利君國際醫藥
(控股)有限公司
Lijun International Pharmaceutical (Holding) Co., Ltd.

(Incorporated in the Cayman Islands with limited liability)

Stock Code : 2005

LIJUN INTERNATIONAL

Annual Report

2006

CONTENTS

CORPORATE INFORMATION

STOCK CODE

2005

EXECUTIVE DIRECTORS

Mr. Wu Qin *(Chairman)*
Mr. Wu Zhihong
Mr. Huang Chao
Mr. Xie Yunfeng
Ms. Sun Xinglai
Mr. Wang Xian Jun

NON-EXECUTIVE DIRECTOR

Mr. Liu Zhiyong

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Qu Jiguang
Mr. Leung Chong Shun
Mr. Chow Kwok Wai

COMPANY SECRETARY

Mr. Lam Yiu Por

REGISTERED OFFICE

Cricket Square, Hutchins Drive,
P.O. Box 2681 GT, Grand Cayman,
KY1-1111, Cayman Islands

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Office 2809, 28th Floor
Office Tower, Convention Plaza
1 Harbour Road, Wanchai
Hong Kong

AUTHORISED REPRESENTATIVES

Mr. Wu Zhihong
Ms. Sun Xinglai

COMPLIANCE ADVISER

Guotai Junan Capital Limited

AUDIT COMMITTEE

Mr. Chow Kwok Wai *(Chairman)*
Mr. Qu Jiguang
Mr. Leung Chong Shun

REMUNERATION COMMITTEE

Mr. Leung Chong Shun *(Chairman)*
Mr. Qu Jiguang
Mr. Chow Kwok Wai

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
P.O. Box 705, Butterfield House, 68 Fort Street
George Town, Grand Cayman, Cayman Islands
British West Indies

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
Shops 1806-1807, 18th Floor, Hopewell Centre
183 Queen’s Road East, Hong Kong

PRINCIPAL BANKERS

Industrial and Commercial Bank of China
China Construction Bank
China Construction (Asia) Bank
China Merchants Bank
China Minsheng Banking Corp., Ltd.
CITIC Industrial Bank
Hang Seng Bank

LEGAL ADVISER TO THE COMPANY AS TO HONG KONG LAW

Dibb Lupton Alsop

AUDITORS

PricewaterhouseCoopers

CHAIRMAN'S STATEMENT

On behalf of the board of directors of Lijun International Pharmaceutical (Holding) Co., Ltd. (the "Company"), I am pleased to present the audited consolidated results of the Company and its subsidiaries (the "Group") for the year ended 31 December 2006.

RESULTS AND DIVIDEND PAYMENTS

In 2006, the revenue of the Group amounted to RMB860,641,000, representing a mild decrease of 2.7%. Profit attributable to equity holders of the Company dropped by 9.4% as compared to that of previous year, amounted RMB84,575,000. The results was considered hard-earned given the harsh market conditions of the pharmaceutical industry in 2006.

The Board proposed a final dividend of HK$0.07 per ordinary share for the year 2006. Taking into account the interim dividend already paid, the total dividend for the year amounts to HK$0.14 per ordinary share.

BUSINESS REVIEW

For the year 2006, the State's rectification regulation over the purchasing administration of the medical products in the hospitals, have had significant impact on the overall pharmaceutical markets, especially with regard to prescriptive medicine. In August 2006, the National Development and Reform Commission of the PRC（中國國家發展和改革委員會）lowered the maximum retail price of the Company's core product, Lijunsha and several types of antibiotics products. These two factors combined positioned the Company's product sales for the year before serious test. Confronted by the sudden market change, the Company takes full advantage of its sales network and brand recognition and adjusted its sales strategies to maintain a satisfactory sales performance.

Antibiotics products continued to see stable sales. Despite the sluggish market conditions for antibiotics products across the country, the core product, Lijunsha, managed to record sales of RMB413,338,000, a mere decrease of 2.1%, and maintained the absolute leading position in similar antibiotics products in the PRC. Lijunsha was also awarded the honor of "Most Recommended Brand By Salesperson In Drug Stores of China（中國藥店店員推薦率最高品牌）". Given the difficult conditions to promote injection and lyophilized powder for injection forms products in hospitals, the Group focused on the sales of the newly launched dispersible tablets of Paiqi series products, which has been fast growing over the recent years, through drug stores. Paiqi dispersible tablet recorded a sales of RMB4,000,000 in the first year of launch, and Paiqi series products recorded a stable sales of over RMB80,000,000. As a result of the rural market development, the sales of Erythromycin tablets increased by 15% to RMB62,080,000.

However, due to various reasons including Cephalosporins products failing to reach the target, antibiotics products recorded a decrease of 7% in the sales of as compared with last year. The overall sales of antibiotics products accounted for 72.1% of the total revenue of the Company.

Non-antibiotics products continued to see steady growth. Through effective academic marketing strategy, Dobesilate recorded a sales of RMB32,847,000, representing a growth of 9.7%, and won the honor of "Chinese Consumers' Most Preferred Brand for Cerebro-Cardiovascular Medicines（中國心腦血管用藥消費者滿意首選品牌）". Owing to the development of sales network in rural areas, the sales of non-antibiotic general finished medicines recorded an increase of 26.7% as compared with last year. As for bulk pharmaceutical products, the Group took advantage of the fact that its Erythromycin products being the first in China to obtain U.S. FDA certification to promote the export of Erythromycin. Coupled by flexible marketing strategies, the bulk pharmaceutical of the Group recorded a total sales of RMB75,189,000 for the year, representing a growth of 3.3%.

The product costs were further lowered through control over raw material prices and internal technical renovation, resulting lower total cost of sales for the year.

CHAIRMAN'S STATEMENT

The Company recorded satisfactory results in terms of acquisition and merger. In June 2006, the Company successfully acquired 20% equity interest in Xi'an Lijun. In March 2007, the Company had entered into an acquisition agreement with vendor to acquire 100% equity interest of New Orient Investments Limited, which is the sole shareholder of its subsidiary Shijiazhuang No. 4 Pharmaceutical Co., Ltd., a well-known company in the PRC for producing and selling infusion products, resulting further diversified product line, extended sales network and quickly expanded profit base to the Company and hence significantly strengthened abilities of the Company to guard against market risks.

OUTLOOK

The Company expects to totally change its situation of excessively relying on antibiotics products. Following the completion of the acquisition of Shijiazhuang No. 4 Pharmaceutical Co., Ltd, the product portfolio will be rapidly diversified, infusion products and Chinese medicine products will account for significant contribution to the total sales and profit of the Group. The new product development, management and leveraging the supplementary advantages of the sales network of the two subsidiaries will be the focal work of the Company to promote fast development of the whole Group.

It is still the Company's objective to maintain the Company's leading position in Macrolide antibiotics. We also plan to take multiple measures to expand the marketshare of Lijunsha products, increase the product categories of Paiqi series in order to suit different market needs and increase sales.

In the meantime, the Company will devote to the development of over-the-counter ("OTC") products. OTC Dobesilate will be launched to market in 2007. On the other hand, following the completion of production line for modern oral solution and modern soft capsules, the Company will introduce new products with unique curative effects integrating advanced new technologies, which are expected to become new driving force for the development of the Company.

It is believed that the State's reform to the medical system and the establishment of the new cooperative medical system in rural areas will contribute to the development of a better regulated medical market, which in turn will help to create greater new markets, bringing more opportunities to major pharmaceutical companies with branding advantages. We believe the medical industry is in a process of integration, and that the current situation is beneficiary to big-sized enterprises. We aim to leverage such opportunities to facilitate fast development through acquisitions of other good quality enterprises in the PRC at proper stages.

On behalf of the Board, I hereby express our genuine gratitude to our investors and employees for their support in the past.

Wu Qin
Chairman

Hong Kong, 26 April 2007

MANAGEMENT DISCUSSION AND ANALYSIS

SALES

As at 31 December 2006, the sales of the Group amounted to approximately RMB860,641,000, representing a decrease of 2.7% as compared with RMB884,709,000 in last year. A breakdown of the sales of the Group for the year ended 31 December 2006 is set out as follows:

	2006		2005		Change
	RMB'000	**%**	*RMB'000*	%	**%**
Antibiotics					
— Lijunsha	**413,338**	**48.0**	422,341	47.7	**-2.1**
— Paiqi	**80,996**	**9.4**	89,083	10.1	**-9.1**
— Erythromycin tablets	**62,080**	**7.2**	54,002	6.1	**15.0**
— Cephalosporin	**28,914**	**3.4**	52,927	6.0	**-45.4**
— Other antibiotics	**35,194**	**4.1**	48,811	5.5	**-27.9**
Total sales of antibiotics finished products	**620,522**	**72.1**	667,164	75.4	**-7.0**
Non-antibiotic					
Dobesilate	**32,847**	**3.8**	29,934	3.4	**9.7**
Other non-antibiotic medicines	**127,042**	**14.8**	100,288	11.3	**26.7**
Total sales of non-antibiotic finished products	**159,889**	**18.6**	130,222	14.7	**22.8**
Sales of bulk pharmaceuticals	**75,189**	**8.7**	72,825	8.2	**3.3**
Others	**5,041**	**0.6**	14,498	1.7	**-65.2**
Group's total revenue	**860,641**	**100**	884,709	100	**-2.7**

MANAGEMENT DISCUSSION AND ANALYSIS

ANTIBIOTICS

Owing to mandatory order of the retail prices cut in antibiotics products by the National Development and Reform Commission and the government's strengthen regulation in distribution and purchase system of pharmaceuticals products to hospital, the overall sale of pharmaceutical industry, especially the prescription drugs such as antibiotics, in the PRC has been greatly affected. The sales of antibiotics, which accounted for more than 70% of the Group's revenue, dropped 7% from RMB 667,164,000 in 2005 to RMB620,522,000 in 2006.

Lijunsha, the Group's most important antibiotic-product, accounted for 48% or RMB413,338,000 (2005: RMB422,341,000) of the Group's total sales. Thanks to the expansion of distribution network in clinic and drugs stores located in rural areas, impact of the two above mentioned policies had been partly off-set. Overall sales of Lijunsha for the year resulted a drop of 2.1% with compared to that of last year.

With the hospital being the main customer, Paiqi and other antibiotic products generally experienced a decrease in turnover comparing to that of last year.

NON-ANTIBIOTIC PRODUCTS

With the expansion of the distribution network in medium and small cities and rural area, sales of non-antibiotic products recorded satisfactory growth in 2006. Total sales of non-antibiotic finished medicines amounted to RMB159,889,000 (2005: RMB130,222,000) in 2006, representing an increase of 22.8% as compared to that of last year. Sales of Dobesilate reached RMB32,847,000 (2005: RMB29,934,000), representing a year-on-year growth of 9.7%.

BULK PHARMACEUTICALS

Sales of bulk pharmaceuticals amounted to RMB75,189,000 (2005: RMB72,825,000), representing an increase of 3.3%.

COST OF GOODS SOLD

While sales of the group dropped by 2.7%, the cost of goods sold decreased by 4.8% from RMB436,842,000 for the year ended 31 December 2005 to RMB415,806,000 for the year ended 31 December 2006. The cost of direct materials, direct labour and overhead represented approximately 70.3%, 8.8% and 20.9% of the total cost of goods sold respectively for the year ended 31 December 2006 while their comparative percentage for 2005 were 70.8%, 9.0% and 20.2% respectively.

GROSS PROFIT MARGIN

Thanks to the improved efficiency in the production procedures, gross profit of the Group in 2006 amounted to RMB444,835,000, representing a gross profit margin of 51.7%, which was increased by 1.1 percentage point comparing to that of last year (50.6%).

SELLING AND MARKETING EXPENSES

For the year ended 31 December 2006, selling and marketing expenses amounted to approximately RMB223,726,000 (2005: RMB202,793,000), which mainly comprised of advertising expenses of approximately RMB52,999,000 (2005: RMB37,781,000), sales commission of approximately RMB105,865,000 (2005: RMB97,331,000), salaries expenses of sales and marketing staff of approximately RMB16,783,000 (2005: RMB17,182,000) and office and rental expense of approximately RMB11,208,000 (2005: RMB14,046,000).

The increase of 10.3% in selling and marketing expenses in 2006 as compared with that of 2005 was mainly attributable to the Group's boost up in advertising expenses to promote the brand name of the Company and its products.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses amounted to approximately RMB123,992,000 (2005: RMB108,414,000) for the year ended 31 December 2006 which mainly comprised of salaries for the administrative staff of approximately RMB40,591,000 (2005: RMB33,877,000), depreciation of approximately RMB10,160,000 (2005: RMB10,663,000), office and rental expenses of approximately RMB9,853,000 (2005: RMB11,195,000), sharing of administrative costs of Shaanxi Xi'an Pharmaceutical Factory of approximately RMB13,000,000 (2005: RMB12,063,000), research and development expenses of approximately RMB7,833,000 (2005: RMB7,429,000) and impairments of trade receivables of approximately RMB3,658,000 (2005: written back of RMB3,784,000).

The increase of 14.4% in general and administrative expenses in 2006 as compared with that of 2005 was mainly attributable to the increase in salaries expenses and impairment provision for trade receivables.

OPERATING PROFIT

Due to the increase in the Group's selling and marketing costs and general and administrative expenses, the Group's operating profit in 2006 was decreased by approximately RMB39,875,000 or 29.1%, amounted to RMB97,293,000 (2005: RMB137,168,000) with its operating profit margin (defined as operating profit divided by total sales) dropped from 15.5% to 11.3%.

FINANCE COSTS

As the Group has drawn certain bank borrowings during the year to finance the acquisition in its subsidiary's interests and for general working capital, the finance cost for the year has increased from RMB7,069,000 in 2005 to RMB10,232,000.

INCOME TAX EXPENSE

Pursuant to the Reply on Enjoying Statutory Reduction and Exemption of Enterprise Income Tax《享受企業所得稅法定減免的覆函》issued by the Foreign-related branch of Xi'an State Tax Bureau (西安市國家稅務局涉外分局) on 13 May 2005, Xi'an Lijun is entitled to an exemption from the enterprise income tax for the first two years and a 50% reduction in the enterprise income tax for the subsequent three years for the years 2005 to 2009.

Income tax expenses for the year ended 2005 was approximately RMB15,122,000 which was mainly represented by written off of deferred income tax assets in the income statement. For the year ended 2006, the overall result in income tax expenses is an recognition of deferred income tax assets of RMB966,000.

PROFIT ATTRIBUTABLE TO EQUITY HOLDERS FOR THE YEAR

Profit attributable to equity holders for the year decreased by 9.4% to RMB84,575,000 (2005: RMB93,311,000) while net profit margin (profit attributable to equity holders for the year divided by total sales) decreased to 9.8% from 10.5% in 2005.

LIQUIDITY AND FINANCIAL RESOURCES

The Group primarily finances its working capital and other capital requirements by net cash generated from operating activities and resorts to external financing including both long-term and short-term bank borrowings from time to time in case the operating cashflow is insufficient to meet the capital requirements.

As at 31 December 2006, the cash and cash equivalents aggregated to RMB167,387,000 (2005: RMB275,122,000), comprising RMB46,469,000 (2005: RMB129,745,000) of cash and cash equivalents denominated in Hong Kong dollars, RMB116,068,000 (2005: RMB145,106,000) in RMB and RMB4,850,000 (2005: RMB271,000) in other currencies.

As at 31 December 2006, the Group has restricted deposits amounted to RMB16,248,000. (2005: nil) as guarantee of the bank borrowings.

Bank borrowings amounted to RMB209,376,000 (2005: RMB113,000,000) as at 31 December 2006, comprising RMB80,376,000 (2005: Nil) of bank borrowings denominated in Hong Kong dollars and RMB129,000,000 (2005: RMB113,000,000) in RMB. The increase was mainly due to bank borrowings obtained for acquisition of 20% interest in Xi'an Lijun in June 2006 and for general working capital of the Group.

Gearing ratio (defined as total liabilities divided by total assets) increased from 36.6% as at 31 December 2005 to 45.1% as at 31 December 2006.

Current ratio (defined as current assets divided by current liabilities) decreased from 1.79 as at 31 December 2005 to 1.43 as at 31 December 2006.

INTEREST RATE AND FOREIGN EXCHANGE RISK

Substantially all of the Group's businesses are operated in the PRC and are denominated in RMB while a small portion of which is denominated in US dollar or HK dollar. Therefore, interest rate and foreign exchange risk is insignificant.

PLEDGE OF ASSETS

As at 31 December 2006, bank deposits of HK$16,077,000 and the Group's land use rights with the net bank amount of approximately RMB4,000,000 was pledged as collateral for the Group's bank borrowings.

CONTINGENT LIABILITIES

As at 31 December 2006, the Group did not have any contingent liabilities.

PROCEEDS FROM INITIAL PUBLIC OFFERING

Proceeds from initial public offering amounted to approximately HK$145,557,000, net of relevant expenses. The proceeds not yet utilized as at 31 December 2006 were mainly deposited in the bank accounts of the Group.

Application of proceeds from initial public offering was as follows:

	Planned Use *HK$'000*	**Actual used as at 31 December 2006** ***HK$'000***
Setting up of the new production line of spray form products	3,800	—
Setting up of the new production line of oral solution products	43,300	**18,919**
Setting up of the new production line of soft capsule form products	21,200	**7,785**
Expansion of production capacities of lyophilized powder for injection	17,300	**9,605**
Improvement of existing products and production technology of Chinese medicines, improvement and expansion of the Group's existing production facilities of Chinese medicines, development of new forms of Chinese medicines, and promotion of the brand name of the Group's Chinese medicines	19,200	—
Enhancement and expansion of the Group's distribution network	9,200	—
Setting up of centralised information and management systems for sales networks	5,800	—
Enhancement of the research and development capability to improve existing and develop new pharmaceutical technology	21,400	**7,795**
Group's Working capital	4,357	**4,357**
Total	145,557	**48,461**

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

DIRECTORS

Executive directors

Mr. Wu Qin (吳秦), aged 54, the chairman of the Company, is responsible for the strategic planning, business development and overall management of the Group. Mr. Wu has been the chairman of Rejoy Group Limited Liability Company ("Rejoy Group") since October 1998. He has also been the chairman and a director of Xi'an Lijun since November 1999. He is also a director of Prime United Industries Limited ("Prime United"), a controlling shareholder of the Company and a director of Success Manage International Limited ("Success Manage"), which held 7.69% interest in the Company. Mr. Wu was the general manager of Xi'an Lijun from November 1999 to April 2002. Mr. Wu has over 30 years of experience in the pharmaceutical industry. Mr. Wu graduated from The Open University of Hong Kong with a degree of Master in Business Administration in 2002. He has been awarded with the Model of National Labor and National May First Labor Award and has been an executive director of Pharmaceutical Administration Association/China Pharmaceutical Association. He also enjoys special subsidy for the year 2002 granted by the State Council of the PRC. He is currently a Deputy of the Tenth National People's Congress, vice president of Shaanxi Industrial and Economic Federation and Deputy Chairman of the Shaanxi Association of Commerce of the China International Association of Commerce. He is also a senior economist, the Deputy Chairman of Law and Social Order Committee of the Standing Committee of Shaanxi Province People's Congress and member of Strategies & Advisory Committee of Shaanxi Province.

Mr. Wu Zhihong (烏志鴻), aged 58, the vice-chairman of the Company and is responsible for investment of the Group. Mr. Wu has been the deputy chairman of Rejoy Group since October 1999 and was the chief executive officer of Rejoy Group from October 1999 to April 2005. He has also been the deputy chairman and a director of Xi'an Lijun since November 1999. Mr. Wu joined the Group since its establishment in November 1999 and has over 30 years of experience in the pharmaceutical industry. He is a director of Prime United and Success Manage. Mr. Wu graduated from Shenyang College of Pharmaceutical with pharmaceutical management profession in 1985. He is also a senior economist and a registered pharmacist accredited by the SFDA in February 2004.

Mr. Huang Chao (黃朝), aged 51, an executive Director and is responsible for finance, production and sales of the Group. Mr. Huang has been a director of Xi'an Lijun since November 1999 and is currently the general manager of Xi'an Lijun. He had been the deputy chairman of Xi'an Lijun until December 2004 and was the deputy chairman of Rejoy Group from August 1999 to September 2005. Mr. Huang joined the Group since its establishment in November 1999 and has over 30 years of experience in pharmaceutical production. He is a director of Prime United and Success Manage. Mr. Huang graduated from The Open University of Hong Kong with a Postgraduate Certificate in Business Administration in 2002, he is also a senior economist.

Mr. Xie Yunfeng (謝雲峰), aged 52, an executive Director and is responsible for supplies and construction of workshops of the Group. Mr. Xie has been a director and the deputy general manager of Xi'an Lijun since November 1999. He was a director of Rejoy Group from August 1999 to May 2004. Mr. Xie joined the Group since its establishment in November 1999 and has over 26 years of experience in pharmaceutical production. He is also a director of Prime United. Mr. Xie graduated from Party School of the CPC Central Committee majoring in law in 2001.

Ms. Sun Xinglai (孫幸來), aged 50, an executive Director and is responsible for public relation of the Group. Ms. Sun has been a director of Xi'an Lijun since May 2004. She was the deputy general manager of Xi'an Lijun during November 1999 to May 2004. Ms. Sun joined the Group since its establishment in 1999. Ms. Sun was a director of Rejoy Group from May 2004 to September 2005 and the chief executive officer of Xi'an Rejoy Technology Investment Co. Ltd. ("Rejoy Technology") from May 2004 to April 2005, and the chairmans of labour unions of Rejoy Group and Xi'an Lijun. Ms. Sun graduated from The Open University of Hong Kong with a degree of Master in Business Administration in 2002.

DIRECTORS *(Continued)*

Executive directors *(Continued)*

Mr. Wang Xian Jun (王憲軍), aged 43, is the chief executive officer of the Company and an executive director of Xi'an Lijun. Mr. Wang has over 20 years' experience in the pharmaceutical industry and is responsible for investor relations and public relations affairs of the Group. Mr. Wang joined Shijazhuang Pharmaceutical Group in 1987 and became the deputy chief engineer in 1989 and a director in 1993. Mr. Wang was the executive director and vice-chairman of China Pharmaceutical Group Limited, a company whose shares are listed on the Main Board of the Stock Exchange, until December 2002. Mr. Wang was also an independent non-executive director of Greater China Holding Limited from July 2002 to August 2005, a company whose shares are listed on the Main Board of the Stock Exchange. Mr. Wang graduated from Beijing Chemical Engineering College with a Master's degree in Engineering in 1987. He joined the Group in July 2004 and was the deputy general manager of Xi'an Lijun from July 2004 to December 2004. He was appointed as general manager of the Company in December 2004. Mr. Wang was promoted to chief executive officer of the Company in October 2005 and an executive director of Xi'an Lijun in June 2006. He was appointed as an executive Director in September 2006.

Non-executive director

Mr. Liu Zhiyong (劉志勇), aged 36, is a non-executive Director. He joined China National Technical Import and Export Corporation as a finance personnel and became the assistant managing director and an executive director of CNTIC Group International Finance Limited in May 1998. Mr. Liu took up the post of the president of Genertec Hong Kong International Capital Limited in July 2003. Mr. Liu is a director of Victory Rainbow Investment Limited, a substantial shareholder of the Company. Mr. Liu graduated from Renmin University of China with a bachelor's degree in Accounting in 1992 and he is a member of CICPA.

Independent non-executive directors

Mr. Qu Jiguang (曲繼廣), aged 51, is an independent non-executive Director. Mr. Qu joined Shijazhuang No.1 Pharmaceutical Factory as deputy factory manager in 1995. He later became a director and the vice general manager of Shijiazhuang Pharmaceutical Group. From January 2000, Mr. Qu has been the chairman and general manager of Shijiazhuang Siyao Pharmaceutical Ltd. Mr. Qu was an executive director of China Pharmaceutical Group Limited, a company listed on the Stock Exchange, from February 2001 to September 2004. Mr. Qu graduated from Tianjin Finance College with a postgraduate degree in Finance in 1999. He is also an economist accredited by The Ministry of Personnel of China.

Mr. Leung Chong Shun (梁創順), aged 41, is an independent non-executive Director. Mr. Leung graduated from the University of Hong Kong with a Bachelor of Laws degree in 1988 and obtained the Postgraduate Certificate in Laws in 1989. Mr. Leung was qualified as a solicitor in Hong Kong in 1991 and England & Wales in 1994. He has been a partner of Woo, Kwan, Lee & Lo, a law firm in Hong Kong, since 1997 and is experienced in corporate finance.

Mr. Chow Kwok Wai (周國偉), aged 40, is an independent non-executive Director. He is also a director, the deputy general manager and qualified accountant of Silver Grant International Industries Limited (Stock Code : 171), a company listed on the Stock Exchange. Mr. Chow has worked in Price Waterhouse, which is now known as PriceWaterhouseCoopers and has accumulated valuable audit experience there. Mr. Chow received his Bachelor's degree in Social Sciences from the University of Hong Kong in 1990. He is a Fellow Member of the Association of Chartered Certified Accountants and a Fellow CPA of the Hong Kong Institute of Certified Public Accountants. Mr. Chow has over 15 years' experience in accounting financial management and corporate finance.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

SENIOR MANAGEMENT

Ms. Han Yamei（韓雅美）, aged 59, is a director of Xi'an Lijun and is responsible for overseeing human resources and sales and marketing of Xi'an Lijun. She joined the Group since its establishment in August 1999. Ms. Han has over 30 years' experience in sales and marketing. She is an economist accredited by Ministry of Personnel of the PRC（中華人民共和國人士部）.

Mr. Zhang Yabin（張亞濱）, aged 39, is a director of Xi'an Lijun and is responsible for overseeing the marketing and promotion of the Xi'an Lijun as well as the development of sale networks. He joined the Group since its establishment in November 1999. Mr. Zhang has over 15 years' experience in pharmaceutical industry. Mr. Zhang graduated with a degree of Master in Business Administration from Online Education College of Renmin University of China（中國工商管理碩士研究生（網絡）學院）in 2002 and also obtained a Bachelor's degree in Organic Chemical Engineering from Dalian University of Technology（大連理工學院）in 1988. He is also a senior engineer accredited by Senior Professional Personnel Qualification of Shaanxi Provincial Government（陝西省人民政府高級專業技術任職資格）and a senior manager accredited by Occupational Skill Testing Authority（職業技能鑑定（指導）中心）.

Mr. Wang Jiding（王繼丁）, aged 57, is the chief accountant of Xi'an Lijun and is responsible for overseeing the finance and accounting function of Xi'an Lijun. He joined the Group since its establishment in November 1999. Mr. Wang has over 25 years' of experience in finance and accounting in the PRC.

Mr. Chen Xiaojun（陳曉軍）, aged 43, is the chief engineer of Xi'an Lijun. He joined the Group since its establishment in November 1999 and is responsible for the research and development of Xi'an Lijun. He was also an officer of technology committee. Mr. Chen graduated from Shenyang School of Pharmacy with a Bachelor's degree in Pharmacy in 1986. He is also a registered pharmacist accredited by the SFDA in 2004.

QUALIFIED ACCOUNTANT AND COMPANY SECRETARY

Mr. Lam Yiu Por（林曉波）, aged 30, is the qualified accountant, company secretary and chief financial officer of the Company. Mr. Lam graduated with a Bachelor's degree in Accountancy from Hong Kong Polytechnic University in 1997. Mr. Lam has more than eight years of experience in the field of finance and accounting. Prior to joining the Company as its qualified accountant, he was the qualified accountant of a company listed on the Stock Exchange. He is a member of the Hong Kong Institute of Certified Public Accountants and an associate member of the Association of Chartered Certified Accountants.

REPORT OF THE DIRECTORS

The Board present their report together with the audited financial statements for the year ended 31 December 2006.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding and the activities of its subsidiaries are set out in note 9 to the financial statements.

RESULTS

The results of the Group for the year are set out in the consolidated income statement on page 40.

DIVIDEND

An interim dividend of HK$0.07 per share, amounting to HK$20,355,000 was declared to the shareholders on 1 September 2006.

The Directors recommend the payment of a final dividend of HK$0.07 per share, amounting to HK$20,335,000. The final dividend is subject to approval by the shareholders at the annual general meeting to be held on 23 May 2007 and payable on 22 June 2007.

Interim dividend and recommended final dividend in aggregate, amounting to HK$40,670,000 or HK$0.14 per share, are equal to approximately 48% of profit attributable to equity holders of the Company for the year ended 31 December 2006.

RESERVES

Details of movements in the reserves of the Group and of the Company during the year are set out in note 18 to the financial statements.

PROPERTY, PLANT AND EQUIPMENT

Details of the movements in property, plant and equipment of the Group and of the Company during the year are set out in note 7 to the financial statements.

SHARE CAPITAL

Details of the movements in share capital of the Company during the year are set out in note 17 to the financial statements.

DISTRIBUTABLE RESERVES

Reserves of the Company as at 31 December 2006 available for distribution amounted to RMB21,528,000 (2005: RMB54,426,000). The Company's share premium account in the amount of RMB121,239,000 (2005: RMB121,239,000) is also available for distribution to shareholders, subject to the condition that no distribution or dividend may be paid to shareholders out of the share premium account unless, immediately following the date on which the distribution or dividend is proposed to be paid, the Company shall be able to pay its debts as they fall due in the ordinary course of business.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's articles of association or the laws of the Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

PURCHASE, SALE OR REDEMPTION OF SECURITIES

The Company has not redeemed any of its Shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's listed securities during the year.

SUBSTANTIAL INVESTMENT AND ACQUISITION

On 23 June 2006, the Group completed the acquisition of 20% of Xi'an Lijun from Rejoy Group Limited Liability Company (the "Rejoy Group") for a consideration of RMB102,556,000. Xi'an Lijun became a wholly-owned subsidiary of the Group after the acquisition. Details of the acquisition had been set out in the circular to the shareholders dated 5 June 2006.

SHARE OPTION SCHEME

Pursuant to a share option scheme approved by a written resolution of all shareholders of the Company on 16 October 2005 ("Scheme"), the Company may grant options to, amongst others, the directors or employees of the Company or its subsidiaries, for the recognition of their contributions to the Group, to subscribe for the Shares. The offer for grant of options ("Offer") must be taken up within 28 days from the date of Offer, with a payment of HK$1.00 as consideration for the grant. The exercise price of the share option will be determined at the higher of (i) the average closing prices of Shares as stated in the Stock Exchange's daily quotations sheets for the five trading days immediately preceding the date of Offer; (ii) the closing price of Shares as stated in the Stock Exchange's daily quotations sheet on the date of Offer; and (iii) the nominal value of the Shares. The share options are exercisable at any time during a period of not more than 10 years from the date of Offer, subject to the terms and conditions of the Scheme and any conditions of grant as may be stipulated by the Board. Unless terminated by the Company by resolution in general meeting, the Scheme shall be valid and effective for a period of 10 years commencing on the date on which the Scheme becomes unconditional.

The maximum number of Shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Scheme and any other schemes shall not exceed 30% of the issued share capital of the Company from time to time. The total number of Shares which may be issued upon exercise of all options to be granted under the Scheme and any other schemes must not, in aggregate, exceed 10% of the number of Shares in issue as at the date dealings in the Shares first commence on the Stock Exchange unless further shareholders' approval has been obtained pursuant to the conditions set out in the Scheme. The total number of Shares issued and to be issued upon exercise of all options granted under the Scheme and any other schemes (including both exercised or outstanding options) to each participant in any 12-month period shall not exceed 1% of the issued share capital of the Company.

No option has been granted by the Company under the Scheme since its adoption.

DIRECTORS

The Directors during the year were:

Executive Directors

Mr. Wu Qin	(appointed on 27 December 2004)
Mr. Wu Zhihong	(appointed on 27 December 2004)
Mr. Huang Chao	(appointed on 27 December 2004)
Mr. Xie Yunfeng	(appointed on 27 December 2004)
Ms. Sun Xinglai	(appointed on 27 December 2004)
Mr. Wang Xian Jun	(appointed on 22 September 2006)

Non-executive Directors

Mr. Liu Zhiyong	(appointed on 27 December 2004)

Independent Non-executive Directors

Mr. Qu Jiguang	(appointed on 16 October 2005)
Mr. Leung Chong Shun	(appointed on 16 October 2005)
Mr. Chow Kwok Wai	(appointed on 16 October 2005)

Pursuant to Article 87 of the Company's articles of association, at every annual general meeting one-third of the directors for the time being (or if their number is not three or a multiple of three, the number nearest to but not less than one-third) shall retire from office by rotation and every retiring director shall be eligible for re-election. Accordingly, Mr. Xie Yunfeng, Ms. Sun Xinglai and Mr. Liu Zhiyong will retire from office by rotation in the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

Furthermore, pursuant Article 86 of the Company's articles of association, any director appointed as an addition to the existing Board shall hold office until the next following annual general meeting of the Company, and shall then be eligible for re-election at that meeting. Accordingly, Mr. Wang Xian Jun will hold office only until the forthcoming annual general meeting and, being eligible, offer himself for re-election.

At the forthcoming annual general meeting, an ordinary resolution will be proposed to re-elect Mr. Xie Yunfeng, Ms. Sun Xinglai and Mr. Wang Xian Jun as executive directors and Mr. Liu Zhiyong as non-executive director.

The Company has received from each of the independent non-executive Directors an annual confirmation of his independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules") and considers the independent non-executive Directors to be independent.

DIRECTORS' SERVICE CONTRACTS

Each of the Directors has entered into a service agreement with the Company for an initial term of 3 years commencing from the appointment date.

Save as disclosed above, none of the Directors has entered into a service contract with the Company which is not determinable by the Company within one year without payment of compensation other than statutory compensation.

DIRECTORS' INTERESTS IN CONTRACTS

Save as disclosed under the heading "Connected transactions", no contracts of significance in relation to the Group's business to which the Company, its holding company or any of its subsidiaries and fellow 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 at any time during the year.

DIRECTORS' RIGHTS TO ACQUIRE SHARES

Apart from the Scheme disclosed above, at no time during the year was the Company, its holding company or any of its subsidiaries and fellow subsidiaries a party to any arrangement to enable the Directors, their respective spouse or minor children to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or in any other body corporate.

EMPLOYEES AND REMUNERATION POLICY

Emoluments of the directors are determined by the Board with reference to the prevailing market practice, the Company's remuneration policy, duties and responsibilities of the Directors within the Group and their contribution to the Group.

As at 31 December 2006, the Group had 2,300 employees, most of whom were members of the Group's production team based in the PRC. The number of workers employed by the Group varies from time to time depending on its needs and the emolument policy of employees is based on industry practice.

The remuneration policy of the Group's employees are periodically reviewed. Apart from social insurance and in-house training programmes, discretionary bonuses and share options may be awarded to employees according to the assessment of individual performance.

The total remuneration cost incurred by the Group for year ended 31 December 2006 was RMB96,806,000 (2005: RMB87,408,000).

RETIREMENT BENEFIT PLANS

As stipulated by the rules and regulations in the PRC, the Group has participated in state-sponsored defined contribution retirement plans for its employees in the PRC. The Group and the eligible employees are required to contribute 20% and 7%, respectively, of the employees' basic salary. The state-sponsored retirement plans are responsible for the entire pension obligations payable to retired employees. Moreover, the Group would pay monthly allowance to old retired persons. The Group has no further pension obligation beyond the above contributions. Expenses incurred by the Group in connection with the retirement benefit plans were approximately RMB12,036,000 for the year ended 31 December 2006 (2005: RMB9,912,000).

In Hong Kong, the Group has set up a retirement scheme in accordance with the mandatory provident fund requirements prescribed by the Mandatory Provident Fund Schemes Ordinance, Chapter 485 of the Laws of Hong Kong. All Hong Kong based employees and the Group are required to contribute 5% of their respective monthly wages (up to a maximum contribution of HK$1,000 by each of the employee and the Group) on a monthly basis to the fund.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN THE SHARES

As at 31 December 2006, the interests of the Directors in the share capital of the Company and 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 by the Company pursuant to section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") in the Listing Rules once the Shares are listed, were as follows:

Long positions in the Shares

Name of Director	Capacity	Number of shares held	% of the issued share capital of the Company
Mr. Wu Qin	Interest in a controlled corporation *(Note)*	22,344,000	7.69%

Note: These Shares were registered in the name of and beneficially owned by Success Manage International Limited ("Success Manage"), the issued share capital of which is held as to approximately 37.88% by Mr. Wu Qin. Pursuant to Part XV of the SFO, Mr. Wu Qin is deemed to be interested in all the Shares held by Success Manage. These Shares has been pledged to Guotai Junan Securities (Hong Kong) Limited.

Save as disclosed above, as at 31 December 2006, none of the Directors or chief executives had an interest or short position in the Shares, underlying shares or debentures of the Company or any of its associated corporations that was required to be recorded pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSON'S INTERESTS IN THE SHARES

The register of substantial shareholders required to be kept by the Company under section 336 of the SFO shows that as at 31 December 2006, the Company had been notified of the following interests and short positions, being 5% or more in the issued share capital of the Company. These interests are in addition to those disclosed above in respect of the Directors and chief executives.

Long positions in the Shares

Name of shareholder	Capacity	Number of Shares	% of the issued share capital of the Company
Prime United *(Note 1)*	Beneficial owner	123,984,000	42.68%
Victory Rainbow Investment Limited	Beneficial owner	58,300,000	20.07%
Grand Ocean Shipping Company Ltd. *(Note 2)*	Interest of controlled corporation	58,300,000	20.07%
Ms. Chen Lin-Dong *(Note 2)*	Interest of controlled corporation	58,300,000	20.07%
Mr. Xu Ming *(Note 2)*	Interest of controlled corporation	58,300,000	20.07%
Success Manage	Beneficial owner	22,344,000	7.69%
Mr. Wu Qiu *(Note 3)*	Interest of controlled corporation	22,344,000	7.69%
Ms. Zhang Mingfang *(Note 3)*	Interest of spouse	22,344,000	7.69%
Guotai Junan Securities Co., Ltd. *(Note 3)*	Person having a security interest in shares	22,344,000	7.69%
Japan Trustee Services Bank, Ltd	Trustee	15,016,000	5.17%

SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSON'S INTERESTS IN THE SHARES *(Continued)*

Notes:

1. Prime United is held as to 2.43% by Mr. Wu Qin, an executive Director, as to approximately 2.43% by Mr. Wu Zhihong, an executive Director, as to approximately 2.41% by Mr. Huang Chao, an executive Director, as to approximately 4% by Mr. Xie Yunfeng, an executive Director, as to approximately 4% by Ms. Han Yamei, a member of the management of Xi'an Lijun, and as to approximately 84.73% by Mr. Wu Qin, Mr. Wu Zhihong, Mr. Huang Chao, Mr. Xie Yunfeng and Ms. Han Yamei who jointly hold such shares on trust for 4,965 individuals who are present and former employees or their respective estates of Xi'an Lijun and Rejoy Group. The beneficial ownership structure in Prime United is a replication of the ownership structure of Rejoy Technology.

2. Victory Rainbow Investment Limited is wholly-owned by Grand Ocean Shipping Company Ltd., a company incorporated in the Republic of Liberia, which in turn is owned as to 50% by Ms. Chen Lin-Dong and 50% by Mr. Xu Ming. By virtue of Part XV of the SFO, each of Grand Ocean Shipping Company Ltd., Ms. Chen Lin-Dong and Mr. Xu Ming is deemed to be interested in the Shares held by Victory Rainbow Investment Limited.

3. Success Manage is held as to approximately 37.88% by Mr. Wu Qin. Pursuant to Part XV of the SFO, the spouse of Mr. Wu Qin, Ms. Zhang Minfang, is deemed to be interested in all the Shares held by Success Manage. These Shares has been pledged to Guotai Junan Securities (Hong Kong) Limited.

MANAGEMENT CONTRACTS

Save as disclosed under the heading "Connected transactions", no other contracts concerning the management and administration of the whole or any substantial part of the business of the Group were entered into or in existence during the year.

MAJOR SUPPLIERS AND CUSTOMERS

During the year, the Group purchased less than 30% of its total purchases from its 5 largest suppliers and sold less than 30% of its turnover to its 5 largest customers.

CONNECTED TRANSACTIONS

Certain related party transactions as disclosed in note 34 to the financial statements also fell under the definition of "connected transaction" or "continuing connected transaction" in Chapter 14A of the Listing Rules, details of which are set out below. The Company has complied with the disclosure requirements, where applicable, in accordance with Chapter 14A of the Listing Rules.

(1) Connected transactions

On 23 June 2006, the Company had completed the acquisition from Rejoy Group for the 20% equity interests in Xi'an Lijun. Before the acquisition, Xi'an Lijun was owned as to 80% by the Company and 20% by Rejoy Group. The consideration is RMB102,556,000 which was arrived at after arm's length negotiations between Rejoy Group and the Company. Rejoy Group was a substantial shareholder of Xi'an Lijun, a subsidiary of the Company, and as such Rejoy Group was a connected person of the Company under the Listing Rules. The transfer therefore constituted a connected transaction of the Company for the purpose of the Listing Rules.

CONNECTED TRANSACTIONS *(Continued)*

(2) Continuing Connected Transaction

(i) Discontinued Continuing Connected Transaction

(a) Lease of land-use rights by Xi'an Lijun from Rejoy Group

Pursuant to the lease of land-use rights agreement entered into between Xi'an Lijun and Rejoy Group on 16 October 2005 ("Land-Use Rights Agreement"), Xi'an Lijun leased land-use rights from Rejoy Group for a term commencing from 1 July 2005 and ending on 31 December 2007. Particulars of the areas of leased land were set out in the property valuation report in Appendix III to the Prospectus dated 2 December 2005 ("Prospectus"). The total areas of the leased land amounted to approximately 113,768 square metres and the rent paid by Xi'an Lijun was at RMB4 per square metre per month. The Group entered into the Land-Use Rights Agreement as the production plants, storage, office buildings of Xi'an Lijun are located on the relevant land.

Rejoy Group was a connected person of the Company under the Listing Rules as it holds 20% of interests of Xi'an Lijun. On 22 June 2006, the Company had completed the acquisition of 20% interests of Xi'an Lijun from Rejoy Group, and Rejoy Group was therefore no longer a connected person of the Company. For the year ended 31 December 2006, the total amount paid by the Group to Rejoy Group in respect of the land-use rights was approximately RMB5,460,864 (2005: RMB5,460,864) , which did not exceed the annual cap of RMB5,460,864 (2005: RMB5,460,864) prescribed for the year ended 31 December 2006 as disclosed in the Prospectus.

(b) Purchase of packaging materials from Xi'an Global Printing Co., Ltd.(西安環球印務有限公司)("Global Printing")

The principal business of Global Printing is printing of packaging materials. The Group had been purchasing packaging materials from Global Printing on an ongoing basis for packaging its own products.

Pursuant to the supply agreement dated 16 October 2005 entered into between Xi'an Lijun and Global Printing, Xi'an Lijun purchased packaging materials from Global Printing for a term of 3 years commencing from 1 January 2005 and ending on 31 December 2007. The Directors confirmed that the purchase prices of packaging materials from Global Printing had been determined in accordance with the market prices and on normal commercial terms, and that the Group had paid to Global Printing for the packaging materials at prices no less favorable than those paid to independent third parties and on terms no less favorable than those the Group could obtain from independent third parties.

Global Printing is connected person of the Company under the Listing Rules as it is held as to 45% by Shaanxi Pharmaceutical Company(陝西省醫藥總公司)("SPC"), which also holds all the interests in Rejoy Group, a substantial shareholder of Xi'an Lijun. On 22 June 2006, the Company had completed the acquisition of 20% interests of Xi'an Lijun from Rejoy Group, and Global Printing was therefore no longer a connected person of the Company. For the year ended 31 December 2006, the total amount paid by the Group to Global Printing for the purchase of packaging materials amounted to approximately RMB6,636,000 (2005: RMB6,883,000), which did not exceed the estimated annual cap of RMB9,000,000 (2005: RMB8,500,000)prescribed for the year ended 31 December 2006 as disclosed in the Prospectus.

CONNECTED TRANSACTIONS *(Continued)*

(2) Continuing Connected Transaction *(Continued)*

(i) Discontinued Continuing Connected Transaction *(Continued)*

(c) Provision of utilities such as electricity, water, steam, cooling salt water and compressed air by Shaanxi Xi'an Pharmaceutical Factory ("Xi'an Pharmacy Factory")

Xi'an Pharmacy Factory had been supplying utilities to Xi'an Lijun. Pursuant to the utilities services agreement entered into between Xi'an Lijun and Xi'an Pharmacy Factory on 16 October 2005, Xi'an Pharmacy Factory supplied utilities including electricity, water, steam, cooling salt water and compressed air to Xi'an Lijun for a term of three years commencing from 1 January 2005 and ending on 31 December 2007. The charges for electricity and water payable by Xi'an Lijun were calculated based on the state-prescribed prices (tax inclusive) plus actual processing costs of Xi'an Pharmacy Factory. In respect of steam, cooling salt water and compressed air, such charges were determined based on actual costs of production incurred by Xi'an Pharmacy Factory. The reason for the Group entering into the above agreement was to satisfy the needs of Xi'an Lijun in respect of its production, office and storage.

Xi'an Pharmacy Factory is a connected person to the Company as it is a wholly-owned subsidiary of Rejoy Group, a substantial shareholder of Xi'an Lijun. On 22 June 2006, the Company had completed the acquisition of 20% interests of Xi'an Lijun from Rejoy Group, and Xi'an Pharmacy Factory was therefore no longer a connected person of the Company. For the year ended 31 December 2006, the total amount paid by the Group to Xi'an Pharmacy Factory in respect of supply of utilities amounted to approximately RMB54,032,000 (2005: RMB50,973,000), which did not exceed the estimated annual cap of RMB60,500,000 (2005: RMB55,000,000) prescribed for the year ended 31 December 2006 as disclosed in the Prospectus.

(d) Sharing of administrative costs between Xi'an Lijun and Xi'an Pharmacy Factory

Xi'an Lijun had been sharing the administrative costs of Xi'an Pharmacy Factory so that the employees of Xi'an Lijun were entitled to enjoy certain facilities and services including hospitals, nursery, schools, security, property management and environmental beautification provided by Xi'an Pharmacy Factory. Pursuant to the agreement entered between Xi'an Lijun and Xi'an Pharmacy Factory on 16 October 2005, Xi'an Lijun shared the administrative costs of Xi'an Pharmacy Factory so that the employees of Xi'an Lijun would continue to be able to enjoy the aforesaid facilities and services provided by Xi'an Pharmacy Factory for a term of three years commencing from 1 January 2005 and ending on 31 December 2007. The total amount of administrative costs was based on the actual costs incurred for the provision of the aforesaid facilities and services. The share of administrative costs borne by Xi'an Lijun was determined with reference to the actual number of employees of Xi'an Lijun utilizing such facilities and services.

Xi'an Pharmacy Factory is a connected person to the Company by virtue of being a wholly-owned subsidiary of Rejoy Group, a substantial shareholder of Xi'an Lijun. On 22 June 2006, the Company had completed the acquisition of 20% interests of Xi'an Lijun from Rejoy Group, and Xi'an Pharmacy Factory was therefore no longer a connected person of the Company. For the year ended 31 December 2006, the total amount paid by the Group to Xi'an Pharmacy Factory in respect of the administration costs amounted to approximately RMB13,000,000 (2005: RMB12,926,000), which did not exceed the estimated annual cap of RMB13,000,000 (2005: RMB13,000,000) prescribed for the year ended 31 December 2006 as disclosed in the Prospectus.

CONNECTED TRANSACTIONS *(Continued)*

(2) Continuing Connected Transaction *(Continued)*

(i) Discontinued Continuing Connected Transaction *(Continued)*

(e) Distribution of the Group's products by Xi'an Rejoy Medicine Co., Ltd.（西安利君醫藥有限公司）("Rejoy Medicine")

Rejoy Medicine has been one of the Group's distributors in Xi'an and is principally engaged in the retail and distribution of pharmaceutical products. Pursuant to the purchase and distribution agreement entered into between Rejoy Medicine and Xi'an Lijun on 16 October 2005, Rejoy Medicine purchased products from Xi'an Lijun and distributed such products to other distributors and end customers for a term of three years commencing from 1 January 2005 and ending on 31 December 2007. The Directors confirmed that the selling prices of the Group's products sold to Rejoy Medicine had been determined in accordance with the market prices and that the Group charged Rejoy Medicine for the products at prices no less favorable than those charged to independent third parties and on terms no less favorable than those the Group could obtain from independent third parties.

Rejoy Medicine is a connected person to the Company as it is held as to 55% by Rejoy Group, a substantial shareholder of the Xi'an Lijun. On 22 June 2006, the Company had completed the acquisition of 20% interests of Xi'an Lijun from Rejoy Group, and Rejoy Medicine was therefore no longer a connected person of the Company. For the year ended 31 December 2006, the Group's sale to Rejoy Medicine amounted to approximately RMB10,154,000 (2005: RMB20,886,000), which did not exceed the estimated annual cap of RMB27,800,000 (2005: RMB27,000,000) prescribed for the year ended 31 December 2006 as disclosed in the Prospectus.

(ii) Continuing connected transactions

(a) Distribution of the Group's products by Rejoy Baichuan Medicines Chemical Engineering Co., Ltd. ("Rejoy Baichuan")

Rejoy Baichuan has been one of the Group's distributors in the northwest market of the PRC and is principally engaged in the retail and distribution of pharmaceutical products. Pursuant to the purchase and distribution agreement entered into between Xi'an Lijun and Rejoy Baichuan on 16 October 2005 , Rejoy Baichuan purchased products from Xi'an Lijun and distributed such products to other distributors and end customers for a term of three years commencing from 1 January 2005 and ending on 31 December 2007. The Directors confirmed that the selling prices of the Group's products sold to Rejoy Baichuan had been determined in accordance with the market prices and that the Group charged Rejoy Baichuan for the products at prices no less favorable than those charged to independent third parties and on terms no less favorable than those the Group could obtain from independent third parties.

Rejoy Baichuan is held as to 84% by Rejoy Technology, the issued share capital of which is held as to 100% by the beneficial shareholders of Prime United, one of the controlling shareholders of the Company. Accordingly, Rejoy Baichuan is a connected person of the Company under the Listing Rules. For the year ended 31 December 2006, the Group's sales to Rejoy Baichuan amounted to approximately RMB19,515,000 (2005: RMB9,043,000), which did not exceed the estimated annual cap of RMB24,800,000 (2005: RMB24,000,000) prescribed for the year ended 31 December 2006 as disclosed in the Prospectus.

CONNECTED TRANSACTIONS *(Continued)*

(2) Continuing Connected Transaction *(Continued)*

(ii) Continuing connected transactions *(Continued)*

(b) Distribution of the Group's products by Liaoning Huabang Pharmaceutical Co., Ltd.（遼寧華邦醫藥有限公司）("Huabang Pharmaceutical")

Huabang Pharmaceutical has been one of the Group's distributors in the northeast market of the PRC and is principally engaged in the retail and distribution of pharmaceutical products. Pursuant to the purchase and distribution agreement entered into between Xi'an Lijun and Huabang Pharmaceutical on 16 October 2005, Huabang Pharmaceutical purchased products from Xi'an Lijun and distributed such products to other distributors and end customers for a term of three years commencing from 1 January 2005 and ending on 31 December 2007. The Directors confirmed that the selling prices of the Group's products sold to Huabang Pharmaceutical had been determined in accordance with the market prices and that the Group charged for the products at prices no less favorable than those charged to independent third parties and on terms no less favorable than those the Group could obtain from independent third parties.

The registered capital of Huabang Pharmaceutical is held as to 100% by the beneficial shareholders of Bondwide Trading Limited, one of the controlling shareholders of the Company. Accordingly, Huabang Pharmaceutical is a connected person of the Company under the Listing Rules. For the year ended 31 December 2006, the Group's did not have any transaction with Huabang Pharmaceutical (2005: RMB4,526,000), the estimated annual cap prescribed for the year ended 31 December 2006 as disclosed in the Prospectus was RMB11,000,000 (2005: RMB11,000,000).

The aforesaid continuing connected transactions have been reviewed by independent non-executive Directors of the Company. The independent non-executive Directors confirmed that the aforesaid connected transactions were entered into (a) in the ordinary and usual course of business of the Group; (b) either on normal commercial terms or on terms no less favourable to the Group than terms available to or from independent third parties; (c) in accordance with 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; (d) have not exceeded the relevant maximum amount capped in accordance to the waiver previously granted by the Stock Exchange.

Based on the work performed, the auditors of the Company have confirmed that the aforesaid continuing connected transaction (a) have been approved by the Board of the Company; (b) have been entered into in accordance with the terms of the relevant agreements governing the transactions; and (c) have not exceeded the caps allowed by the Stock Exchange in the previous waiver.

SUFFICIENCY OF PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the Directors, it is confirmed that a sufficient public float of more than 25% of the issued capital of the Company has been maintained as at 31 December 2006.

POST BALANCE SHEET EVENTS

On 25 March 2007, the Company entered into an acquisition agreement with CMP Group Limited (the "Vendor") and China Pharmaceutical Company Limited (being the guarantor of the Vendor under the acquisition agreement) to purchase the entire interests in, and a shareholder loan of, New Orient Investments Limited ("New Orient") at a consideration which is equivalent to the aggregate sum of (i) 7.5 times the audited profit attributable to the shareholders of New Orient and its subsidiaries (excluding any profit or loss generated in connection with foreign exchanges) for the year ended 31 December 2006; and (ii) any income generated in connection with foreign exchanges for the year ended 31 December 2006. However, in any event, the consideration shall not exceed HK$510,000,000.

The Acquisition constitutes a major transaction of the Company under Rule 14.06(3) of the Listing Rules. As Mr. Qu Jiguang is a connected person of the Company and also the ultimate controlling shareholder of the Vendor, the entering into of the Acquisition Agreement constitutes a connected transaction for the Company under Chapter 14A of the Listing Rules. The Acquisition agreement is subject to approval of the Independent Shareholders at the extraordinary general meeting.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Board has adopted a code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard set out in the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Model Code. The Directors confirmed that there were not any non-compliance with the standard set out in the Model Code and the Company's code of conduct regarding Directors' securities transactions during the year ended 31 December 2006.

AUDITORS

The financial statements have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment at the forthcoming annual general meeting.

ANNUAL GENERAL MEETING

The 2007 Annual General Meeting of the Company will be held at Salon IV, M/F, Grand Hyatt Hong Kong, 1 Harbour Road, Wanchai, Hong Kong on 23 May 2007 at 11:00 a.m. and the Notice of Annual General Meeting will be published and dispatched in due course.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from Thursday, 17 May 2007 to Wednesday, 23 May 2007 (both days inclusive) during which period no transfer of Shares will be effected. In order to qualify for the proposed final dividend and the entitlement to attend and vote at the forthcoming annual general meeting, all transfer documents, accompanied by the relevant share certificates, must be lodged with the Company's branch share registrar and transfer office of the Company in Hong Kong, Computershare Hong Kong Investor Services Limited, at Shops 1806-1807, 18th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:30 p.m. on Wednesday, 16 May 2007.

On behalf of the Board
Wu Qin
Chairman

Hong Kong, 26 April 2007

CORPORATE GOVERNANCE REPORT

REPORT ON CORPORATE GOVERNANCE PRACTICES

The Company applied the principles and complied with all requirements of the Code on Corporate Governance Practices ("CG Code") contained in Appendix 14 of the Listing Rules.

The following summarises the Company's corporate governance practices.

Key Corporate Governance Principles and the Company's Practices

A.1 Board of directors

The Board is responsible for leadership and control of the Company and oversees the Group's businesses, strategic direction and performance. The Management was delegated the authority and responsibility by the Board for the management of the Group. In addition, the Board has also delegated various responsibilities to the Board Committees. Further details of these committees are set out in this report.

Four board meeting was held for the year ended 31 December 2006 and the attendance was as follows:

Number of meeting	4	Attendance
Wu Qin	4/4	100%
Wu Zhihong	4/4	100%
Huang Chao	4/4	100%
Xie Yunfeng	4/4	100%
Sun Xinglai	4/4	100%
Wang Xian Jun	1/4	25%
Liu Zhiyong	3/4	75%
Qu Jiguang	3/4	75%
Leung Chong Shun	4/4	100%
Chow Kwok Wai	4/4	100%

All directors were given an opportunity to contact the Company Secretary to include matters in the agenda for regular board meeting.

Notice of at least 14 days were given of a regular board meeting. For all other board meeting, reasonable notice will be given.

All minutes of Board meetings were recorded in sufficient detail the matters considered by the board and decisions reached. Draft and final versions of minutes of Board meetings were sent to all directors for their comment and record respectively within 3 business days after the board meeting was held.

The Company has established the Policy on obtaining independent professional advice by directors to enable the directors, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the Company's expense.

If a substantial shareholder or a Director has a conflict of interest in a matter to be considered by the Board which the Board has determined to be material, the matter shall be discussed by a Board meeting actually hold.

All directors have access to the advice and services of the company secretary with a view to ensuring that board procedures, and all applicable rules and regulations, are followed. Minutes of board meetings and meetings of board committee are be kept by a duly appointed secretary of the meeting and such minutes are open for inspection at any reasonable time and on reasonable notice by any director.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

A.2 Chairman and chief executive officer

The Board appointed Mr. Wu Qin as the Chairman, who was responsible for the leadership and effective running of the Board, and ensuring that all key and appropriate issues were discussed by the Board in a timely and constructive manner.

The Board appointed Mr. Wang Xian Jun as the Chief Executive Officer, who was delegated with the responsibilities of investor relation and public relation of the Group. The Board also comprises Independent Non-Executive Directors who bring strong independent judgment, knowledge and experience to the Board. As noted below, all the Audit Committee members are Independent Non-Executive Directors. This structure is to ensure a sufficient balance of power and authority in place within the Group.

The chairman is responsible for ensuring that directors receive adequate information, which is complete and reliable, in a timely manner.

A.3 Board composition

The Board comprises six executive Directors, being Mr. Wu Qin, Mr. Wu Zhihong, Mr. Huang Chao, Mr. Xie Yunfeng, Ms. Sun Xinglai and Mr. Wang Xian Jun, one non-executive Directors, being Mr. Liu Zhiyong, and three independent non-executive Directors, being Mr. Qu Jiguang, Mr. Leung Chong Shun and Mr. Chow Kwok Wai. The Directors are considered to have a balance of skill and experience appropriate for the requirements of the business of the Company, details of the directors are shown on page 10 to 12 under the section of Directors and Senior Management.

There are sufficient numbers of independent non-executive directors in the Company, among which, Mr. Chow Kwok Wai is a certified public accountant and Mr. Leung Chong Shun is a qualified solicitor in Hong Kong.

All Directors are expressly identified by categories of executive directors, non-executive director and independent non-executive directors, in all corporate communications that disclose the names of Directors of the Company.

There are no financial, business, family and other material or relevant relationships among members of the board.

A.4 Appointments, re-election and removal

At each annual general meeting one third of the Directors for the time being (or, if their number is not a multiple of three, the number nearest to but not less than one-third) shall retire from office by rotation provided that every Director shall be subject to retirement at least once every three years.

A special resolution had been proposed and passed by the shareholders in the annual general meeting held on 18 April 2006 to amend the articles of association of the Company, since then a Director appointed to fill a casual vacancy on the Board held office only until the next following general meeting rather than the next following annual general meeting and the relevant requirement under the CG Code had been fully complied with.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

A.4 Appointments, re-election and removal *(Continued)*

Mr. Wang Xian Jun was appointed as an executive Director to the Board on 22 September 2006. Pursuant to Article 86(3) of the Articles of Association, the Directors shall have the power from time to time and at any time to appoint any person as a Director either to fill a casual vacancy on the Board or as an addition to the existing Board. Any Director so appointed by the Board shall hold office only until the next following general meeting of the Company and shall then be eligible for re-election. Accordingly, Mr. Wang Xian Jun, will hold office only until the forthcoming annual general meeting and, being eligible, offer himself for re-election. Pursuant to Article 87 of the Articles of Association, Mr. Xie Yunfeng (an executive Director), Ms. Sun Xinglai (an executive Director) and Mr. Liu Zhiyong (a non-executive Director) will retire from office by rotation in the forthcoming annual general meeting. Mr. Xie Yunfeng, Ms. Sun Xinglai, Mr. Wang Xian Jun and Mr. Liu Zhiyong, being eligible, offer themselves for re-election at the AGM.

Every Director including non-executive director, including those appointed for a specific term, were subject to retirement by rotation at least once very three years.

The Company had not established a Nomination Committee and retained the functions to the Board. The Directors from time to time identify individual suitable to be a Board member and make recommendation to the Board. The main criteria in selecting a candidate are whether if he can add value to the management through his contributions in the relevant strategic business areas and if the appointment results a strong and diverse Board. In 2006, the Board had nominated and appointed Mr. Wang Xian Jun as executive Directors in addition to the Board.

A.5 Responsibilities of directors

Every newly appointed Director of the Company received an information package from the Company on the first occasion of his appointment. This information package is a comprehensive, formal and tailored induction on the responsibilities and ongoing obligations to be observed by a director. In addition, the package includes materials on the operations and business of the Company. The management of the Company conducted briefing on their responsibilities and obligations under the laws and applicable regulations such as Listing Rules and Company Ordinance as was necessary.

The functions of non-executive directors include but not limited to the following:

(a) participating in board meetings of the Company to bring an independent judgment to bear on issues of strategy, policy, performance, accountability, resources, key appointments and standards of conduct;

(b) taking the lead where potential conflicts of interests arise;

(c) serving on the audit and remuneration committees; and

(d) scrutinising the Company's performance in achieving agreed corporate goals and objectives, and monitoring the reporting of performance.

Every director ensure that he can give sufficient time and attention to the affairs of the Company.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

A.5 Responsibilities of directors *(Continued)*

The Board has adopted a code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard set out in the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Model Code. The Directors confirmed that there were not any non-compliance with the standard set out in the Model Code and the Company's code of conduct regarding Directors' securities transactions during the year ended 31 December 2006.

A.6 Supply of and access to information

In respect of regular board and committee meetings, agendas and accompanying board papers were sent in full to all directors at least 3 days before the intended date of meetings.

The management and the Company Secretary assists the Chairman in establishing the meeting agenda and board papers, providing with adequate information in a timely manner to enable the board and committees in making decision to the matter being discussed in the meetings. Each Director may request inclusion of items in the agenda. The Board and each Director may separately and independently access to the issuer's senior management and shall receive prompt response.

Minutes of the Board/committees meetings are kept by the Company Secretary and are open for inspection by Directors.

B.1 Remuneration of directors and senior management

The Board has established a Remuneration Committee, chaired by Mr. Leung Chong Shun and with committee members of Mr. Qu Jiguang and Mr. Chow Kwok Wai, all of them are independent non-executive directors appointed by the Board.

The principal responsibilities of Remuneration Committee include formulation of the remuneration policy, review and recommending to the Board the annual remuneration policy, and determination of the remuneration of the executive Director and members of the Senior Management. The overriding objective of the remuneration policy is to ensure that the Group is able to attract, retain, and motivate a high-calibre team which is essential to the success of the Group.

One meeting had been held for the Remuneration Committee during the year ended 31 December 2006 and the attendance was as follows:

Number of meeting	1	Attendance
Leung Chong Shun	1	100%
Qu Jiguang	0	0%
Chow Kwok Wai	1	100%

The functions specified in Code Provision B1.3 (a) to (f) of the CG Code had been included in the Terms of Reference of the Remuneration Committee, which also explains the role and the authority delegated by the Board.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

B.1 Remuneration of directors and senior management (Continued)

The remuneration committee should consult the chairman and/or chief executive officer about their proposals relating to the remuneration of other executive directors and have access to professional advice if considered necessary.

The remuneration committee will make available on request, its terms of reference, explaining its role and the authority delegated to it by the board.

The terms of reference of the remuneration committee include the following specific duties: -

(a) to make recommendations to the board on the issuer's policy and structure for all remuneration of directors and senior management and on the establishment of a formal and transparent procedure for developing policy on such remuneration;

(b) to have the delegated responsibility to determine the specific remuneration packages of all executive directors and senior management, including benefits in kind, pension rights and compensation payments, including any compensation payable for loss or termination of their office or appointment, and make recommendations to the board of the remuneration of non-executive directors. The remuneration committee should consider factors such as salaries paid by comparable companies, time commitment and responsibilities of the directors, employment conditions elsewhere in the group and desirability of performance-based remuneration;

(c) to review and approve performance-based remuneration by reference to corporate goals and objectives resolved by the board from time to time;

(d) to review and approve the compensation payable to executive directors and senior management in connection with any loss or termination of their office or appointment to ensure that such compensation is determined in accordance with relevant contractual terms and that such compensation is otherwise fair and not excessive for the issuer;

(e) to review and approve compensation arrangements relating to dismissal or removal of directors for misconduct to ensure that such arrangements are determined in accordance with relevant contractual terms and that any compensation payment is otherwise reasonable and appropriate; and

(f) to ensure that no director or any of his associates is involved in deciding his own remuneration. The remuneration committee shall advise shareholders on how to vote with respect to any service contracts of directors that require shareholders' approval under rule 13.68 of the Listing Rules.

The Remuneration Committee will be provided with sufficient resources to discharge its duties.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

B.1 Remuneration of directors and senior management *(Continued)*

The following is a summary of the work of the Remuneration Committee during 2006 regarding the remuneration of Directors:

(i) review the terms of executive director's service contract; and

(ii) review the remuneration of Directors;

The objective of remunerating non-executive Directors is to ensure that they are remunerated sufficiently but not excessively for their efforts and time dedicated to the Company. Every of the non-executive Directors has entered into a service agreement with the Company for an initial term of 3 years commencing from the appointment date. The annual emolument is HK$180,000 for each of the independence non-executive directors, namely Mr. Qu Jiguang, Mr. Leung Chong Shun and Mr. Chow Kwok Wai and is HK$60,000 for Mr. Liu Zhiyang, a non-executive Director.

Remuneration packages of executive Directors comprise fixed and variable components:

(1) Fixed component — base salary; and

(2) Variable component — annual performance bonus.

Fringe benefits include the provident fund, medical insurance and other miscellaneous benefits.

All the Directors are entitled to participate in the share option scheme.

Emoluments of the Directors are determined by the Board with reference to the prevailing market practice, his duties and responsibilities within the Group and his contribution to the Group.

Details of the remuneration of Directors for the year ended 31 December 2006 are set out in the page 76 of the Annual Report.

C.1 Accountability and audit

The Board presents a balanced, clear, and comprehensible assessment of the Company's performance, position, and prospects

Management of the Company provides such explanation and information to the Board as will enable the Board to make an informed assessment of the financial and other information put before the Board for approval.

The Directors are responsible for overseeing the preparation of accounts of each financial period, which give a true and fair view of the state of affairs of the Group and of the results and cash flow for that period. In preparing the accounts for the year ended 31 December 2006, the Directors have:

1. selected suitable accounting policies and applied them consistently;

2. approved adoption of all HKFRSs;

3. made judgments and estimates that are prudent and reasonable; and

4. have prepared the accounts on the going concern basis.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

C.1 Accountability and audit *(Continued)*

Acknowledgement from the Directors of their responsibility for preparing the accounts has been received.

A statement by the auditors about their reporting responsibilities is included in the page 35-36 of the 2006 Annual Report under the section Report of the Auditors.

During the year, the Company has announced its annual results in a timely manner after the end of the relevant period, as laid down in the Listing Rules; and during the year, the Company has issued annual and interim reports, other price-sensitive announcements and other financial disclosures required under the Exchange Listing Rules, and reports to regulators as well as to information required to be disclosed pursuant to statutory requirements.

C.2 Internal controls

The directors had conducted a review of the effectiveness of the system of internal control of the Group which covered all material controls, including financial, operational and compliance controls and risk management functions.

C.3 Audit committee

The Board establishes formal and transparent arrangements for considering how it applies the financial reporting and internal control principles and for maintaining an appropriate relationship with the Company's auditors. The audit committee established by the Company have clear terms of reference.

All the members of the Audit Committee are independent non-executive Directors. The Audit Committee is chaired by Mr. Chow Kwok Wai who is a certificated public accountant and the committee members are Mr. Qu Jiguang and Mr. Leung Chong Shun.

The functions specified in Code Provision C3.3 (a) to (n) of the CG Code had been included in the Terms of Reference of the Audit Committee. The Terms of Reference of the Audit Committee also explains the role and the authority delegated by the Board.

Two meetings had been convened by the Audit Committee during the year ended 31 December 2006 and the attendance was as follows:

Number of meeting	2	Attendance
Chow Kwok Wai	2	100%
Qu Jiguang	1	50%
Leung Chong Shun	2	100%

Full minutes of audit committee meetings will be kept by the Company Secretary. Draft and final versions of minutes of the audit committee meetings will be sent to all members of the committee for their comment and records respectively, within 3 business days after the meeting.

The Audit Committee of the Company does not have a former partner of the Company's existing audit firm.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

C.3 Audit committee *(Continued)*

The terms of reference of the audit committee includes the following duties:

(a) to be primarily responsible for making recommendation to the board on the appointment, reappointment and removal of the external auditor, and to approve the remuneration and terms of engagement of the external auditor, and any questions of resignation or dismissal of that auditor;

(b) to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process in accordance with applicable standard. The audit committee should discuss with the auditor the nature and scope of the audit and reporting obligations before the audit commences;

(c) to develop and implement policy on the engagement of an external auditor to supply non-audit services. For this purpose, external auditor shall include any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally. The audit committee should report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken;

(d) to monitor integrity of financial statements of an issuer and the issuer's annual report and accounts, half-year report and, if prepared for publication, quarterly reports, and to review significant financial reporting judgements contained in them. In this regard, in reviewing the issuer's annual report and accounts, half-year report and, if prepared for publication, quarterly reports before submission to the board, the committee should focus particularly on:

    (i) any changes in accounting policies and practices;

    (ii) major judgmental areas;

    (iii) significant adjustments resulting from audit;

    (iv) the going concern assumptions and any qualifications;

    (v) compliance with accounting standards; and

    (vi) compliance with the Exchange Listing Rules and other legal requirements in relation to financial reporting;

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

C.3 Audit committee *(Continued)*

(e) In regard to (d) above:

(i) members of the committee must liaise with the issuer's board of directors, senior management and the person appointed as the issuer's qualified accountant and the committee must meet, at least once a year, with the issuer's auditors; and

(ii) the committee should consider any significant or unusual items that are, or may need to be, reflected in such reports and accounts and must give due consideration to any matters that have been raised by the issuer's qualified accountant, compliance officer or auditors;

(f) to review the issuer's financial controls, internal control and risk management systems;

(g) to discuss with the management the system of internal control and ensure that management has discharged its duty to have an effective internal control system;

(h) to consider any findings of major investigations of internal control matters as delegated by the board or on its own initiative and management's response;

(i) where an internal audit function exists, to ensure co-ordination between the internal and external auditors, and to ensure that the internal audit function is adequately resourced and has appropriate standing within the issuer, and to review and monitor the effectiveness of the internal audit function;

(j) to review the group's financial and accounting policies and practices;

(k) to review the external auditor's management letter, any material queries raised by the auditor to management in respect of the accounting records, financial accounts or systems of control and management's response;

(l) to ensure that the board will provide a timely response to the issues raised in the external auditor's management letter;

(m) to report to the board on the matters set out in this code provision; and

(n) to consider other topics, as defined by the board.

The audit committee shall make available on request its terms of reference, explaining its role and the authority delegated to it by the board.

The audit committee has been provided with sufficient resources to discharge its duties.

PricewaterhouseCoopers had been appointed to be the auditor of the Group. During 2006, total fees amounted HK$2,300,000 paid/payable to PricewaterhouseCoopers were wholly related to audit services.

The Audit Committee recommended the re-appointment of PricewaterhouseCoopers to be the auditor of the Group in 2007.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

D.1 Delegation by the board

The Company has a formal schedule of matters specifically reserved to the Board and those delegated to management. There should be a clear division of responsibilities amongst committees and each of them should have a specific terms of reference.

The Board is responsible for determining the overall strategy and approving the annual business plan of the Group, and ensuring the business operations are properly planned, authorised, undertaken and monitored. All policy matters of the Group, material transactions or transactions where there is conflict of interests are reserved for the Board's decisions.

The Board has delegated the day-to-day responsibility to the executive management.

D.2 Board committees

The Board has prescribed sufficiently clear terms of reference for the Audit Committee and the Remuneration Committee.

The terms of reference of the Audit Committee and the Remuneration Committee require the committees to report back to the board on their decisions or recommendations.

E.1 Effective communication

In respect of each substantially separate issue at a general meeting, a separate resolution will be proposed by the chairman of the meeting.

The chairman of the Board will attend the annual general meeting and arrange for the chairman of the Audit and Remuneration Committees or members to be available to answer questions at the annual general meeting.

E.2 Voting by poll

The chairman of a meeting will ensure disclosure in the Company's circulars to shareholders of the procedures for and the rights of shareholders to demand a poll in compliance with the requirements about voting by poll contained in the Listing Rules.

The chairman of a meeting and/or Directors who, individually or collectively, hold proxies in respect of shares representing 5% or more of the total voting rights at a particular meeting will demand a poll in certain circumstances where, on a show of hands, a meeting votes in the opposite manner to that instructed in those proxies. If a poll is required under such circumstances, the chairman of the meeting will disclose to the meeting the total number of votes represented by all proxies held by directors indicating an opposite vote to the votes cast at the meeting on a show of hands.

The Company will count all proxy votes and, except where a poll is required, the chairman of a meeting will indicate to the meeting the level of proxies lodged on each resolution, and the balance for and against the resolution, after it has been dealt with on a show of hands. The Company will ensure that votes cast are properly counted and recorded.

The chairman of a meeting will at the commencement of the meeting ensure that an explanation is provided of:

(a) the procedures for demanding a poll by shareholders before putting a resolution to the vote on a show of hands; and

(b) the detailed procedures for conducting a poll and then answer any questions from shareholders whenever voting by way of a poll is required.

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22nd Floor Prince's Building
Central, Hong Kong

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF LIJUN INTERNATIONAL PHARMACEUTICAL (HOLDING) CO., LTD.
(Incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Lijun International Pharmaceutical (Holding) Co., Ltd. (the "Company") and its subsidiaries (together, the "Group") set out on pages 37 to 83, which comprise the consolidated and company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these consolidated financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion 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 Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

INDEPENDENT AUDITOR'S REPORT

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 26 April 2007

CONSOLIDATED BALANCE SHEET

As at 31 December 2006
(All amounts in RMB)

	Note	As at 31 December 2006 RMB'000	2005 RMB'000
ASSETS			
Non-current assets			
Land use rights	*6*	**6,945**	7,014
Property, plant and equipment	*7*	**359,943**	336,726
Intangible assets	*8*	**6,983**	—
Deferred income tax assets	*10*	**8,402**	7,436
Available-for-sale financial assets	*11*	**609**	609
		382,882	351,785
Current assets			
Inventories	*12*	**85,485**	93,385
Trade and bills receivable	*13*	**215,867**	151,326
Prepayments, deposits and other receivables	*14*	**47,039**	66,000
Restricted cash	*15*	**16,248**	—
Cash and cash equivalents	*16*	**167,387**	275,122
		532,026	585,833
Total assets		**914,908**	937,618
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	*17*	**30,229**	30,229
Reserves	*18*	**472,088**	470,496
		502,317	500,725
Minority interest		**—**	93,647
Total equity		**502,317**	594,372

CONSOLIDATED BALANCE SHEET

As at 31 December 2006
(All amounts in RMB)

	Note	As at 31 December 2006 RMB'000	As at 31 December 2005 RMB'000
LIABILITIES			
Non-current liabilities			
Long-term bank borrowings	*19*	**28,131**	—
Long-term payables	*20*	**12,713**	16,512
		40,844	16,512
Current liabilities			
Trade and bills payable	*21*	**52,192**	60,264
Advance receipts from customers		**10,348**	14,516
Accruals and other payables	*22*	**96,649**	108,831
Income tax payable		**14,628**	14,628
Dividend payable	*34*	**2,582**	—
Amount due to minority shareholder of a subsidiary	*34*	**11,742**	14,763
Short-term bank borrowings	*19*	**169,188**	108,000
Current portion of long-term bank borrowings	*19*	**12,057**	5,000
Current portion of long-term payables	*20*	**2,361**	732
		371,747	326,734
Total liabilities		**412,591**	343,246
Total equity and liabilities		**914,908**	937,618
Net current assets		**160,279**	259,099
Total assets less current liabilities		**543,161**	610,884

WU QIN
Director

WU ZHIHONG
Director

The notes on pages 43 to 83 are an integral part of these consolidated financial statements.

BALANCE SHEET OF THE COMPANY

As at 31 December 2006
(All amounts in RMB)

		As at 31 December	
		2006	2005
	Note	***RMB'000***	*RMB'000*
ASSETS			
Non-current assets			
Property, plant and equipment	*7*	**2,559**	1,040
Investments in a subsidiary	*9*	**323,697**	152,040
		326,256	153,080
Current assets			
Dividends receivable		**46,969**	59,052
Prepayments, deposits and other receivables	*14*	**2,890**	32,081
Restricted cash	*15*	**16,248**	—
Cash and cash equivalents	*16*	**13,740**	129,745
		79,847	220,878
Total assets		**406,103**	373,958
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	*17*	**30,229**	30,229
Reserves	*18*	**292,155**	327,705
Total equity		**322,384**	357,934
LIABILITIES			
Non-current liabilities			
Long-term bank borrowings	*19*	**28,131**	—
Current liabilities			
Accruals and other payables	*22*	**761**	16,024
Short-term bank borrowings	*19*	**40,188**	—
Current portion of long-term borrowings	*19*	**12,057**	—
Dividend payable	*34*	**2,582**	—
		55,588	16,024
Total liabilities		**83,719**	16,024
Total equity and liabilities		**406,103**	373,958
Net current assets		**24,259**	204,854
Total assets less current liabilities		**350,515**	357,934

WU QIN
Director

WU ZHIHONG
Director

The notes on pages 43 to 83 are an integral part of this financial statement.

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2006
(All amounts in RMB)

	Note	Year ended 31 December 2006 RMB'000	2005 RMB'000
Revenue	23	**860,641**	884,709
Cost of sales		**(415,806)**	(436,842)
Gross profit		**444,835**	447,867
Other gains — net	23	**176**	508
Selling and marketing costs		**(223,726)**	(202,793)
General and administrative expenses		**(123,992)**	(108,414)
Operating profit		**97,293**	137,168
Finance income	25	**5,340**	1,569
Finance costs	25	**(10,232)**	(7,069)
Profit before income tax		**92,401**	131,668
Income tax expense	26	**966**	(15,122)
Profit for the year		**93,367**	116,546
Attributable to:			
Equity holders of the Company		**84,575**	93,311
Minority interest		**8,792**	23,235
		93,367	116,546
Earnings per share for profit attributable to the equity holders of the Company during the year (expressed in RMB per share)			
— basic	31	**0.29**	0.44
— diluted	31	**0.29**	0.44
Dividends	30	**41,363**	48,367

The notes on pages 43 to 83 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2006
(All amounts in RMB)

		Attributable to equity holders of the Company				
	Note	**Share capital** *RMB'000*	**Reserves** *RMB'000*	**Total** *RMB'000*	**Minority interest** *RMB'000*	**Total equity** *RMB'000*
Balance at 1 January 2005		1	259,318	259,319	86,022	345,341
Issue of share capital		30,228	149,874	180,102	—	180,102
Share issue expenses		—	(28,635)	(28,635)	—	(28,635)
Profit for the year		—	93,311	93,311	23,235	116,546
Dividends paid to equity holders of the Company		—	(3,372)	(3,372)	—	(3,372)
Dividends paid to minority interest of a subsidiary		—	—	—	(15,610)	(15,610)
Balance at 31 December 2005		30,229	470,496	500,725	93,647	594,372
Profit for the year		—	84,575	84,575	8,792	93,367
Exchange difference		—	(2,652)	(2,652)	—	(2,652)
Dividends paid/payable to equity holders of the Company		—	(68,472)	(68,472)	—	(68,472)
Dividends paid to minority interest of a subsidiary		—	—	—	(11,742)	(11,742)
Acquisition of minority interest	*33*	—	(11,859)	(11,859)	(90,697)	(102,556)
Balance at 31 December 2006		30,229	472,088	502,317	—	502,317

The notes on pages 43 to 83 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2006
(All amounts in RMB)

	Note	Year ended 31 December 2006 RMB'000	2005 RMB'000
Cash flows from operating activities			
Cash generated from operations	*32(a)*	**35,480**	152,280
Interest paid		**(10,232)**	(7,069)
Income tax paid		**—**	(2,828)
Net cash generated from operating activities		**25,248**	142,383
Cash flows from investing activities			
Acquisition of minority interest in a subsidiary	*33*	**(102,556)**	—
Purchase of property, plant and equipment		**(51,739)**	(30,028)
Proceeds from sale of property, plant and equipment	*32(b)*	**305**	1,498
Purchase of intangible assets		**(7,367)**	—
Proceeds from sale of a parcel of land use right	34(c)	**—**	486
(Increase)/decrease in due from related parties		**(3,047)**	236
Interest received		**5,340**	1,569
Net cash used in investing activities		**(159,064)**	(26,239)
Cash flows from financing activities			
New bank loans		**305,846**	73,000
Repayment of bank loans		**(213,470)**	(97,000)
Increase of restricted bank deposits as the guarantee for bank borrowings *(Note 19)*	15	**(16,248)**	—
Proceeds from share issue, net of share issue expenses	*32(c)*	**30,606**	120,861
Dividend paid		**(80,653)**	(28,963)
Repayment of shareholders' loan		**—**	(47,594)
Net cash inflows from financing activities		**26,081**	20,304
Net (decrease)/increase in cash and cash equivalents		**(107,735)**	136,448
Cash and cash equivalents at beginning of year	*16*	**275,122**	138,674
Cash and cash equivalents at end of the year	*16*	**167,387**	275,122

The notes on pages 43 to 83 are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in RMB)

1. GENERAL INFORMATION

Lijun International Pharmaceutical (Holding) Co., Ltd. (the "Company") and its subsidiaries (together the "Group") are principally engaged in the research, development, manufacture and sale of a wide range of finished medicines and bulk pharmaceuticals through a network of independent retailers. The Group has manufacturing plants in the Shaanxi Province, the People's Republic of China ("PRC"), and sells to customers mainly in the PRC.

The Company is a limited liability company incorporated in the Cayman Islands on 28 September 2004. The address of its registered office is Century Yard, Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY1-1111, Cayman Islands.

The Company's shares have been listed on The Stock Exchange of Hong Kong Limited since 20 December 2005.

These consolidated financial statements are presented in Renminbi (RMB), unless otherwise stated. These consolidated financial statements have been approved for issue by the Company's Board of Directors on 26 April 2007.

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.

2.1 Basis of preparation

The financial statements of Lijun International Pharmaceutical (Holding) Co., Ltd. have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS"). The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets.

The preparation of financial statements in conformity with HKFRS 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. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

(a) Amendments to published standards effective in 2006

Hong Kong Accounting Standards ("HKAS") 19 (Amendment), Employee Benefits, is mandatory for a company's accounting periods beginning on or after 1 January 2006. It introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. The amendment does not have significant impact to the Group and the adoption of this amendment only impacts the format and extent of disclosures presented in the consolidated financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.1 Basis of preparation *(Continued)*

(b) Standards and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

The following standards and interpretations to existing standards that have been issued and will become mandatory for a company's accounting periods beginning on or after 1 May 2006 but which the Group has not early adopted:

HKFRS 7, Financial instruments: Disclosures, and the complementary Amendment to HKAS 1, Presentation of Financial Statements — Capital Disclosures. HKFRS 7 introduces new disclosures relating to financial instruments. This standard does not have any impact on the classification and valuation of the Group's financial instruments.

HKFRS 8, 'Operating segments', effective for annual periods beginning on or after 1 January 2009. This standard supersedes HKAS 14 Segment Reporting, under which segments were identified and reported on risk and return analysis. Items were reported on the accounting policies used for external reporting. Under HKFRS 8, segments are components of an entity regularly reviewed by an entity's chief operating decision-maker. Items are reported based on the internal reporting. Management is currently assessing the impact of HKFRS 8 on the Group's operations. The Group will apply HKFRS 8 with effect from 1 January 2009.

Hong Kong International Financial Reporting Interpretation Committee ("HK(IFRIC)")-Int 8, Scope of HKFRS 2 (effective for annual periods beginning on or after 1 May 2006). HK(IFRIC)-Int 8 requires the consideration of transactions involving the issuance of equity instruments — where the identifiable consideration received is less than the fair value of the equity instruments issued as to whether they fall within the scope of HKFRS 2. The Group will adopt HK(IFRIC)-Int 8 from 1 January 2007, but it is not expected to have any impact on the Group's consolidated financial statements.

HK(IFRIC)-Int 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). HK(IFRIC)-Int 10 prohibits the reversal of impairment losses recognised in an interim period in respect of goodwill, investments in equity instruments and investments in financial assets carried at cost, at a subsequent balance sheet date. The Group will adopt HK(IFRIC)-Int 10 from 1 January 2007, but it is not expected to have significant impact on the Group's consolidated financial statements.

(c) Interpretations to existing standards that are not yet effective and not relevant to the Group's operations

The following interpretations to existing standards have been issued and are mandatory for a company's accounting periods beginning on or after 1 March 2006 but are not relevant to the Group's operations:

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.1 Basis of preparation *(Continued)*

(c) ***Interpretations to existing standards that are not yet effective and not relevant to the Group's operations*** *(Continued)*

HK(IFRIC)-Int 7, Applying the Restatement Approach under HKAS 29, Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006). HK(IFRIC)-Int 7 provides guidance on how to apply requirements of HKAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period. As none of the Group's entities operates in a hyperinflationary economy, HK(IFRIC)-Int 7 is not relevant to the Group's operations;

HK(IFRIC)-Int 9, Reassessment of embedded derivatives (effective for annual periods beginning on or after 1 June 2006). HK(IFRIC)-Int 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment if required. As none of the Group's entities have changed the terms of their contracts, HK(IFRIC)-Int 9 is not relevant to the Group's operations.

(d) ***Standards, amendments and interpretations effective in 2006 but not relevant to the Group's operations***

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but are not relevant to the Group's operations:

- HKAS 21 Amendment — Net Investment in a Foreign Operation;
- HKAS 39 Amendment — Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- HKAS 39 Amendment — The Fair Value Option;
- HKAS 39 and IFRS 4 Amendment — Financial Guarantee Contracts;
- HKFRS 6, Exploration for and Evaluation of Mineral Resources;
- HKFRS 1 Amendment — First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;
- HK(IFRIC)-Int 4, Determining whether an Arrangement contains a Lease;
- HK(IFRIC)-Int 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
- HK(IFRIC)-Int 6, Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.2 Consolidation

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

(a) 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 de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill (Note 2.7). If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

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 the investments in subsidiaries are stated at cost less provision for impairment losses (Note 2.9). The results of subsidiaries are accounted by the Company on the basis of dividend received and receivable.

(b) Transactions with minority interests

The Group applies a policy of treating transactions with minority interests as transactions with equity owners of the Group. For purchases from minority interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is deducted from equity. Gains or losses on disposals to minority interests are also recorded in equity. For disposals to minority interests, differences between any proceeds received and the relevant share of minority interests are also recorded in equity.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

2.4 Foreign currency translation

(a) Functional and presentation currency

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

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges or qualifying net investment hedges.

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount are recognised in equity.

Translation differences on non-monetary financial assets and liabilities are reported as part of the fair value gain or loss. Translation difference on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available for sale are included in the available-for-sale reserve in equity.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.5 Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses, if any. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged in the income statement during the financial period in which they are incurred.

Depreciation on other assets is calculated using the straight-line method to allocate their costs or revalued amounts to their residual values over their estimated useful lives, as follows:

—	Buildings	20-40 years
—	Plant and machinery	8-18 years
—	Vehicles	5-10 years
—	Furniture, fittings and equipment	8-10 years

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

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.9).

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within other (losses)/gains — net, in the income statements. When revalued assets are sold, the amounts included in other reserves are transferred to retained earnings.

Construction-in-progress represents buildings, plant and machinery under construction or pending installation and is stated at cost less accumulated impairment losses, if any. Cost includes the costs of construction and acquisition. 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 available for the intended use, the costs are transferred to property, plant and equipment and depreciated in accordance with the policy as stated above.

2.6 Land use rights

All land in the PRC is state-owned or collectively-owned and no individual land ownership right exists. The Group acquired the right to use certain land. The premiums paid for such right are treated as prepayment for operating lease and recorded as land use rights, which are amortised over the use terms of 50 years using the straight-line method.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.7 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates and is tested annually for impairment as part of the overall balance. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

(b) Patents

Acquired patents are shown at historical cost. Patents have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of patents over their estimated useful lives (8 years).

2.8 Financial assets

The Group classifies its financial assets in the following categories: loans and receivable and available-for-sale. The classification depends on the purposes for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) 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 are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as trade and other receivables in the balance sheet (Note 2.11).

(b) 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.8 Financial assets *(Continued)*

Regular purchases and sales of financial assets are recognised on the trade-date — the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets. Financial assets are derecognised 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 are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences on monetary securities are recognised in profit or loss; translation differences on non-monetary securities are recognised in equity. Changes in the fair value of monetary and non-monetary securities classified as available for sale are recognised in equity.

When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as gains and losses from investment securities.

Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement as part of other income. Dividends on available-for-sale equity instruments are recognised in the income statement as part of other income when the Group's right to receive payments is established.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group established fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets in impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss — measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss — is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described in Note 2.11.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.9 Impairment of investments in subsidiaries and non-financial assets

Assets that have an indefinite useful life or have not yet available for use are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment 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 asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.10 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 (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses.

2.11 Trade and other receivables

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

2.12 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

2.13 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.14 Trade and other payables

Trade and other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.15 Borrowings and borrowing costs

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

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Borrowing costs incurred for the construction of any qualifying asset that is required to complete and prepare the asset for its intended use are capitalised as part of the cost of that asset. Other borrowing costs are expensed.

2.16 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 consolidated financial statement. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income 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 investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference can be controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.17 Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave are recognised when they are accrued to employees. A provision is made for the estimated liability for annual leave and long-service leave as a result of service rendered by employees up to the balance sheet date. Employee entitlements to sick leave and maternity leave are not recognised until the time of leave.

(ii) Pension obligations

The Group has arranged for its Hong Kong employees to join the Mandatory Provident Fund Scheme (the "MPF Scheme"). Under the MPF Scheme, the Group and its Hong Kong employees make monthly contributions to the scheme at 5% of the employees' earnings as defined under the Mandatory Provident Fund legislation, subject to a cap of Hong Kong dollar 1,000 per person per month and any excess contributions are voluntary.

The Group contributes on a monthly basis to defined contribution plans organised by provincial government in the PRC based on a percentage of the relevant employee's monthly salaries. The Group's contributions to defined contributions plans are expensed as incurred. The Group has no legal or constructive obligations to pay further contributions even if the schemes do not hold sufficient assets to pay all employees the benefits relating to employee in the current and prior periods.

Compensations for employee termination and early retirement are recognised in the earlier of the periods in which the Group established a constructive obligation and created a valid expectation on the employee, entered into an agreement with the employee specifying the terms, or after the individual employee has been advised of the specific terms.

2.18 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 the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one items included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessment of the time value of money and the risk specific to the obligation. The increase in the provision due to the passage of time is recognised as interest expense.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.19 Revenue recognition

Revenue comprises the fair value of consideration received or receivable for the sale of goods in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts.

The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Revenue from the sale of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the Group entity has delivered products to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

Processing income is recognised in the accounting period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Interest income is recognised on a time-proportion basis using the effective interest method.

Dividend income is recognised when the right to receive payment is established.

2.20 Operating leases

Leases in which 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.21 Research and development costs

Research expenditure is expensed as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility, and costs can be measured reliably. Other development expenditures are expensed as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs with a finite useful life that have been capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit.

2.22 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

3. FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: interest rate risk, credit risk, liquidity risk and foreign exchange risk.

(i) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates as the Group has no significant interest-bearing assets. The Group's exposure to changes in interest rates is mainly attributable to its bank loans. Bank loans at variable rates expose the Group to cash flow interest-rate risk. Details of the Group's bank borrowings have been disclosed in Note 21 of this section.

The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

(ii) Credit risk

The Group has no significant concentrations of credit risk. The carrying amounts of bank and cash balances, trade and bills receivables, and other receivables represent the Group's maximum exposure to credit risk in relation to financial assets. The Group has policies that limit the amount of credit exposure to any financial institutions. The Group has also policies in place to ensure that the sales of products are made to customers with appropriate credit history and the Group performs periodic credit evaluations of its customers.

3. FINANCIAL RISK MANAGEMENT *(Continued)*

3.1 Financial risk factors *(Continued)*

(iii) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities. The Group aims to maintain flexibility in funding by keeping committed credit lines available.

(iv) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions denominated and settled in RMB. However, foreign currencies, mainly United States Dollars ("USD"), are required to settle the Group's sales of bulk pharmaceuticals to overseas customers and the relative expenses. RMB is not freely convertible into other foreign currencies and conversion of RMB into foreign currencies is subject to rules and regulations of foreign exchange control promulgated by the PRC government.

The Group has not used any forward contracts, currency borrowings or other means to hedge its foreign currency exposure. As a result, the Group considers it has no material foreign exchange risk.

3.2 Fair value estimation

The carrying amounts of the Group's financial assets which mainly include bank and cash balances, trade and bills receivables, other receivables; and financial liabilities, which mainly include trade and bills payables, short-term bank loans, approximate their fair values due to their short maturities.

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. The fair values of non-current borrowings are disclosed in Note 21.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

4.1 Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS *(Continued)*

4.1 Critical accounting estimates and assumptions *(Continued)*

(i) Useful lives of property, plant and equipment

The Group's management determines the estimated useful lives for its property, plant and equipment. This estimate is based on the historical experience of the actual useful lives of property, plant and equipment of similar nature and functions. It could change significantly as a result of technical innovations and competitor actions in response to severe industry cycles.

Management will increase the depreciation charge where useful lives are less than previously estimated lives, or will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

(ii) Net realisable value of inventories

Net realisable value of inventories is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses. These estimates are based on the current market condition and the historical experience of manufacturing and selling products of similar nature. It could change significantly as a result of competitor actions in response to severe industry cycles. Management will reassess the estimations by the balance sheet date.

(iii) Impairment of trade and bills receivable

The Group's management determines the provision for impairment of trade and bills receivables. This estimate is based on the credit history of its customers and the current market condition. Management reassess the provision on each of the balance sheet date.

(iv) Impairment of property, plant and equipment

The impairment loss for property, plant and equipment is recognised for the amount by which the carrying amount exceeds its recoverable amount in accordance with the accounting policy stated in Note 2.9. The recoverable amounts have been determined based on fair value less costs to sell, which is based on the best information available to reflect the amount that obtainable at each of the balance sheet date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs to disposal.

5. SEGMENT INFORMATION

The Group primarily operates in one business segment — manufacturing and sale of pharmaceutical products. It operates principally in one geographical segment — the PRC. Substantially all of the Group's assets were located in the PRC. Accordingly, no analysis of segment information is presented.

6. LAND USE RIGHTS — GROUP

	RMB'000
At 1 January 2005	
Cost	10,455
Accumulated amortisation	(441)
Net book amount	10,014
Year ended 31 December 2005	
Opening net book amount	10,014
Disposals	(2,918)
Amortisation charge for the year	(82)
Closing net book amount	7,014
At 31 December 2005	
Cost	7,425
Accumulated amortisation	(411)
Net book amount	7,014
Year ended 31 December 2006	
Opening net book amount	7,014
Amortisation charge for the year	(69)
Closing net book amount	6,945
At 31 December 2006	
Cost	7,425
Accumulated amortisation	(480)
Net book amount	6,945

All of the Group's land use rights are located in Xi'an and Weinan, Shaanxi Province, the PRC and are held on leases of 50 years from the dates of acquisition.

As at 31 December 2006, the net book amount of the Group's land use rights of approximately RMB 4,000,000 (2005: RMB 4,000,000) was pledged as collateral for the Group's bank loans (Note 19(d)).

The amortisation of land use rights is charged to general and administrative expenses.

7. PROPERTY, PLANT AND EQUIPMENT

Group

	Buildings RMB'000	Plant and machinery RMB'000	Furniture and fixtures RMB'000	Vehicles RMB'000	Construction-in-progress RMB'000	Total RMB'000
At 1 January 2005						
Cost	201,291	256,893	17,054	24,694	22,184	522,116
Accumulated depreciation and impairment losses	(40,926)	(130,512)	(6,606)	(8,759)	—	(186,803)
Net book amount	160,365	126,381	10,448	15,935	22,184	335,313
Year ended 31 December 2005						
Opening net book amount	160,365	126,381	10,448	15,935	22,184	335,313
Additions	—	—	1,260	1,912	34,744	37,916
Transfer	10,124	17,257	398	—	(27,779)	—
Disposal	(1,420)	(39)	—	—	—	(1,459)
Charge for the year *(Note 24)*	(6,690)	(23,497)	(2,417)	(2,440)	—	(35,044)
Closing net book amount	162,379	120,102	9,689	15,407	29,149	336,726
At 31 December 2005						
Cost	209,407	273,872	18,688	26,349	29,149	557,465
Accumulated depreciation and impairment losses	(47,028)	(153,770)	(8,999)	(10,942)	—	(220,739)
Net book amount	162,379	120,102	9,689	15,407	29,149	336,726
Year ended 31 December 2006						
Opening net book amount	162,379	120,102	9,689	15,407	29,149	336,726
Additions	954	874	1,366	4,502	46,019	53,715
Transfer	3,982	2,628	—	—	(6,610)	—
Disposal	—	—	—	(341)	(25)	(366)
Charge for the year *(Note 24)*	(6,858)	(18,271)	(2,201)	(2,802)	—	(30,132)
Closing net book amount	160,457	105,333	8,854	16,766	68,533	359,943
At 31 December 2006						
Cost	214,343	277,374	20,054	30,264	68,533	610,568
Accumulated depreciation and impairment losses	(53,886)	(172,041)	(11,200)	(13,498)	—	(250,625)
Net book amount	160,457	105,333	8,854	16,766	68,533	359,943

The buildings are located in Xi'an and Weinan, Shaanxi Province, the PRC.

The depreciation of property, plant and equipment is charged to cost of sales, selling and marketing costs and general and administrative expenses.

7. PROPERTY, PLANT AND EQUIPMENT *(Continued)*

Company

	Furniture and fixtures *RMB'000*	Vehicles *RMB'000*	Total *RMB'000*
Year ended 31 December 2005			
Addition	1,076	—	1,076
Charge for the year	(36)	—	(36)
Closing net book amount	1,040	—	1,040
At 31 December 2005			
Cost	1,076	—	1,076
Accumulated depreciation and impairment losses	(36)	—	(36)
Net book amount	1,040	—	1,040
Year ended 31 December 2006			
Opening net book amount	1,040	—	1,040
Addition	18	1,830	1,848
Charge for the year	(104)	(225)	(329)
Closing net book amount	954	1,605	2,559
At 31 December 2006			
Cost	1,094	1,830	2,924
Accumulated depreciation and impairment losses	(140)	(225)	(365)
Net book amount	954	1,605	2,559

8. INTANGIBLE ASSETS — GROUP

	Goodwill *RMB'000*	Patent *RMB'000*	Total *RMB'000*
At 1 January 2005			
Cost	751	—	751
Accumulated amortisation and impairment	(150)	—	(150)
Net book amount	601	—	601
Year ended 31 December 2005			
Opening net book amount	601	—	601
Impairment for the year *(Note 24)*	(601)	—	(601)
Closing net book amount	—	—	—
At 31 December 2005			
Cost	751	—	751
Accumulated amortisation and impairment	(751)	—	(751)
Net book amount	—	—	—
Year ended 31 December 2006			
Opening net book amount	—	—	—
Additions	—	7,367	7,367
Amortisation for the year *(Note 24)*	—	(384)	(384)
Closing net book amount	—	6,983	6,983
At 31 December 2006			
Cost	751	7,367	8,118
Accumulated amortisation and impairment	(751)	(384)	(1,135)
Net book amount	—	6,983	6,983

9. INVESTMENTS IN A SUBSIDIARY — COMPANY

	Company	
	2006	2005
	RMB'000	*RMB'000*
Unlisted shares	**323,697**	152,040

The following is a list of the principal subsidiaries at 31 December 2006:

Name	Place of incorporation and kind of legal entity	Principal activities and place of operation	Paid in, issued and fully paid share capital	Interest held	
				2006	2005
Xi'an Lijun Pharmaceutical Co., Ltd. ("Xi'an Lijun")	Limited liability company incorporated in PRC	Manufacturing and sale of pharmaceutical products in PRC	RMB 280,000,000	**100% (Directly held)**	80% (Directly held)
Shaanxi Rejoy Hengxintang Pharmaceutical Co., Ltd. ("Hengxintang")	Limited liability company incorporated in PRC	Manufacturing and sale of traditional Chinese medicine in PRC	RMB 10,000,000	**51% (Indirectly held)**	41% (Indirectly held)

10. DEFERRED INCOME TAX ASSET — GROUP

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Deferred tax assets:		
— Deferred tax asset to be recovered after more than 12 months	**5,455**	7,436
— Deferred tax asset to be recovered within 12 months	**2,947**	—
	8,402	7,436

10. DEFERRED INCOME TAX ASSET — GROUP

The movements in deferred tax assets are as follows:

	Accrual of sales commission and others	Provisions for impairment of trade receivables	Inventory write-down	Timing difference in expense recognition	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
At 1 January 2005	8,563	6,993	1,879	5,123	22,558
Recognised in the income statement *(Note 26)*	(8,563)	(4,086)	(708)	(1,765)	(15,122)
At 31 December 2005	—	2,907	1,171	3,358	7,436
Recognised in the income statement *(Note 26)*	2,663	(1,109)	(143)	(445)	966
At 31 December 2006	2,663	1,798	1,028	2,913	8,402

11. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Available-for-sale financial assets represent unlisted and listed shares in certain limited liability companies in the PRC.

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Equity securities:		
Xi'an Lijun Transportation Co., Ltd. — unlisted	**129**	129
Sichuan Quanxing Co., Ltd. — listed	**480**	480
	609	609

The Group's investment in unlisted shares represents the 14.37% share of a joint venture in the PRC, Xi'an Lijun Transportation Co., Ltd..

12. INVENTORIES — GROUP

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Raw materials	**38,934**	41,907
Work in progress	**23,874**	13,935
Finished goods	**32,229**	47,304
	95,037	103,146
Less: Provision for impairment of inventory	**(9,552)**	(9,761)
	85,485	93,385

The Group reversed RMB 209,000 (2005: RMB 2,764,000) for impairment of inventories during the year ended 31 December 2006. The reversal has been included in cost of sales (Note 32).

13. TRADE AND BILL RECEIVABLE — GROUP

The Group generally required its customers to settle sales invoices within 3 months. Ageing analysis of trade and bills receivables is as follows:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Within 3 months	**182,551**	127,698
4 to 6 months	**24,027**	18,525
7 to 12 months	**14,185**	9,534
1 to 2 years	**2,265**	2,204
2 to 3 years	**683**	2,234
More than 3 years	**3,843**	13,638
	227,554	173,833
Less: Provision for impairment of receivables	**(11,687)**	(22,507)
	215,867	151,326

The Group has written off approximately RMB 14,478,000 (2005: RMB 983,000) and recognised loss of RMB 3,658,000 (2005: Write back of RMB 3,784,000) for impairment of its trade receivables during the year ended 31 December 2006. The loss has been included in general and administrative expenses.

There is no concentration of credit risk with respect to trade and bills receivables, as the Group has a large number of customers, nationally dispersed. The carrying amounts of the trade and bills receivables approximate their fair value.

13. TRADE AND BILL RECEIVABLE — GROUP *(Continued)*

At the respective balance sheet dates, the trade and bills receivables were denominated in currencies as follows:

	2006	2005
	RMB'000	*RMB'000*
USD	**1,329**	65
RMB	**226,225**	173,768
	227,554	173,833

14. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group As at 31 December		**Company As at 31 December**	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Proceeds from new issue of shares retained by the underwriters *(Note 32)*	**—**	30,606	**—**	30,606
Receivables relating to disposal of staff quarters	**16,416**	12,916	**—**	—
Prepayments to suppliers	**11,681**	9,633	**—**	—
Prepaid advertising expenses	**7,774**	3,067	**—**	—
Receivables relating to disposal of land use right	**2,940**	2,940	**—**	—
Other receivables	**8,228**	6,838	**2,890**	1,475
	47,039	66,000	**2,890**	32,081

15. RESTRICTED CASH

As at 31 December 2006, the Group has restricted deposits amounted to RMB 16,248,000 (2005: nil) as guarantee of the bank borrowings *(Note 19)*.

16. BANK AND CASH BALANCES

Bank and cash balances were denominated in currencies as follows:

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
RMB	**116,068**	145,106	**—**	—
HKD	**46,469**	129,745	**13,740**	129,745
EUR	**4,690**	—	**—**	—
USD	**160**	271	**—**	—
	167,387	275,122	**13,740**	129,745

Cash and cash equivalents represented bank and cash balances. RMB is not a freely convertible currency in the international market. The remittance of these RMB funds out of the PRC is subject to the exchange control restrictions imposed by the PRC Government.

The weighted average effective interest rate per annum on cash at bank was approximately 1.08% (2005: 1.08%).

17. SHARE CAPITAL

	Number of shares	**Amount**
	(thousands)	*RMB'000*
At 1 January 2005	10	1
Capitalisation issue	209,990	21,851
	210,000	21,852
New share issue	80,500	8,377
At 31 December 2005 and 2006	290,500	30,229

The total authorised number of ordinary share is 1,000,000,000 (2005: 1,000,000,000), with a par value of HK$ 0.10 per share (2005: HK$ 0.10 per share).

On 18 October 2004, one share was allotted and issued at par.

On 28 December 2004, 9,999 shares were allotted, issued and fully paid at par.

In December 2005, the Company issued 80,500,000 shares at HK$2.15 per share for cash (including 70,000,000 shares on 19 December 2005 and 10,500,000 shares on 21 December 2005) in connection with the listing of the Company's share on the SEHK, and raised a net proceeds of approximately RMB 151,467,000 after netting off share issue expenses amounted to approximately RMB 28,635,000. In addition, 209,990,000 shares are credited as fully paid pursuant to the capitalisation issue immediately following the issue of new shares.

18. RESERVES

Group

	Share premium RMB'000	Capital reserve (Note a) RMB'000	Statutory reserves (Note b) RMB'000	Exchange difference RMB'000	Retained earnings RMB'000	Total RMB'000
At 1 January 2005	—	168,752	45,949	—	44,617	259,318
Issue of share capital	149,874	—	—	—	—	149,874
Share issue expenses	(28,635)	—	—	—	—	(28,635)
Profit for the year	—	—	—	—	93,311	93,311
Transfer to statutory reserves	—	—	13,804	—	(13,804)	—
Dividends	—	—	—	—	(3,372)	(3,372)
At 31 December 2005	121,239	168,752	59,753	—	120,752	470,496
Profit for the year	—	—	—	—	84,575	84,575
Transfer to statutory reserve	—	—	11,236	—	(11,236)	—
Dividends	—	—	—	—	(68,472)	(68,472)
Acquisition of minority interest *(Note 33)*	—	(11,859)	—	—	—	(11,859)
Exchange difference	—	—	—	(2,652)	—	(2,652)
At 31 December 2006	121,239	156,893	70,989	(2,652)	125,619	472,088

Company

	Share premium RMB'000	Capital Surplus RMB'000	Exchange difference RMB'000	Retained earnings RMB'000	Total RMB'000
At 1 January 2005	—	152,040	—	—	152,040
Issue of share capital	149,874	—	—	—	149,874
Share issue expenses	(28,635)	—	—	—	(28,635)
Profit for the year	—	—	—	54,426	54,426
At 31 December 2005	121,239	152,040	—	54,426	327,705
Profit for the year	—	—	—	35,574	35,574
Dividends	—	—	—	(68,472)	(68,472)
Exchange difference	—	—	(2,652)	—	(2,652)
At 31 December 2006	121,239	152,040	(2,652)	21,528	292,155

18. RESERVES *(Continued)*

	Group As at 31 December		Company As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Retained earnings representing:				
— Proposed final dividend	**20,430**	48,367	**20,430**	48,367
— Others	**105,189**	72,385	**1,098**	6,059
Total Retained earnings	**125,619**	120,752	**21,528**	54,426

(a) Capital reserve

Capital reserve of the Company includes the difference between the Company's 80% share in paid-up capital of Xi'an Lijun Pharmaceutical Co., Ltd. and the nominal value of the share capital issued by the Company upon the Reorganisation.

(b) Statutory reserves

In accordance with the PRC regulations and the Articles of the Association of the Group's subsidiaries established in the PRC, each of the Group's subsidiaries is required to set aside 10% of its statutory net profit for the year after offsetting any prior years' accumulative losses as determined under the PRC accounting regulations to the statutory surplus reserve fund before distributing their net profit. When the balance of such reserve reaches 50% of each PRC subsidiary's share capital, any further appropriation is optional. The statutory surplus reserve fund can be utilised to offset prior years' losses or to issue bonus shares. However, such statutory surplus reserve fund must be maintained at a minimum of 25% of the PRC subsidiary's share capital after such issuance.

In addition, each of the PRC subsidiaries is required to set aside 5% to 10% of its statutory net profit for the year to the statutory public welfare fund. The statutory public welfare fund is to be utilised to build or acquire capital items for the subsidiary's employees and cannot be used to pay off staff welfare expenses.

19. BANK BORROWINGS

	Group As at 31 December		Company As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Long-term				
— Due within one year	**12,057**	5,000	**12,057**	—
— Due over one year	**28,131**	—	**28,131**	—
Short-term	**169,188**	108,000	**40,188**	—
Total borrowings	**209,376**	113,000	**80,376**	—
Representing:				
Unsecured	**124,000**	108,000	**—**	—
Secured *	**5,000**	5,000	**—**	—
Guaranteed **	**80,376**	—	**80,376**	—
	209,376	113,000	**80,376**	—

* As at 31 December 2006, the net book amount of the Group's land use rights (Note 6) of approximately RMB 4,000,000 was pledged as collateral for the Group's bank borrowings (2005: RMB 4,000,000).

** The guaranteed bank borrowings as at 31 December 2006 was borrowed by the Company and guaranteed by Xi'an Lijun as well as bank deposits amounted to approximately RMB 16,248,000.

(a) An analysis of the carrying amounts of the Group's bank borrowings by type and currency is as follows:

	Group As at 31 December		Company As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
RMB				
— at floating rates	**129,000**	113,000	**—**	—
HK dollars				
— at floating rates	**80,376**	—	**80,376**	—
	209,376	113,000	**80,376**	—

The carrying amounts of the group's bank borrowings approximate their fair value.

(b) The weighted average effective interest rates per annum for bank loans was approximately 6.47% (2005: 6.40%).

19. BANK BORROWINGS *(Continued)*

(c) The maturity of the Group's non-current bank borrowings at respective balance sheet dates is as follows:

	Group		Company	
	As at 31 December		As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Within 1 year	**12,057**	5,000	**12,057**	—
Between 1 to 2 years	**16,075**	—	**16,075**	—
Between 2 to 5 years	**12,056**	—	**12,056**	—
	40,188	5,000	**40,188**	—

(d) The collaterals of the Group's borrowings are analysed as follows:

	As at 31 December		As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Net book amount of land use right *(Note 6)*	**4,000**	4,000	**—**	—

(e) The Group has the following undrawn borrowing facilities at the respective balance sheet dates:

	As at 31 December		As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Floating rate and expiring within one year	**364,000**	214,000	**—**	—

20. LONG-TERM PAYABLES — GROUP

Long term payables mainly represent retirement benefits and early retirement allowance payable to the employees of Xi'an Lijun Pharmaceutical Co., Ltd..

The maturity profile of the long-term payable is as follows:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Within 1 year	**2,361**	732
Between 1 to 2 years	**2,362**	659
Between 2 to 5 years	**3,557**	1,680
More than 5 years	**6,794**	14,173
	15,074	17,244
Less: Current portion included in current liabilities	**(2,361)**	(732)
	12,713	16,512

21. TRADE AND BILLS PAYABLE — GROUP

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Trade payable	**52,192**	56,264
Bills payable	**—**	4,000
	52,192	60,264

The carrying amounts of the trade and bills payable approximate their fair value.

Ageing analysis of trade and bills payable at respective balance sheet dates are as follows:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Within 3 months	**36,186**	55,037
4 to 6 months	**1,296**	1,003
7 to 12 months	**657**	897
1 to 3 years	**12,272**	1,709
More than 3 years	**1,781**	1,618
	52,192	60,264

22. ACCRUALS AND OTHER PAYABLES

	Group As at 31 December		Company As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Accrued distribution expenses	**21,190**	27,016	**—**	—
Taxation payables, other than income tax	**13,212**	10,527	**—**	—
Payable for property, plant and equipment	**11,343**	9,367	**—**	—
Welfare payables	**11,618**	23,271	**—**	—
Salary and wages payable	**10,240**	11,148	**—**	—
Amount due to Rejoy Group Limited Liability Company ("Rejoy Group")	**6,350**	—	**—**	—
Deposits from employees	**5,972**	5,407	**—**	—
Advertising expense payables	**3,027**	2,871	**—**	—
Accrued management bonus	**2,380**	3,000	**—**	—
Accrued advertising expenses	**961**	1,940	**—**	—
Professional fee payables	**761**	6,592	**761**	6,592
Others	**9,595**	7,692	**—**	9,432
	96,649	108,831	**761**	16,024

23. REVENUE AND OTHER GAINS

The Group is principally engaged in the manufacturing and sale of pharmaceutical products. Revenue recognised is as follows:

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Revenue:		
— Sales of pharmaceutical products	**857,456**	880,452
— Processing income	**2,312**	3,410
— Sales of raw materials and by products	**873**	847
	860,641	884,709
Other gains — net:		
— Investment income	**176**	—
— Gain on disposal of a land use right	**—**	508
	176	508
	860,817	885,217

24. EXPENSE BY NATURE — GROUP

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Raw material and consumables used	**307,306**	314,627
Sales commission	**105,865**	97,331
Staff costs including directors' emoluments		
— wages and salaries	**67,307**	66,635
— pension costs (Note 28)	**12,036**	9,912
— welfare expenses	**17,463**	10,861
Utility expenses	**54,032**	50,973
Advertising expenses	**52,999**	37,781
Depreciation of property, plant and equipment	**30,132**	35,044
Research and development costs	**7,833**	7,429
Operating leases — rental expenses in respect of land use right in the PRC	**5,461**	5,461
Provision/(reversal of) for impairment of receivables	**3,658**	(3,508)
Auditors' remuneration	**2,300**	1,768
Amortisation of intangible assets (charged to general and administrative expenses)	**384**	(39)
Amortisation of land use rights (charged to general and administrative expenses)	**69**	82
Loss/(gain) on disposal of property, plant and equipment	**61**	—
Impairment of goodwill	**—**	601
Reversal of inventory write-down	**(209)**	(2,764)
Change in investories of finished goods and work in progress	**(8,032)**	5,077
Others	**104,859**	110,778
Total cost of sales, selling and marketing costs and general and administrative expenses	**763,524**	748,049

25. FINANCE INCOME AND COSTS — GROUP

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Financial income		
— Interest income on demanded bank deposit	**5,340**	1,569
Financial costs		
— Interest expense on bank borrowings wholly repayable within five years	**(10,232)**	(7,069)

26. INCOME TAX EXPENSE

The Company was incorporated in the Cayman Islands as an exempted company with limited liability under the Company Law of the Cayman Islands and, accordingly, is exempted from payment of the Cayman Islands income tax.

No Hong Kong profits tax was provided as the Group had no assessable profit in Hong Kong in 2006 and 2005.

According to relevant PRC rules and regulations, Xi'an Lijun Pharmaceutical Co., Ltd., being qualified as an encouraged domestic enterprise in the western region of the PRC, is entitled to preferential PRC Enterprise Income Tax ("EIT") rate of 15% from 2002 to 2004, on an annual approval basis.

In December 2004, Xi'an Lijun Pharmaceutical Co., Ltd. has obtained approval to be designated as a sino-foreign joint venture enterprise and therefore ceased to be entitled to the preferential EIT rate of 15%. In May 2005, the EIT rate of Xi'an Lijun Pharmaceutical Co., Ltd has been approved to be 24%, which was effective from 1 Januanry 2005. Being incorporated as foreign investment enterprise in PRC, Xi'an Lijun Pharmaceutical Co., Ltd. has obtained approvals in May 2005 from the relevant tax authorities in Xi'an, which is also effective from 1 January 2005, for their entitlement to exemption from EIT for the first two years and 50% reduction in EIT for the next three years, commencing from the first profitable year after offsetting all unexpired tax losses carried forward from the previous years in accordance with the relevant tax rules and regulations applicable to foreign investment enterprises in PRC.

Shaanxi Rejoy Hengxintang Pharmaceutical Co., Ltd. is subject to EIT levied at an approved rate of taxable income based on its audited accounts prepared in accordance with the laws and regulations in the PRC. As at 31 December 2006, Shaanxi Rejoy Hengxintang Pharmaceutical Co., Ltd. has accumulated net losses brought forward and has submitted application for its applicable tax rate and is still awaiting approval from tax authority.

The amounts of taxation credited/(charged) to the income statement represent:

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Current taxation — EIT	**—**	—
Deferred taxation *(Note 10)*	**966**	(15,122)
	966	(15,122)

26. INCOME TAX EXPENSE *(Continued)*

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

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Profit before income tax	**92,401**	131,668
Weighted average EIT rates in the PRC	**24%**	24%
Tax calculated at the weighted average EIT rate	**(22,176)**	(31,600)
Tax exemption	**21,755**	28,259
Effect of change in the estimate of the reversal period of temporary differences in which different tax rate are applied	**1,387**	—
Expenses not deductible for tax purposes	**—**	(345)
Effect of change of the Group's tax status for the calculation of deferred taxation	**—**	(11,436)
Tax charge	**966**	(15,122)

27. PROFIT ATTRIBUTABLE TO THE COMPANY's EQUITY HOLDERS

The consolidated profit attributable to the Company's equity holders includes profit of RMB 35,574,000 (2005: RMB 54,426,000) dealt with in the financial statements of the Company.

28. RETIREMENT BENEFITS — GROUP

(a) Pension obligations

As stipulated by the rules and regulations in the PRC, the Group has participated in state-sponsored defined contribution retirement plans for its employees in the PRC. The Group and the eligible employees are required to contribute 20% and 7%, respectively, of the employees' basic salary. The state-sponsored retirement plans are responsible for the entire pension obligations payable to retired employees. Moreover, the Group would pay monthly allowance to old retirement persons. The Group has no further pension obligation beyond the above contributions.

(b) Early retirement benefits

Compensation for early retirement is recognised in the earlier of the periods in which the Group established a constructive obligation and created a valid expectation on the employee, entered into an agreement with the employee specifying the terms, or after the individual employee has been advised of the specific terms.

29. DIRECTORS AND SENIOR MANAGEMENT'S EMOLUMENTS — GROUP

(a) Directors' emoluments

The emoluments of all executive and non-executive directors during the years, on a named basis, are set out as below:

Name of Director	Fees	Salary	Other benefits	Contribution to state-sponsored retirement plans	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
2005					
Executive Directors					
Mr. Wu Qin	874	145	29	8	1,056
Mr. Wu Zhihong	625	143	29	8	805
Mr. Huang Chao	624	143	29	8	804
Mr. Xie Yunfeng	375	75	27	8	485
Ms. Sun Xinglai	374	80	28	7	489
	2,872	586	142	39	3,639
Non-executive Directors					
Mr. Chow Kwok Wai	39	—	—	—	39
Mr. Leung Chong Shun	39	—	—	—	39
Mr. Qu Jiguang	39	—	—	—	39
Mr. Liu Zhiyong	14	—	—	—	14
	131	—	—	—	131
	3,003	586	142	39	3,770
2006					
Executive Directors					
Mr. Wu Qin	844	70	25	4	943
Mr. Wu Zhihong	603	151	8	4	766
Mr. Huang Chao	603	5	8	4	620
Mr. Xie Yunfeng	362	5	4	4	375
Ms. Sun Xinglai	362	181	21	4	568
Mr. Wang Xian Jun	653	151	17	—	821
	3,427	563	83	20	4,093
Non-executive Directors					
Mr. Chow Kwok Wai	181	—	—	—	181
Mr. Leung Chong Shun	181	—	—	—	181
Mr. Qu Jiguang	181	—	—	—	181
Mr. Liu Zhiyong	60	—	—	—	60
	603	—	—	—	603
	4,030	563	83	20	4,696

No Directors of the Company waived any emoluments during the years.

29. DIRECTORS AND SENIOR MANAGEMENT'S EMOLUMENTS — GROUP *(Continued)*

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group during the years are also directors of the Company and their emoluments are detailed in (a) above.

(c) During the years, no emoluments were paid by the Company to any of the directors as an inducement to join or upon joining the Group or as compensation for loss of office.

30. DIVIDENDS

An interim dividend in respect of the six months ended 30 June 2006 of HK$0.07 per share, amounting to a total dividend of RMB 20,933,000 was approved at the meeting of the board of directors on 1 September 2006.

A final dividend in respect of 2006 of HK$0.07 per share, amounting to a total dividend of RMB 20,430,000 is to be proposed at the upcoming annual general meeting. These financial statements do not reflect this dividend payable.

	2006	2005
	RMB'000	*RMB'000*
Approved interim dividend of HK$0.07(2005: Nil) per ordinary share	**20,933**	—
Proposed final dividend of HK$0.07(2005: HK$0.16) per ordinary share	**20,430**	48,367
	41,363	48,367

31. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company of RMB 84,575,000 by the weighted average number of 290,500,000 ordinary shares in issue during the year.

The comparative basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company of RMB 93,311,000 by the weighted average number of 212,426,000 ordinary shares in issue for the year ended 2005.

32. CONSOLIDATED CASH FLOW STATEMENT

(a) Cash generated from operations

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Profit before income tax	**92,401**	131,668
Provision/(reversal of) for impairment of receivables	**3,658**	(3,508)
Reversal of inventory write-downs	**(209)**	(2,764)
Depreciation of property, plant and equipment	**30,132**	35,044
Loss/(gain) on disposals of property, plant and equipment	**61**	(39)
Gain on disposal of a land use right	**—**	(508)
Amortisation of land use right	**69**	82
Amortisation of intangible assets	**384**	—
Impairment of goodwill	**—**	601
Interest income	**(5,340)**	(1,569)
Interest expense	**10,232**	7,069
Operating profit before working capital changes	**131,388**	166,076
Changes in working capital:		
Decrease/(increase)in inventories	**8,109**	(9,562)
Increase in trade and bills receivables	**(59,361)**	(21,076)
(Increase)/decrease in prepayments, deposits and other receivables	**(11,252)**	10,835
(Increase)/decrease in amounts due from related parties	**(8,838)**	27,518
Decrease in trade and bills payables and deposits and advance receipts from customers	**(11,928)**	(5,737)
Decrease in taxation payable, accruals, and other payables	**(12,328)**	(12,538)
Decrease in amounts due to related parties	**(310)**	(3,236)
Net cash inflow generated from operations	**35,480**	152,280

(b) Proceeds from disposal of property, plant and equipment

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Net book amount disposed *(Note 7)*	**366**	1,459
Gain/(loss) on disposal of property, plant and equipment	**(61)**	39
Proceeds from disposal of property, plant and equipment	**305**	1,498

32. CONSOLIDATED CASH FLOW STATEMENT *(Continued)*

(c) Proceeds from issue of new shares

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Proceeds from issue of new shares (including share premium)	—	180,102
Less: Share issue expenses	—	(28,635)
Net proceeds from issue of new shares (including share premium)	—	151,467
Proceeds received from/(retained by) the underwriters *(Note 14)*	**30,606**	(30,606)
Proceeds from share issue	**30,606**	120,861

33. BUSINESS COMBINATIONS — GROUP

In June 2006, the Company acquired 20% equity interests in Xi'an Lijun Pharmaceutical Co.,Ltd. ("Xi'an Lijun") from the Rejoy Group for a cash consideration of approximately RMB102,556,000.

Details of the acquisition are as follows:

	RMB'000
Purchase consideration — cash paid	102,556
Less: 20% minority interest of Xi'an Lijun	(90,697)
Excess of the consideration over the carrying amount of the interests acquired	11,859

Such excess of the consideration over the carrying amount of the interests acquired is recognised directly in equity.

(All amounts in RMB)

34. RELATED PARTY TRANSACTIONS AND BALANCES — GROUP

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control.

(a) During the years, the directors are of the view that the following companies are related parties of the Group:

Name	Relationship
Rejoy Group	Shareholder of Xi'an Lijun Pharmaceutical Co., Ltd. before 22 June 2006
Xi'an Rejoy Technology Investment Co., Ltd. ("Rejoy Technology")	Shareholder of Xi'an Lijun Pharmaceutical Co., Ltd. before 28 December 2004
Shaanxi Xi'an Pharmaceutical Factory ("Xi'an Pharmacy Factory")	Wholly-owned subsidiary of Rejoy Group
Xi'an Rejoy Packaging Materials Co., Ltd. ("Rejoy Packaging")	Subsidiary of Rejoy Technology
Rejoy Baichuan Medicines Chemical Engineering Co., Ltd. ("Rejoy Baichuan")	Subsidiary of Rejoy Technology
Liaoning Huabang Pharmaceutical Co., Ltd. ("Huabang Pharmaceutical")	Shareholder of Xi'an Lijun Pharmaceutical Co., Ltd. before 28 December 2004
Xi'an Rejoy Medicine Co., Ltd. ("Rejoy Medicine")	Subsidiary of Rejoy Group
Rejoy Group Zhenjiang Pharmaceutical Co., Ltd. ("Zhenjiang Pharmaceutical")	Subsidiary of Rejoy Group before October 2005
Xiyao Construction and Installation Co., Ltd. ("Xiyao Construction")	Joint venture of Xi'an Pharmacy Factory after March 2005 (wholly-owned subsidiary of Xi'an Pharmacy Factory before March 2005)
Xi'an Rejoy Real Estate Co., Ltd. ("Rejoy Real Estate")	Subsidiary of Rejoy Technology after November 2004 (Joint venture of Xi'an Lijun Pharmaceutical Co., Ltd. before November 2004)
Global Printing Co., Ltd. ("Global Printing")	Controlled by the same ultimate parent company of Rejoy Group

34. RELATED PARTY TRANSACTIONS AND BALANCES — GROUP *(Continued)*

(b) Saved as disclosed elsewhere in these consolidated financial statements, the Group had the following significant transactions with related parties:

Nature of transactions	Name of related party	Year ended 31 December **2006** ***RMB'000***	2005 *RMB'000*
Purchasing of raw materials and packaging materials	Global Printing	**6,636**	6,883
	Rejoy Baichuan	—	68
	Rejoy Packaging	—	717
	Zhenjiang Pharmaceutical	—	5,143
		6,636	12,811
Sales of finished goods	Rejoy Baichuan	**19,515**	9,043
	Rejoy Medicine	**10,154**	20,886
	Huabang Pharmaceutical	—	4,526
		29,699	34,455
Provision of utilities from	Xi'an Pharmacy Factory	**54,032**	50,973
Sharing of administrative costs from	Xi'an Pharmacy Factory	**13,000**	12,926
Lease of land use rights from	Rejoy Group	**5,461**	5,461
Lease of office premises to	Rejoy Group	**200**	200
Discontinued: Provision of assets management services by	Xi'an Pharmacy Factory	—	280
Provision of building construction services by	Xiyao Construction	—	1,809

34. RELATED PARTY TRANSACTIONS AND BALANCES — GROUP *(Continued)*

(c) The Group had the following significant balances with related parties:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Amounts due from related parties included in trade receivables		
— Rejoy Baichuan	**8,809**	1,627
— Rejoy Medicine	**8,268**	4,879
— Huabang Pharmaceutical	**—**	1,733
	17,077	8,239
Amounts due from related parties included in prepayments, deposits and other receivables		
— Xi'an Pharmacy Factory	**3,600**	404
— Rejoy Real Estate	**—**	30
— Rejoy Group	**—**	60
— Rejoy Technology	**—**	59
	3,600	553
Amounts due to related parties included in trade payables		
— Global Printing	**1,528**	1,656
— Rejoy Baichuan	**—**	5
— Rejoy Packaging	**—**	177
	1,528	1,838
Amounts due to related parties included in accruals and other payables		
— Rejoy Group	**6,350**	—
Dividend payable to the equity holders of the Company	**2,582**	—
Amount due to minority shareholder of a subsidiary	**11,742**	14,763

The related party balances are all unsecured, interest-free and have no pre-determined terms of repayment.

35. COMMITMENTS — GROUP

(a) Capital commitments

Capital expenditure at the balance sheet dates but not yet incurred is as follows:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Purchase of property, plant and equipment		
— Contracted but not provided for	**14,824**	10,158

35. COMMITMENTS — GROUP *(Continued)*

(b) Operating lease commitments

The future aggregate minimum lease rental expenses in respect of office premises in the PRC and Hong Kong under non-cancellable operating leases are payable as follows:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Not later than one year	**6,760**	6,821
Later than one year and not later than five years	**1,091**	6,824
	7,851	13,645

36. CONTINGENT LIABILITIES

The Group did not have significant contingent liabilities as at 31 December 2006.

37. EVENTS AFTER THE BALANCE SHEET DATE

The significant subsequent events of the Group were as follow:

(i) On 25 March 2007, the Company entered into an acquisition agreement with CMP Group Limited (the "Vendor") and China Pharmaceutical Company Limited (being the guarantor of the Vendor under the acquisition agreement) to purchase the entire interests in, and a shareholder loan of, New Orient Investments Limited ("New Orient") at a consideration which is equivalent to the aggregate sum of (i) 7.5 times the audited profit attributable to the shareholders of New Orient and its subsidiaries (excluding any profit or loss generated in connection with foreign exchanges) for the year ended 31 December 2006; and (ii) any income generated in connection with foreign exchanges for the year ended 31 December 2006. However, in any event, the consideration shall not exceed HK$510,000,000.

(ii) On 9 February 2007, the directors of Xi'an Lijun proposed a final dividends of RMB 18,041,400 in respect of the year ended 31 December 2006.

(iii) On 16 March 2007, the National People's Congress approved the Corporate Income Tax Law of the People's Republic of China (the new "CIT Law"). The new CIT Law reduces (increases) the corporate income tax rate for domestic enterprises (foreign invested enterprises) from 33% (15% or 24%) to 25% with effect from 1 January 2008. The new CIT Law also provides for preferential tax rates, tax incentives for prescribed industries and activities, grandfathering provisions as well as determination of taxable profit. As at the date that these consolidated financial statements are approved for issue, detailed measures concerning these items has yet to be issued by the State Council. Consequently, the Group is not in a position to assess the impact, if any, to the carrying value of deferred tax assets and liabilities as at 31 December 2006. The Group will continue to evaluate the impact as more detailed regulations are announced.

FINANCIAL SUMMARY

(All amounts in RMB)

	Year ended 31 December				
	2002 *RMB'000* (Audited)	2003 *RMB'000* (Audited)	2004 *RMB'000* (Audited)	2005 *RMB'000* (Audited)	**2006** ***RMB'000*** **(Audited)**
RESULTS					
Turnover	860,863	896,307	903,006	884,709	**860,641**
Profit before income tax	116,517	102,790	131,392	131,668	**92,401**
Income tax expense	(40,493)	(15,056)	(22,331)	(15,122)	**966**
Profit for the year	76,024	87,734	109,061	116,546	**93,367**
Attribute to:					
Equity holders of the Company	60,819	70,333	88,632	93,311	**84,575**
Minority interest	15,205	17,401	20,429	23,235	**8,792**

	As at 31 December				
	2002 *RMB'000*	2003 *RMB'000*	2004 *RMB'000*	2005 *RMB'000*	**2006** ***RMB'000***
ASSETS AND LIABILITIES					
Total assets	595,453	661,711	786,614	937,618	**914,908**
Total liabilities	(299,531)	(335,658)	(441,273)	(343,246)	**(412,591)**
Minority interest	(73,134)	(83,548)	(86,022)	(93,647)	**—**
Shareholder's equity	222,788	242,505	259,319	500,725	**502,317**