB'000 unless otherwise stated)

30 Significant related party transactions

(a) The Group has following significant related party transactions:

	2005	2004
Sales of goods to:		
– 北京動感九六體育用品有限責任公司 (Beijing Dong Gan Jiu Liu Sporting Goods Company Limited), a company controlled by the family members of Mr. Chen Yi Hong, a former director	9,663	15,509
– 北京動感競技經貿有限公司 (Beijing Dong Gan Jing Ji Commercial Company Limited), a company controlled by the family members of Mr. Chen Yi Hong, a former director	345	911
Sponsorship fee paid to:		
– 北京一動體育發展有限公司 (Beijing Edo Sports Development Company Limited), a company controlled by 上海寧晟企業管理有限公司 (Shanghai Ning Sheng Corporate Management Co., Ltd.), a company controlled by the family members of Mr. Li Ning, chairman of the Company	3,250	2,640
Consideration received from disposal of a subsidiary to:		
– 上海泰坦體育用品有限公司 (Shanghai Tai Tan Sporting Goods Co., Ltd.), a company controlled by Mr. Chen Yi Hong, a former director (Note 5 (b))	8,614	–

In the opinion of the Directors, these transactions were entered into at terms as agreed with the related parties in the ordinary course of business.

30 Significant related party transactions (Continued)

(b) Significant balances with related parties are as follows:

	2005	2004
Other payables		
– 上海雷德體育發展有限公司 (Shanghai Lei De Sporting Goods Co., Ltd.), being a minority shareholder of a subsidiary, controlled by Mr. Chen Yi Hong, a former director, and his family members	–	1,840
Accounts receivable		
– 北京動感九六體育用品有限責任公司 (Beijing Dong Gan Jiu Liu Sporting Goods Co., Ltd.)	–	1,738

The above balances are interest free, unsecured and have no fixed term of repayment.

31 Events after the balance sheet date

On 3 January 2006, the Company granted to certain employees 360,000 share options at the subscription price of HK\$5.50 per share pursuant to the Company's Post-IPO Option.

32 Approval of the financial statements

The financial statements were approved by the Board of Directors on 22 March 2006.

Information for Investors

SHARE INFORMATION

Listing: the Main Board of the Hong Kong Stock Exchange

Stock code: 2331

Board lot: 2,000 shares

Shares outstanding as at 31 December 2005: 1,026,166,667 shares

Market capitalization as at 31 December 2005: HK\$5,643,916,669

Dividends per share for 2005:

Interim	RMB2.30 cents (equivalent to HK2.21 cents)
Final	RMB5.00 cents (equivalent to HK4.81 cents)

FINANCIAL CALENDAR

Announcement of interim results	25 August 2005
Announcement of annual results	22 March 2006
Book closing dates for final dividend	9 May 2006 – 12 May 2006
Record date for final dividend	12 May 2006
Annual general meeting	12 May 2006
Payment of final dividend	on or about 22 May 2006

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68 Fort Street
Grand Cayman
Cayman Islands

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

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Glossary

In this annual report, unless the context states otherwise, the following expressions have the following meanings:

"AIGLE"	Aigle International S. A., a corporation organized under the laws of France
"Alpha Talent"	Alpha Talent Management Limited, a limited liability company incorporated in the British Virgin Islands and beneficially owned by Mr. Li Ning for the purpose of holding the relevant Shares under the Share Purchase Scheme
"ATP"	Association Tennis Professional
"Beijing Dong Xiang"	北京動向體育發展有限公司 (Beijing Dong Xiang Sports Development Co., Ltd.), a limited liability company established in the PRC and a former indirect 80% owned subsidiary of the Company
"Beijing Li Ning"	北京李寧體育用品有限公司 (Beijing Li Ning Sports Goods Co., Ltd.), a limited liability company established in the PRC and an indirect wholly-owned subsidiary of the Company
"Board"	the board of Directors of the Company
"Company"	Li Ning Company Limited, a company incorporated in the Cayman Islands with limited liability, the shares of which are listed on the Hong Kong Stock Exchange
"Director(s)"	the director(s) of the Company
"Group"	the Company and its subsidiaries
"HK\$"	Hong Kong dollars, the lawful currency of Hong Kong
"Hong Kong"	the Hong Kong Special Administrative Region in the PRC
"Hong Kong Li Ning"	Li Ning Sports (Hong Kong) Company Limited, an indirect wholly-owned subsidiary of the Company incorporated in Hong Kong
"Hong Kong Stock Exchange"	The Stock Exchange of Hong Kong Limited
"Listing Rules"	Rules Governing the Listing of Securities on the Hong Kong Stock Exchange
"NBA"	National Basketball Association
"Pre-IPO Share Option Scheme"	the pre-IPO share option scheme of the Company adopted on 5 June 2004
"Post-IPO Share Option Scheme"	the post-IPO share option scheme of the Company adopted on 5 June 2004
"PRC"	People's Republic of China
"RMB"	Renminbi, the lawful currency of the PRC
"Shanghai Li Ning"	李寧體育(上海)有限公司 (Li Ning Sports (Shanghai) Company Limited), a limited liability company established in the PRC and an indirect wholly-owned subsidiary of the Company
"Share Purchase Scheme"	the share purchase scheme set up by Mr. Li Ning and adopted by Alpha Talent on 5 June 2004
"Share(s)"	Share(s) of HK\$0.10 each in the share capital of the Company
"Shareholders"	shareholders of the Company