山東羅欣藥業股份有限公司

Shandong Luoxin Pharmacy Stock Co., Ltd.*

(a joint stock limited company incorporated in the People's Republic of China with limited liability)

Stock Code : 8058

ANNUAL REPORT 2005

* *For identification purposes only*

Characteristics of the growth enterprise market ("GEM") of the Stock Exchange of Hong Kong Limited (the "Stock Exchange")

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision in invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

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The Stock Exchange takes no responsibility for the contents of this report, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole any part of the contents of this report.

This report, for which the directors (the "Directors") of Shandong Luoxin Pharmacy Stock Co., Ltd. ("the Company") collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the listing of securities on GEM of the Stock Exchange (the "GEM Listing Rules") for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief, (1) the information contained in this report is accurate and complete in all material respects and is not misleading; (2) there are no other matters the omission of which would make any statement in this report misleading; and (3) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

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CORPORATE INFORMATION

Directors	**Executive Directors** Liu Baoqi Liu Zhenhai Li Minghua Wang Qingyu **Non-executive Directors** Zhou Wuxian Yin Chuangui Liu Yuxin **Independent non-executive Directors** Foo Tin Chung, Victor Fu Hongzheng Shao Youmei
Supervisors	Li Yonggang Gao Xiaoling Sun Song Zhu Enqiang
Compliance officer	Liu Baoqi
Qualified accountant	Lau Hon Kee *(CPA, CPA (Aust.))*
Company secretary	Lau Hon Kee *(CPA, CPA (Aust.))*
Authorised representatives	Liu Baoqi No. 5 from the West, North 2nd Row Dong Hu Xiao Qu, Luozhuang Area Linyi City, Shandong Province the PRC Lau Hon Kee Flat 4, 31/F, Choi On House Yue On Court Apleichau Hong Kong
Registered office	Luoqi Road, High and New Technology Experimental Zone, Linyi City, Shandong Province the PRC

CORPORATE INFORMATION

Principal place of business in Hong Kong	Unit 10, 11/F, Tower B, Southmark, 11 Yip Hing Street Wong Chuk Hang Hong Kong
Members of the Audit Committee	Foo Tin Chung Victor *(chairman of the audit committee)* Fu Hongzheng Shao Youmei
Compliance Adviser	Kingsway Capital Limited 5th Floor Hutchison House 10 Harcourt Road Central Hong Kong
Legal Adviser to the Company	Arculli Fong & Ng (in association with King & Wood, PRC Lawyers) 908, Hutchison House Central Hong Kong
Auditors	PricewaterhouseCoopers 22nd Floor Prince's Building Central Hong Kong
H Share share registrar and transfer office	Computershare Hong Kong Investor Services Limited Rooms 1712-16, 17th Floor Hopewell Centre 183 Queen's Road East Hong Kong
Principal Bankers	China Construction Bank Linyi City Luozhuang District Branch The Centre of Longtan Road Luozhuang District, Linyi City Shandong Province, PRC
	Industrial and Commercial Bank of China Linyi City Luozhuang District Branch Baoquan Road, Luozhuang District Linyi City, Shandong Province PRC
Stock Code	8058

CHAIRMAN'S STATEMENT

Through the sustained effort of the management and employees, H Shares in Shandong Luoxin Pharmacy Stock Co., Ltd. ("We" or the "Company") were successfully listed on the GEM on 9 December 2005. The listing has promoted the enterprise onto the platform of capital market, and vigorously created the drive for the future development of the Company.

During the year of 2005, we had finished the second phase of extension project with various new plants and the addition of many sets of production facilities. As a result, our dose forms became more diversified, our production capacity enhanced, thereby ensuring better product quality. Through the cooperation with our research and development partners and our own scientific research strength, we have strengthened the scientific research and development, resulting in various new products being constantly launched in the market. This has served as the solid foundation for our considerable corporate development. We have enlarged the market by extending sales channels, perfecting the sales networks, increasing the number of sales staff, and upgrading the overall quality of the sales team, forming five channels to deal with aspects of merchandising, logistics, end users, over the counter trade and raw materials. Our product brands are promoted rapidly. We continue to focus on human resources, including active recruitment and training of our staff, promote learning, strengthen training and enhance skills. We persist in the principle of selecting, employing and managing the best people. The qualified will remain while the unqualified will be eliminated. As a result, the overall quality of the employees, management level and the serving spirit can further be enhanced. The employees are really more united and more loyal to the Company. In general, we had had better results in the year 2005, thus enabling our enterprise to step forward solidly once again.

As a result of population growth in China, the acceleration of urbanization, the speeding up of industrial modernization and globalization, the pharmaceutical industry will grow more rapidly in 2006. We will continue to persist in the value of "rewarding the shareholders, benefiting the employees, repaying the society and strengthening the enterprise". Our Company has been creating different competitive edges, and enhancing the core competitiveness of our enterprise. Our Company will also accelerate in commencing the production of exclusively patented 3-H products namely high-tech, high quality and high-value added products; and the high-end and systematic production of antibiotics. Our Company will also strengthen the innovation in the following 7 areas, namely, concept, systems, technology, management, mechanism, market development and human resources development. I firmly believe that our business will have considerable and rapid growth, thereby eventually bringing significant profit and return.

The rapid development and advancement of Luoxin depends on the sustained effort of the management and employees, as well as the unfailing support from all the shareholders, customers, suppliers and business partners. I would like to extend my gratitude to all the directors for their contribution. I would also like to extend my sincere gratitude on behalf of the board of directors to all the above-mentioned who have been devoting their efforts to facilitate the development of the Company and have been tremendously supportive in relation to the advancement of the Company.

Liu Baoqi
Chairman

22 March 2006

FINANCIAL SUMMARY

	2005	2004
	RMB'000	RMB'000
Turnover	**249,689**	169,000
Gross Profit	**105,400**	97,324
Profit attributable to shareholders	**36,930**	28,233
Earnings per share (RMB)	**0.079**	0.061

- Turnover for the year ended 31 December 2005 amounted to approximately RMB249,689,000 (2004: RMB169,000,000), representing an increase of approximately 47.74% as compared with the corresponding period of last year.

- Profit attributable to shareholders for the year ended 31 December 2005 amounted to RMB36,930,000 (2004: RMB28,233,000), representing an increase of approximately 30.80% as compared with the corresponding period of last year.

EXECUTIVE DIRECTORS

Mr. Liu Baoqi (劉保起), aged 44, is an executive Director and the chairman of the Company. He is responsible for the strategic planning and overall management of the Company. Mr. Liu completed his tertiary course in economics and management from the School of Shandong Provincial Communist Party (中共山東省委黨校) in 1996. Mr. Liu obtained the qualification of pharmacist. He has about 17 years of experience in the medical and pharmaceutical industry in the PRC. Mr. Liu joined Shandong Luoxin Factory (the predecessor of the Company) in 1995. Before joining Shandong Luoxin Factory, Mr. Liu worked for Linyi Luozhuang Pharmacy Company (the predecessor of Linyi Luoxin) from 1988 to 1995. Mr. Liu was named as the Outstanding Young Entrepreneur in Linyi City (臨沂市優秀青年企業家) and Ten Outstanding Young Persons in Linyi City (臨沂市十大傑出青年) in May and October 1996 respectively. Mr. Liu is also a delegate of the Linyi City People's Congress. Mr. Liu is the uncle of Mr. Liu Zhenhai.

Mr. Liu Zhenhai (劉振海), aged 30, is an executive Director and the vice-chairman of the Company. He is responsible for the overall financial and strategic planning of the Company. He has about 11 years of experience in the medical and pharmaceutical industry in the PRC. Before joining the Company in 2001, Mr. Liu had over 7 years' experience working in the accounting and finance department of Linyi Luozhuang Pharmacy Company (the predecessor of Linyi Luoxin). Mr. Liu is the nephew of Mr. Liu Baoqi.

Ms. Li Minghua (李明華), aged 40, is an executive Director, the general manager and head of research and development department of the Company. She is responsible for assisting the Chairman in Company's overall business development and operation. She graduated from Shenyang Pharmacy University (瀋陽藥科大學) with a bachelor's degree in pharmacy. Ms. Li is a senior professional engineer in medicine in the PRC certified by Hei Long Jiang Human Resource Department (黑龍江人事廳) and a registered practising pharmacist. Before joining the Company in 2001, Ms. Li had over 15 years' experience working in several pharmaceutical enterprises in the PRC.

Mr. Wang Qingyu (王慶余), aged 43, is an executive Director and the vice-general manager of the Company. He is responsible for the supervision of the overall production process of the Company's medicine products. Mr. Wang graduated from the University of Shanghai medical workers (上海醫藥職工大學) majoring in chemical pharmacy. Before joining the Shandong Luoxin Factory (the predecessor of the Company) in 1995, Mr. Wang had over 7 years' experience working in a pharmaceutical enterprise in the PRC.

NON-EXECUTIVE DIRECTORS

Mr. Zhou Wuxian (周武先), aged 48, is a non-executive Director and the legal representative of Qingdao Guofeng Jiaozhou. Mr. Zhou completed his tertiary course in the Shandong Chinese Medicine College (山東中醫學院). Mr. Zhou has over 23 years' experience in the medical and pharmaceutical industry in the PRC. In November 2004, Mr. Zhou became a non-executive Director of the Company.

Mr. Yin Chuangui (尹傳貴), aged 49, is a non-executive Director, and the authorized representative of Linyi People Hospital. Mr. Yin graduated from the Weifang Medical College (濰坊醫學院) with a bachelor's degree specialising in health management. In May 2001, Mr. Yin was nominated by Linyi People Hospital as a non-executive Director.

Mr. Liu Yuxin (劉玉欣), aged 47, is a non-executive Director. Mr. Liu completed his tertiary course in the Yishui Medical College (沂水醫學專科學校). In May 2001, Mr. Liu was nominated by Pingyi People Hospital as a non-executive Director. Mr. Liu is also a member of the Chinese People's Political Consultative Conference of Shandong Province.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Foo Tin Chung Victor (傅天忠), aged 36, has been appointed as the independent non-executive Director since April 2005. Mr. Foo has over ten years' experience in the finance and accounting fields. Mr. Foo is the financial controller, qualified accountant, company secretary and compliance officer of Jinheng Automotive Safety Technology Holdings Limited, a company listed on GEM, since June 2004. Mr. Foo holds a bachelor's degree in accounting and information system in the University of New South Wales in Australia. He is a CPA of the Hong Kong Institute of Certified Public Accountants and a CPA of CPA Australia. Mr. Foo held senior management position in listed companies in Hong Kong and was an auditor of an international audit firm from 1994 to 2004.

Mr. Fu Hongzheng (付宏征), aged 42, was appointed as the independent non-executive Director in June 2001. Mr. Fu graduated from Pharmacy School of Yanbian University (延邊大學藥學院) in 1985 with a bachelors' degree and got his master's degree from the Shenyang Medical University (瀋陽醫科大學) in 1991.

Ms. Shao Youmei (邵幼梅), aged 57, was appointed as the independent non-executive Director in August 2002. Ms. Shao graduated from the University of Continuing Technology Education for Jinan Workers (濟南市職工業餘科技大學) majoring in pharmacy. She was the vice principal of the Shandong Provincial Drugs Supervision and Safety Control Office (山東省藥品監督管理局).

SUPERVISORS

Mr. Li Yonggang (李永剛), aged 44, is the Supervisor and the chairman of Linyi Municipal Pharmacy. In June 2001, Mr. Chow was nominated by Linyi Municipal Pharmacy as the chairman of board of Supervisors.

Ms. Gao Xiaoling (高小玲), aged 42, is the Supervisor and the vice general manager of Lijun Group (Sales Company). In May 2001, Ms. Gao was nominated by Lijun Group as a member of board of Supervisors.

Mr. Sun Song (孫松), aged 35, is the Supervisor and the manager of the Company's bulk medicine workshop. Mr. Sun graduated from the University of Hei Long Jiang (黑龍江大學) majoring in organic chemistry in 1993.

Mr. Zhu Enqiang (祝恩強), aged 42, is the Supervisor and the staff representative of the Company. Before joining the Company in 2001, Mr. Zhu had over 9 years' experience working in Linyi Luozhuang Pharmacy Company (the predecessor of Linyi Luoxin).

SENIOR MANAGEMENT

Mr. Han Fengsheng (韓風生), aged 30, is the secretary of the Board. Mr. Han graduated from the Dalian University (大連大學) majoring in computer science. Before joining the Company in November 2001, Mr. Han had over 5 years experience working in the information technology department of Linyi Luozhuang Pharmacy Company (the predecessor of Linyi Luoxin).

Mr. Ji Honghai (季紅海), aged 31, is the vice general manager of the Company and is responsible for the sales and marketing operation of the Company. Mr. Ji graduated from the University of Jinan City Workers (濟南市職工大學) majoring in financial accounting. Mr. Ji joined Shandong Luoxin Factory (the predecessor of the Company) in 1997. Before joining Shandong Luoxin Factory, he worked for Linyi Luozhuang Pharmacy Company (the predecessor of Linyi Luoxin) from 1996 to 1997.

Mr. Zhao Xuekun (趙學昆), aged 70, is the chief engineer of the Company and is responsible for advising the Company's product development, production technology and GMP compliance issues. Mr. Zhao completed his tertiary course Shenyang Pharmacy College (瀋陽藥學院). Before joining Shandong Luoxin Factory (the predecessor of the Company) in 1996, Mr. Zhao had over 39 years experience working in a hospital, drug control and inspection center and health department of Linyi City.

Mr. Lau Hon Kee (劉漢基), CPA, CPA (Aust.), aged 35, is the full-time financial controller and company secretary of the Company. Mr. Lau is responsible for accounting, financial reporting and internal control procedures of the Company. Mr. Lau holds a Bachelor's degree in Commerce from Australian National University and he is a CPA of the Hong Kong Institute of Certified Public Accountants and a CPA of CPA Australia. Before joining the Company in March 2003, Mr. Lau has over 10 years' experience in finance & accounting field, and held senior management position in several service and manufacturing companies.

Operational Review

During the year under review, we actively expanded our market and immensely attracted our customers by taking advantage of our competitive edges gained from our large selection and diversification of products. As we offered both low-end and high-end products, the brand name of "Luoxin" was strengthened and our sales volume increased rapidly. Meanwhile, we enlarged our sales team and upgraded the quality of our sales staff. We also enlarged our sales networks to cover 27 provinces and 4 municipalities throughout the country. Smooth sales channels for merchandising, logistics, end users, over the counter trade and raw materials have been established. We strived to offer a wide and comprehensive range of products. We have also held more promotional and marketing activities such as press conferences and academic exchanges for the launch of our new products and increased our advertising expenditures. In addition, we have participated in PharmChina for several times and hired exhibition booths in order to promote our products and hold negotiations for business cooperation. We are recognised for our ability to offer a wide and comprehensive range of products in the industry. In 2005, we continued to make our sustained effort in research and development, and launched tens of new products in the market. Our achievements in technological development further enhances our strategy to drive the growth of the Company from technical advancement, and optimise our products structure. Benefiting from the diversification of products, our competitiveness was obviously enhanced. This laid a solid foundation for the substantial development of our company. While focusing on the development of new products, we also made sustained effort in optimising our production technology, improve the quality of our products and lower the production costs to create competitive edges of product diversity, and the continuous development of the company.

Financial Review

The Company recorded a turnover of approximately RMB249,689,000 for the year ended 31 December 2005, representing an increase of approximately 47.74% from approximately RMB169,000,000 for the corresponding period of last year. While the cost of sales was approximately RMB144,289,000 for the year, representing an increase of 101.31% over the corresponding period of last year, the gross profit rate decreased from approximately 57.59% of the corresponding period of last year to approximately 42.21% for the year.

The reason for the decrease in gross profit rate was due to the fact that the sales mix of the Company's products has been changed comparing with that of last year. By the beginning of 2005, the National Food and Drugs Authority started to impose further price control measures on certain antibiotic drugs. Some of the Company's products with higher gross profit rate the were speculated by the drug dealers to be subject to the new price control measures. Dealers in the market were waiting for the outcome of the price control measures and avoided placing orders in respect of such products. Accordingly the sales of these products decreased until the final announcement was made by the relevant authority in the third quarter of the year.

In response to the market's reaction to the price control measures, the Company immediately changed its production plan and sales mix to reduce the concentration risk on certain products. As a result, a number of the company's products with a lower gross profit rate were manufactured and sold during the year. Although the overall gross profit rate decreased, gross profit for the year increased to approximately RMB105,400,000 from approximately RMB97,324,000 of the corresponding period of last year, representing an increase of approximately 8.30%.

Operating expenditure amounted to approximately RMB43,390,000, representing a decrease of 7.86% with that of last year. The reason was that the management considered the changes of the pharmaceutical market during the year and put in more effort to tighten the cost control measures over selling and distribution expenses.

Profit attributable to shareholders was approximately RMB36,930,000, representing an increase of 30.80% as compared with last year. The weighted average earnings per share was RMB0.079.

Major Events

On 9 December 2005, the H shares (the "H Shares") of the Company were successfully listed on GEM of the Stock Exchange by way of placing (the "Placing").

Pursuant to the Placing, the Company issued 164,560,000 H shares of which 14,960,000 H Shares was converted from domestic shares of the Company. After the completion of Placing, the registered share capital of the Company was RMB60,960,000 divided into 609,600,000 shares of RMB0.1 each.

The nominal price of each ordinary share was RMB0.1 and the placing price for each placing H Share in the Placing was HK$0.26.

The gross and net proceeds from the placing was approximately HK$42,785,600 and HK$31,500,000, respectively.

The proceeds were intended to enhance and upgrade the production facilities of the Company, increase the coverage of its marketing and sales network and its customers base in the PRC, broaden its product range and settle the remaining development fee. No proceed had been utilised during the year as the intended plans are going to be implemented in 2006.

Liquidity and Financial Resources

Except the major event described above, our working capital is in generally financed from our internally generated cash flow.

As at 31 December 2005, the Company's cash and cash equivalents amounted to RMB155,503,000. (2004: RMB108,960,000) As at 31 December 2005, its short term loan amounted to RMB105,700,000 (2004:RMB104,190,000). Certain facilities and buildings of the Company were pledged to secure our bank loans of the Company.

The Company's gearing ratio as at 31 December 2005 was 29.9% (2004: 36.8%), based on the amount of bank borrowings as at 31 December 2005 divided by total assets as at 31 December 2005 multiplied by 100%.

Pledged bank deposits/cash and cash equivalents

As at 31 December 2005, the Company's property, plant and equipment and bank deposit of RMB33,166,000 and RMB7,478,000 were pledged to secure the banking facilities of the Company respectively.

Significant Investments

As at 31 December 2005, the Company did not have any significant investments.

Major Acquisition and Disposal

For the year ended 31 December 2005, the Company did not make any major acquisition or disposal.

Contingent Liabilities

As at 31 December 2005, the Company did not have any substantial contingent liabilities.

Exchange Risk

The Company operates and conducts business in PRC and all the Company's transactions, assets and liabilities are denominated in Renminbi.

All cash and cash equivalents and pledged deposits of the Company are denominated in Renminbi and bank deposits are placed with banks in the PRC. The remittance of these funds out of the PRC is subject to the exchange control restrictions imposed by the PRC government.

Employees and Remuneration Policies

The Directors believe that the quality of the employees is the most important factor for the sustainable development and growth of our company, and enhancing our profitability. We offer our remuneration packages to our employees based on their performance, working experience and the current salary level in the market. Other salaries and fringe benefits are appropriate.

The Company has set up a Remuneration Committee to give advice on the overall strategy of remuneration policies. For details, please see section in Corporate Governance Report.

Prospects

The Company shall continue to specialise in technological research, production and sales of pharmaceutical products, and to enhance its core competitiveness in order to generate income. The Company shall continue to strengthen the cooperation with its research and development partners and increase the capacity of its own research team. The Company shall keep on launching new products. In 2006, the Company plan to launch the patented Rhodiola for Injection, a traditional Chinese medicine product for injection and thirty other new products in the market. The Directors believe that the pharmaceutical industry will grow even faster in 2006 as the population in the PRC is increasing tegmen with the accelerating pace of urbanisation and industrial modernisation in the PRC, and the influence of globalisation. As a result, the Company shall also enjoy substantial and rapid growth, which will generate substantial profit and returns.

On the other hand, the Company is actively seeking an extra piece of land adjacent to the existing location in Linyi. The Company is now planning for the establishment of a new manufacturing plant. The sales team of the Company is currently under expansion by recruiting experienced sales personnel and their commission package are subject to review from time to time. The Company is realising the business objective stated in the prospectus.

Pursuant to Rules 18.44 of the GEM Listing Rules, the Board present this corporate governance report to disclose its corporate governance practices adopted during the year to the shareholders. This report highlights some of the most important corporate governance practices of the Company.

The Board considers that good corporate governance of the Company is central to safeguarding the interests of the shareholders and enhancing the performance of the Company. The board is committed to maintain and ensure high standard of corporate governance and will continuously review and improve the corporate governance practices and standards of the Company to ensure that business activities and decision making process are regulated in a proper and prudent manner.

The Board

The Board comprises of 4 executive Directors, namely, Mr. Liu Baoqi, Mr. Liu Zhenhai, Ms. Li Minghua and Mr. Wang Qingyu with Mr. Liu Baoqi acting as chairman of the Board, 3 non-executive Directors, namely, Mr. Zhou Wuxian, Mr. Yin Chuangui and Mr. Liu Yuxin and 3 independent non-executive Directors, namely, Mr. Foo Tin Chung, Victor, Mr. Fu Hongzheng and Ms. Shao Youmei. As the Company is incorporated in the PRC, 4 supervisors namely, Mr. Li Yonggang, Ms. Gao Xiaoling, Mr. Sun Song and Mr. Zhu Enqiang were also appointed to monitor the decision making of the Board.

Biographical details of the Directors and their relationships (if any) have been set out in the section "Profiles of Directors and senior management" in this report.

In accordance with the article 96 of the articles of association of the Company, (the "Articles of Association"), the Directors were appointed for the period of 3 years and were elected by the shareholders at general meetings.

The Board is responsible for the overall strategic development of the Company. The board is also responsible the financial performance and internal control policies and procedures of the Company's business operation

Commitments

The full Board will meet at each quarter, to review the overall development, operation and financial performance, result of each period and other matters of the Company that requires the approval of the Board. All Board members are able to access the board materials and allow them to have reasonable time to review and sufficient information for their decision making. The Chairman is the one who responsible for the agenda of the board meetings.

Moreover, the Board meets regularly to discuss the daily operation issue of the Company. For those non-executive and independent non-executive Directors are not personally present in the Company's headquarter, conference call will be used as the Company is actively taking advice from them.

Appointment of directors

The Directors all carried out their work in a dedicated, diligent and proactive manner with reasonable prudence. They carried our their duties imposed by the Company Law, the articles of association of the Company and the GEM Listing Rules, complied with relevant requirements and strictly implemented resolutions of general meetings.

Executive directors were appointed were based on their expertise and responsible for different area of the Company's business. The non-executive directors and supervisors were appointed on a representation base from other major shareholders, promoters and staff union of who could bring role of monitor to the decision and operation of the Company.

The independent non-executive directors also serve important role in the board. They bring independent judgment on issues of strategic direction and future development; opinion on connected transactions and risk management on audit issues. One of the independent non-executive Directors is a qualified accountant and the rest of them meet the Listing Rules requirements. The Board has received annual confirmation in respect of the independence of each of the independent non-executive Directors and believes that their independence is in compliance with the GEM Listing Rules as at the date of this report.

The Board will consider the past performance, qualification, general market conditions and the Articles of Association in selecting and recommending candidates for directorships.

All directors are regularly updated on governance and regulatory matters. There is set of policies and procedures for the directors to obtain independent professional advice.

Board Meetings

During year 2005, the Board has held 2 meetings. Directors were given sufficient time to review documents and information relating to matters that have to be discussed during such meetings.

Details of Directors' attendance at Board meetings held in 2005 are as follows:

Board Meetings	**Dates of meeting**	
Executive Directors	8 April 2005	20 November 2005
Mr. Liu Baoqi	✓	✓
Mr. Liu Zhenhai	✓	✓
Ms. Li Minghua	✓	✓
Mr. Wang Qingyu	✓	✓
Non-executive Directors		
Mr. Zhou Wuxian	✓	✓
Mr. Yin Chuangui	✓	✓
Mr. Liu Yuxin	✓	✓
Independent non-executive Directors		
Mr. Foo Tin Chung, Victor	N/A *(note)*	✓
Mr. Fu Hongzheng	✓	✓
Ms. Shao Youmei	✓	✓

note: Mr. Foo was only appointed as a Director on 8 April 2005

Directors' Securities Transactions

The Company has adopted a model code of conduct for securities dealings by Directors on terms no less exacting than the required standard of dealings as set out in Rules 5.48 to 5.67 of the GEM Listing Rules. The Company has confirmed, after making specific enquiries with the Directors, the Directors have complied with the required standard of dealings and such code of conduct in relation to securities dealings by Directors for the period the listing of the Company's H Shares on GEM and 31 December 2005.

Chairman and Chief Executive Officer

Under A.2.1 of the Code, "the roles of chairman and chief executive officer should be separate and should not be performed by the same individual". Mr. Liu Baoqi concurrently takes up the posts of chairman and chief executive officer of the Company. Such deviation is due to the fact that Mr. Liu is the controlling shareholder of the Linyi Luoxin Pharmacy Company Limited, a promoter and controlling shareholder of the Company. Mr. Liu is one of the most important initial management shareholder of the company. He has extensive professional knowledge and experience in PRC pharmaceutical industry. As the Company has a short history and is still in its development and expansion stage, after careful consideration of the Board, it is of the view that the chairman and chief executive officer should be performed by the same individual.

Committees

As part of the corporate governance practices, the Board has established the following committees which are all chaired and composed of independent non-executive directors.

Audit Committee

The Audit Committee was established on 20 in November 2005 and its current members include:
Mr. Foo Tin Chung, Victor *(Chairman)*
Mr. Fu Hongzheng
Ms. Shao Youmei

The Company has established an audit committee (the "Audit Committee") with written terms of reference in compliance with paragraph C3 of the Code Corporate Governance Practices as set out in Appendix 15 of the GEM Listing Rules. The duties of the Audit Committee are to review and supervise the financial reporting process and the Company's internal control policies and procedures. The appointments of the Audit Committee members are based on their broad experience of medicinal field and professional knowledge on financial reporting and management.

The Audit Committee meets regularly to review the financial reporting matters and internal control policies and procedures issues; and see how the Company can comply with these requirements. The Audit Committee also acts as the communication bridge between the Board and the auditors in relation to the planning and scope of audit work. The audited results of the Company for the year have been reviewed by the Audit Committee.

Since the H Shares of the Company were only listed on GEM on 9 December 2005 and the Audit Committee was only established on 20 November 2005, the Audit Committee did not hold any meeting in 2005. Since its establishment, the Audit Committee held 2 meetings and the attendances of the meeting are shown below:

Audit Committee Meetings	**Dates of meeting**	
Executive Directors	23/01/2006	15/3/2006
Mr. Foo Tin Chung, Victor	✓	✓
Mr. Fu Hongzheng	✓	✓
Ms. Shao Youmei	✓	✘ *(note)*

note: Ms. Shao Youmei was unable to attend the Audit Committee meeting on 15 March 2006 for health reasons.

Remuneration Committee

The Remuneration Committee is established in December 2005 and its current members include:

Mr. Foo Tin Chung, Victor *(Chairman)*
Mr. Fu Hongzheng
Ms. Shao Youmei

The Company established a remuneration committee (the "Remuneration Committee") with written terms of reference in compliance with paragraph B1 of the Code Corporate Governance Practices as set out in Appendix 15 of the GEM Listing Rules. The duties of the Remuneration Committee include the evaluation of the performance and making recommendations on the remuneration package of the Directors and senior management and the evaluation and making of recommendations on other employee benefit arrangements.

The appointments of the Remuneration Committee members are based on their broad experience of medicinal field and knowledge on financial management, in particular, the remuneration to local workforces, as 2 of the independent non-executive Directors are experienced medical professional in the PRC.

As there were only short period of time since the establishment of the remuneration committee, there was no meeting held. However, committee members will meet in the beginning of second quarter in 2006, to discuss and review the future trend of the remuneration of Directors and senior management and make recommendation for their remuneration packages accordingly.

Investor Relationship and Communication

The Company is committed to a policy of open and regular communication and reasonable disclosure of information to its shareholders and investment public. Information of the Company is disseminated to the shareholders and interested parties in the following manner:

- Delivery of the quarterly, interim and annual results and reports to all shareholders and interest parties;
- Publication of announcements on the quarterly, interim and annual results on the Stock Exchange websites, and issue of other announcements and shareholders' circulars in accordance with the continuing disclosure obligation under the GEM Listing Rules;

The Company is also actively seeking a service provider of investor relation in coming period in order to maintain an effective communication channel with the investment public.

Accountability and Audit

The Directors are responsible for overseeing the preparation of accounts of each financial period by the management. The Directors are also committed to make appropriate announcement, in accordance with GEM Listing Rules, to disclose all information that are necessary for shareholders to assess the financial performance and other matters of the Company.

During the period, the Board has reviewed the engagement of auditors and their remuneration. Auditors' remuneration payable to auditor by the company amounted to HK$650,000.

The Board is also responsibility to regular review the internal control of the Company. Senior Management are required to work cohere with set of policies and procedures of internal control. For details, please see followings section. The Audit Committee will also give advice on internal control issues and takes active role in communication with the directors and senior management for the best practice of internal control of the Company.

Internal Control

The Company has developed and established an Internal Control Policies and Procedures within the corporation before listing. This set of policies and procedures is monitoring the operation of the Company in 3 areas, namely: Sales and accounts receivables cycles, purchase & accounts payables cycles, and other policies & procedures, including statutory reporting. Emphasis has been placed on the level of approval on the utilization of the Company resources and compliance with financial reporting and listing reporting requirements.

The Company will keep on reviewing the policies and procedures in order to maintain high level of internal control of its operation.

REPORT OF THE DIRECTORS

The board of Directors (the "Board") is pleased to present the report of the Directors for the year ended 31 December 2005.

Principal activities and geographical analysis of operations

The principal activity of the Company is the manufacturing and selling of pharmaceutical products.

Results and Dividends

The results of the Company for the year are set out in the income statement on page 26.

The directors recommend the payment of a final dividend of RMB0.02 per ordinary share, totalling RMB12,192,000.

Reserves

Movements in the reserves of the Company during the year are set out in note 27 to the accounts.

Property, plant and equipment

Details of the movements in property, plant and equipment of the Company are set out in note 16 to the accounts.

Share capital

Details of the movements in share capital of the Company are set out in note 26 to the accounts.

Distributable reserves

According to the Company Law of the People's Republic of China, the distributable reserves of the Company at 31 December 2005, amounted to RMB53,326,000 (2004: RMB21,935,000).

Three year financial summary

A summary of the results and of the assets and liabilities of the Company for the last three financial years is set out on page 58.

Placing and use of proceed

On 9 December 2005, H Shares of the Company were successfully listed on GEM of the Stock Exchange by way of Placing.

Pursuant to the Placing, the Company issued 164,560,000 H Shares of which 14,960,000 H Shares was converted from domestic shares of the Company. After the completion of Placing, the registered share capital of the Company was RMB60,960,000 divided into 609,600,000 shares of RMB0.1 each.

The nominal price of each ordinary share was RMB0.1 and the placing price for each placing H Share in the Placing was HK$0.26.

The gross and net proceeds from the placing was approximately HK$42,785,600 and HK$31,500,000, respectively.

The proceeds were intended to enhance and upgrade the production facilities of the Company, increase the coverage of its marketing and sales network and its customers base in the PRC, broaden its product range and settle the remaining development fee. No proceed had been utilised during the year as the intended plans are going to be implemented in 2006.

Purchase, sale or redemption of listed securities

The Company has not redeemed any of its listed securities during the year. The Company has not purchased or sold any of the Company's listed securities during the year.

Share Options

The Company did not adopt any share option plan since the incorporation of the Company.

Directors

The directors during the year were:

Executive directors

Liu, Baoqi (劉保起)
Liu, Zhenhai (劉振海)
Li, Minghua (李明華)
Wang, Qingyu (王慶余)

Non-executive directors

Liu, Yuxin (劉玉欣)
Yin, Chuangui (尹傳貴)
Zhou, Wuxian (周武先)

Independent non-executive directors

Fu, Hongzheng (付宏征)
Shao, Youmei (邵幼梅)
Foo, Victor Tin Chung (傅天忠)

In accordance with Article 96 of the Articles of Association adopted by the shareholders of the Company on 20 November 2005, the term of directorship for each of the Director is for a term of three years.

Mr. Liu, Baoqi (劉保起), Mr. Liu, Zhenhai (劉振海), Ms. Li, Minghua (李明華) being executive Directors, had retired and been re-elected on 30 November 2004.

Mr. Wang, Qingyu (王慶余), an executive Director was appointed on 30 November 2004.

Mr. Liu, Yuxin (劉玉欣), Mr. Yin, Chuangui (尹傳貴), non-executive Directors, had retired and been re-elected on 30 November 2004.

Mr. Zhou, Wuxian (周武先), a non-executive Director, was appointed on 30 November 2004.

Mr. Fu, Hongzheng (付宏征), an independent non-executive Director, had retired and been re-elected on 30 November 2004.

Ms. Shao, Youmei (邵幼梅), an independent non-executive Director, appointed on 28 August 2002, had retired and been re-elected on 30 November 2004.

Mr. Foo, Victor Tin Chung (傅天忠), an independent non-executive Director, was appointed on 8 April 2005.

Directors' service contracts

Each of the executive Directors, non-executives Directors, independent non-executive Directors and supervisors of the Company has entered into a service contract with the Company commencing from various dates of their respective service contracts for a term of three years.

Save as disclosed above, none of the Directors and supervisors of the Company has entered into service contracts with Company which were not terminable by the Company within one year without compensation (other than statutory compensation).

Directors and supervisors' interests in contracts

Save as disclosed above, none of the Directors and supervisors of the Company had a material interest, either directly or indirectly, in any contracts of significance in relation to the Company's business.

Directors' and Supervisors' Interests in the Shares, Underlying Shares and Debentures of the Company

As at 31 December 2005, the interests and short positions of each Directors and supervisors of the Company in the shares, underlying shares and debentures of the Company, as recorded in the register required to be kept by the Company under Section 352 of Part XV of the Securities and Futures Ordinance (the "SFO"), or as otherwise notified to the Company and the Stock Exchange pursuant to Rule 5.46 of the GEM Listing Rules were as follows:

Long position of domestic shares of the Company, as at 31 December 2005

Name of director	Capacity/ Nature of Interest	Number of domestic shares	% of total issued domestic shares	% of Company's Share Capital
Mr. Liu Baoqi (劉保起) *(Note 1)*	Interest of controlled corporation	230,000,000	51.68%	37.73%
Mr. Liu Zhenhai (劉振海)	Beneficial Owner	35,000,000	7.86%	5.74%

Note 1: These 230,000,000 domestic shares are registered in the name of Linyi Luoxin Pharmacy Company Limited ("Linyi Luoxin"). Liu Baoqi (劉保起) is interested in 51.72% of the registered share capital of Linyi Luoxin. As Liu Baoqi (劉保起) is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Linyi Luoxin. For the purpose of the SFO, Liu Baoqi (劉保起) is deemed to be interested in the entire 230,000,000 Domestic Shares held by Linyi Luoxin.

Substantial shareholders' Interests and/or Short Positions in the Shares, Underlying Shares of the Company

The register of substantial shareholders (not being a Director or supervisor of the Company) required to be kept under section 336 of Part XV of the SFO shows that as at 31 December 2005, the Company had been notified of the following substantial shareholders' interests and short positions, being 5% or more of the Company's issued share capital. These interests are in addition to those disclosed above in respect of the Directors and chief executives.

Long position of domestic shares of the Company, as at 31 December 2005

Name	Capacity/ Nature of Interest	Number of domestic shares	% of total issued domestic shares	% of Company's Share Capital
Linyi Luoxin	Beneficial Owner	230,000,000	51.68%	37.73%
Zuo Hongmei (左洪梅)	Family interest *(note 1)*	230,000,000	51.68%	37.73%
Cao Tingting (曹婷婷)	Family interest *(note 2)*	35,000,000	7.86%	5.74%
Liu Zhendong (劉振東)	Beneficial Owner	35,000,000	7.86%	5.74%
Chen Weiwei (陳偉偉)	Family interest *(note 3)*	35,000,000	7.86%	5.74%
Linyi City People's Hospital	Beneficial Owner	34,560,000	7.77%	5.67%
Pinyi County People's Hospital	Beneficial Owner	34,560,000	7.77%	5.67%

Notes:

1. These 230,000,000 Domestic Shares are registered in the name of Linyi Luoxin. Linyi Luoxin is owned as to approximately 51.72% by Liu Baoqi (劉保起). As Liu Baoqi (劉保起) is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Linyi Luoxin, for the purpose of the SFO, Liu Baoqi (劉保起) is deemed to be interested in the entire 230,000,000 Domestic Shares held by Linyi Luoxin. Zuo Hongmei (左洪梅), as wife of Liu Baoqi (劉保起), is taken to be interested in the entire 230,000,000 Domestic Shares held by Liu Baoqi (劉保起).

2. These 35,000,000 Domestic Shares are registered in the name of Liu Zhenhai (劉振海), for the purpose of the SFO, Cao Tingting (曹婷婷), as wife of Liu Zhenhai (劉振海), is taken to be interested in the entire 35,000,000 Domestic Shares held by Liu Zhenhai (劉振海).

3. These 35,000,000 Domestic Shares are registered in the name of Liu Zhendong (劉振東), for the purpose of the SFO, Chen Weiwei (陳偉偉), as wife of Liu Zhendong (劉振東), is taken to be interested in the entire 35,000,000 Domestic Shares held by Liu Zhendong (劉振東).

4. Each of Cao Tingting, Liu Zhendong, Chen Weiwei, Linyi City People's Hospital and Pinyi County People's Hospital are not considered to be a substantial shareholder for the purpose of the GEM Listing Rules as each of them is only interested in less than 10% of the total registered share capital of the Company.

Management Contracts

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

Major suppliers and customers

The percentages of purchases and sales for the year attributable to the Company's major suppliers and customers are as follows:

Purchases	
— the largest supplier	25.4%
— five largest suppliers combined	49.1%
Sales	
— the largest customer	14.2%
— five largest customers combined	36.3%

None of the directors, their associates or any shareholder (which to the knowledge of the directors owns more than 5% of the Company's share capital) had an interest in the major suppliers or customers noted above.

Connected Transactions

Details of certain related party transactions as disclosed in notes 15, 30 and 31 to the accounts did not constitute connected transactions under the GEM Listing Rules as the transactions were transacted before the listing of the H Shares of the Company which were not required to be disclosed in accordance with Chapter 20 of GEM Listing Rules.

Competing business

Set out below is information disclosed pursuant to paragraph 11.04 of GEM Listing Rules of the Listing Rules:—

Linyi Luoxin

Mr Liu Baoqi is an executive director and chairman of Linyi Luoxin and a controlling shareholder holding 37.73% of the registered capital of Linyi Luoxin.

Before non-competition undertaking in favour of the Company was signed by Linyi Luoxin on 7 November 2002, Linyi Luoxin was engaged in the sales of chemical medicines, Chinese medicines, medical equipment, health and beauty products. Since the execution of the non-competition undertaking, Linyi Luoxin has undertaken to cease its chemical medicine business. In June 2005, Linyi Luoxin signed a supplementary non-competition undertaking whereby it will carry out its sales activities in Linyi City only and confirmed that its customers are small and mid-sized medical institutions which are below county-level hospital. The Company had received from Linyi Luoxin an annual confirmation in respect of the compliance of these undertakings.

Qingdao Guofeng Group Jiaozhou Pharmacy Limited ("Qingdao Guofeng Jiaozhou")

Qingdao Guofeng Jiaozhou is a company with limited liability established in the PRC, holding 3.28% of the registered share capital of the Company. It is principally engaged in the sales of Chinese medicines, medical medicines, bio-chemical medicines, medical equipment and healthy products. To the best knowledge of the Directors, Qingdao Guofeng Jiaozhou does not engaged on development and manufacturing of medicine products and it does not have any R&D and production capabilities for medicine manufacturing in the PRC.

Qingdao Guofeng Jiaozhou serves as a regional distributor in Qingdao city and Jiaozhou district and procures medicine products from other suppliers in the PRC.

The Directors advised that some of the medicine products sold by Qingdao Guofeng Jiaozhou which have same or similar curative effects with those of the Company may be in competition with the Company's products.

Lijun Group Limited Liability Company ("Lijun Group")

Lijun Group is a company with limited liability in the PRC, holding approximately 1.42%of the registered share capital of the Company. Its scope of business mainly includes development, production and sales of Chinese medicines, chemical medicines and medical equipment.

The Directors advised that some of the medicine products sold by Lijun Group which have same or similar curative effects with those of the Company may be in competition with the Company's products.

Linyi Municipal Pharmacy Group Company ("Linyi Municipal Pharmacy")

Linyi Municipal Pharmacy is a State-owned enterprise established in the PRC, holding approximately 1.42% of the registered share capital of the Company. Linyi Municipal Pharmacy is principally engaged in the sale of Chinese and chemical medicines, medical equipment and health products in Linyi City and nearby districts. To the best knowledge of the Directors, Linyi Municipal Pharmacy does not and will not engage in the development and manufacturing of medicine products and it does not have any R&D and production capabilities for medicine manufacturing in the PRC.

Linyi Municipal Pharmacy serves as a regional distributor in Linyi city and nearby districts, and procures medicine products from other suppliers in the PRC. The Directors advised that some of medicine products sold by Linyi Municipal Pharmacy which have same or similar curative effects with those of the Company may be in competition with the products of the Company.

Compliance Adviser's Interests

As at 31 December 2005, as notified by the Company's compliance adviser, Kingsway Capital Limited (the "Compliance Adviser"), neither the Compliance Adviser nor any of its directors, employees or associates (as referred to in Note 3 to Rule 6.35 of the GEM Listing Rules) had any interest in the securities of the Company, or any right to subscribe for or to nominate persons to subscribe for the securities of the Company.

Pursuant to the compliance adviser agreement dated 28 November 2005 entered into between the Company and the Compliance Adviser, the Compliance Adviser shall receive a fee for acting as the Company's compliance adviser for the period from 9 December 2005 to 31 March 2008.

Statement of no change in auditors

There has been no change in the auditors of the Company in any of the preceding three years from the year ended 31 December 2005.

Auditors

The accounts have been audited by PricewaterhouseCoopers. The Directors will nominate new Company's Auditors in place of the retiring Auditors, Messrs PricewaterhouseCoopers. The nomination for the appointment will be tabled for the shareholders' approval in the coming Annual General Meeting.

On behalf of the Board
Liu Baoqi
Chairman

Hong Kong, *22 March 2006*

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22/F, Prince's Building
Central, Hong Kong

AUDITORS' REPORT TO THE SHAREHOLDERS OF
SHANDONG LUOXIN PHARMACY STOCK CO., LTD.
(incorporated in the People's Republic of China with limited liability)

We have audited the accounts on pages 26 to 57 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Company's directors are responsible for the preparation of accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those accounts 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.

Basis of opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the circumstances of the Company, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the Company as at 31 December 2005 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 22 March 2006

INCOME STATEMENT

For the Year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000
Turnover	*5*	**249,689**	169,000
Cost of sales		**(144,289)**	(71,676)
Gross profit		**105,400**	97,324
Other revenue	*5*	**1,548**	2,007
Selling and distribution expenses		**(21,879)**	(27,091)
General and administrative expenses		**(21,511)**	(20,003)
Operating profit		**63,558**	52,237
Finance costs	*7*	**(7,142)**	(5,626)
Profit before taxation		**56,416**	46,611
Income tax expense	*8*	**(19,486)**	(18,378)
Profit attributable to shareholders		**36,930**	28,233
Dividends	*9*	**12,192**	48,182
Earnings per share (RMB)	*13*	**0.079**	0.061

BALANCE SHEET

As at 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000
Non-current assets			
Purchased technical know-how	*14*	**2,908**	2,290
Prepayments to acquire technical know-how	*15*	**8,155**	9,005
Property, plant and equipment	*16*	**67,025**	42,918
Construction-in-progress	*17*	**16,064**	—
Land use rights	*18*	**1,852**	1,892
Deferred tax assets	*19*	**4,594**	4,260
		100,598	60,365
Current assets			
Inventories	*20*	**38,803**	34,264
Trade and bills receivables	*21*	**27,550**	16,182
Other receivables, deposits and prepayments		**23,278**	19,558
Pledged bank deposits	*22*	**7,478**	44,129
Cash and cash equivalents	*22*	**155,503**	108,960
		252,612	223,093
Current liabilities			
Trade and bills payables	*23*	**19,948**	38,991
Other payables and accruals		**41,924**	25,125
Taxation payable		**1,734**	937
Short-term bank loans	*24*	**105,700**	104,190
		169,306	169,243
Net current assets		**83,306**	53,850
Total assets less current liabilities		**183,904**	114,215
Non-current liabilities			
Deferred income	*25*	**20,380**	20,380
Net assets		**163,524**	93,835
Financed by:			
Share capital	*26*	**60,960**	46,000
Reserves (including final dividend proposed of RMB12,192,000 (2004: Nil))	*27*	**102,564**	47,835
Shareholders' funds		**163,524**	93,835

CASH FLOW STATEMENTS

For the Year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000
Cash flows from operating activities			
Net cash inflow/(outflow) generated from/(used in) operations	*28(i)*	**46,548**	(4,200)
Interest received		**1,548**	2,007
Interest paid		**(7,142)**	(5,626)
PRC income tax paid		**(19,023)**	(18,813)
Net cash generated from/(used in) operating activities		**21,931**	(26,632)
Cash flows from investing activities			
Purchase of property, plant and equipment		**(9,008)**	(3,253)
Additions of construction-in-progress		**(36,716)**	(3,768)
Proceeds from sales of fixed assets		**66**	—
Decrease in amount due from shareholders		**—**	227
Purchase of technical know-how		**(1,500)**	(400)
Decrease/(increase) in prepayments to acquire technical know-how		**850**	(80)
Net cash outflow from investing activities		**(46,308)**	(7,274)
Cash flows from financing activities			
Proceeds from issue of shares		**40,452**	—
Shares issuance costs		**(7,693)**	—
Dividend paid		**—**	(48,182)
New bank loans	*28(ii)*	**118,800**	141,263
Repayment of bank loans	*28(ii)*	**(117,290)**	(97,073)
Decrease /(increase) in pledged bank deposits		**36,651**	(20,074)
Net cash generated from/(used in) financing activities		**70,920**	(24,066)
Net increase/(decrease) in cash and cash equivalents		**46,543**	(57,972)
Cash and cash equivalents, beginning of the year		**108,960**	166,932
Cash and cash equivalents, end of the year		**155,503**	108,960

STATEMENTS OF CHANGES IN EQUITY

For the Year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000
Total equity, beginning of year		**93,835**	113,784
Profit attributable to shareholders		**36,930**	28,233
Net proceeds from issuance of new shares	*27*	**32,759**	—
Dividend paid		**—**	(48,182)
Total equity, end of year		**163,524**	93,835

1 General information

The Company was established as a collectively-owned enterprise under the name of Shandong Luoxin Factory in the People's Republic of China (the "PRC") on 14 December 1995 and was converted into a joint stock co-operative enterprise on 12 July 1997. On 19 November 2001, Shandong Luoxin Factory underwent a corporate reorganisation and was transformed into a joint stock limited liabilities company with a registered capital of RMB46 million by way of promotion. Subsequent to the above reorganisation, the name of the Company was changed to Shandong Luoxin Pharmacy Stock Co., Ltd. The H shares of the Company have been listed on the Growth Enterprise Market (the "GEM") of The Stock Exchange of Hong Kong Limited since 9 December 2005.

The Company's registered office is located at Luoqi Road, High and New Technology Experimental Zone, Linyi City, Shandong Province, the PRC.

The principal activities of the Company are manufacturing and selling of pharmaceutical products.

The accounts are presented in thousands of units of Renminbi (RMB'000), unless otherwise stated. These accounts have been approved for issue by the Board of Directors on 22 March 2006.

2 Summary of significant accounting policies

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

2.1 Basis of preparation

The accounts of the Company have been prepared in accordance with Hong Kong Financial Reporting Standards (HKFRS). The accounts have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities at fair value through profit or loss.

The preparation of accounts 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 Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the accounts, are disclosed in Note 4 to the accounts.

The HKICPA has issued certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the accounting periods beginning on or after 1 January 2006 or later periods but which the Company has not early adopted, as follows:

- **HKAS 19 (Amendment), Employee Benefits (effective from 1 January 2006)**
  This amendment introduces the option of an alternative recognition approach for actuarial gains and losses. These amendments are not relevant to the Company's operations, as the Company does not maintain any defined benefit plan during the year.

2 Summary of significant accounting policies (Continued)

2.1 Basis of preparation (Continued)

- **HKAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006)**

  The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the consolidated accounts, provided that: (a) the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction; and (b) the foreign currency risk will affect consolidated profit or loss. This amendment is not relevant to the Company's operations as the Company has no subsidiary.

- **HKAS 39 (Amendment), The Fair Value Option (effective from 1 January 2006)**

  This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Company believes that this amendment should not have a significant impact on the classification of financial instruments.

- **HKAS 39 and HKFRS 4 (Amendment), Financial Guarantee Contracts (effective from 1 January 2006)**

  This amendment requires issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, to be initially recognised at their fair value, and subsequently measured at the higher of (a) the unamortised balance of the related fees received and deferred, and (b) the expenditure required to settle the commitment at the balance sheet date. Management considered this amendment to HKAS 39 and concluded that it is not relevant to the Company.

- **HKFRS 1 (Amendment), First-time Adoption of Hong Kong Financial Reporting Standards and HKFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)**

  These amendments are not relevant to the Company's operations, as the Company is not a first-time adopter and does not carry out exploration for and evaluation of mineral resources.

- **HKFRS 6, Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)**

  HKFRS 6 is not relevant to the Company's operations.

2 Summary of significant accounting policies (Continued)

2.1 Basis of preparation (Continued)

- **HKFRS 7, Financial Instruments: Disclosures, and a complementary Amendment to HKAS 1, Presentation of Financial Statements — Capital Disclosures (effective from 1 January 2007)**

  HKFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces HKAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and disclosure requirements in HKAS 32, Financial Instruments: Disclosure and Presentation. It is applicable to all entities that report under HKFRS. The amendment to HKAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Company assessed the impact of HKFRS 7 and the amendment to HKAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of HKAS 1. The Company will apply HKFRS 7 and the amendment to HKAS 1 from annual periods beginning 1 January 2007.

- **HKFRS-Int 4, Determining whether an Arrangement contains a Lease (effective from 1 January 2006)**

  HKFRS-Int 4 requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether: (a) fulfillment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset. Management is currently assessing the impact of HKFRS-Int 4 on the Company's operations.

- **HKFRS-Int 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006)**

  HKFRS-Int 5 is not relevant to the Company's operations.

- **HK(IFRIC)-Int 6, Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment (effective from 1 December 2005)**

  HK(IFRIC)-Int 6 is not relevant to the Company's operations.

2 Summary of significant accounting policies (Continued)

2.2 Foreign and presentation currency

(a) Functional and presentation currency

Items included in the accounts of the Company are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The accounts are presented in Renminbi, 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.

2.3 Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and any accumulated impairment losses. 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 Company and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income statement during the period in which they are incurred.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate cost to their residual values over their estimated useful lives, as follows:

Buildings	20 - 40 years
Plant and machinery	10 years
Office equipment	5 years
Motor vehicles	5 years

The asset's 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 (see Note 2.6).

Gains and losses on disposals are determined by comparing proceeds with carrying amount.

2 Summary of significant accounting policies (Continued)

2.4 Construction-in-progress

Construction-in-progress comprises buildings, plant and machinery on which construction work or installation has not been completed and which, upon completion, management intends to use for long-term purpose. It is stated at cost which includes construction expenditure incurred, interest on loan and other direct costs attributable to the construction or installation less any accumulated impairment losses. On completion, the buildings, plant and machinery are transferred to respective categories at cost less any accumulated impairment losses.

2.5 Purchased technical know-how

Purchased technical know-how is stated at cost less accumulated amortisation and any accumulated impairment losses. It is recognised as an intangible asset if it is probable that the future economic benefits that are attributable to the asset will flow to the Company and amortised on a straight-line basis over its estimated economic life of a period of five years since the commencement of related production.

2.6 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation, which are at least tested annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. 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). Non-financial assets other than goodwill that suffered on impairment are reviewed for possible reversal of the impairment of each reporting date.

2.7 Research and development costs

Research costs are expensed as incurred. Development costs incurred on development projects relating to the design and testing of new or improved products are recognised as an intangible asset when it is probable that the project will be a success consisting its commercial and technological feasibility, and costs can be measured reliably. Such development costs are recognised as an asset and amortised from the commencement of the commercial production of the product on a straight-line basis over a period of not more than five years to reflect the pattern in which the related economic benefits are recognised. Development costs that do not meet the above criteria are expensed as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

2 Summary of significant accounting policies (Continued)

2.8 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 materials, direct labour and an appropriate proportion of all production overhead expenditure. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2.9 Trade receivables

Trade 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 receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of 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 effective interest rate. The amount of the provision is recognised in the income statement.

2.10 Cash and cash equivalents

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

2.11 Share capital

Share capital is classified as equity.

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

2.12 Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Provisions are not recognised for future operating losses.

Provision 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 assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2 Summary of significant accounting policies (Continued)

2.13 Contingent liabilities

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

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

2.14 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 accounts. Deferred income tax is determined using tax rates 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.

2.15 Revenue recognition

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 goods are delivered to customers and the title has passed.

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

2.16 Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services 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 Company's contributions to defined contribution retirement schemes are expensed as incurred.

2 Summary of significant accounting policies (Continued)

2.17 Borrowings

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 Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

2.18 Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grants will be received.

Government grant relating to purchase of property, plant and equipment is included in non-current liabilities as deferred income and is expensed in the income statement on a straight-line basis over the expected useful lives of the related assets.

2.19 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 expensed in the income statement on a straight-line basis over the period of the lease.

2.20 Dividend distribution

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

3 Financial risk management

3.1 Financial risk factors

The Company's activities expose it to a variety of financial risks, including market risk, credit risk and liquidity risk.

The risk management is carried out by the Company's Directors. They identify, evaluate and minimise financial risk in close co-operation with the Company's operating units.

(a) Market risk

(i) Foreign exchange risk

The Company operates and conducts business in PRC and all the Company's transactions, assets and liabilities are denominated in Renminbi.

All cash and cash equivalents and pledged deposits of the Company are denominated in Renminbi and bank deposits are placed with banks in the PRC. The remittance of these funds out of the PRC is subject to the exchange control restrictions imposed by the PRC government.

(ii) Price risk

The Company is exposed to the increasing price competition and life cycle of the products that have elastic price sensitive on demand. Moreover, the National Development and Reform Commission imposes price control on the products. The Company adjusts the product price in response to the change in price risk over time.

(b) Credit risk

As at 31 December 2004 and 2005, approximately 28.6% and 32.8% of the trade receivables was concentrated on the top five customers, respectively. The carrying amount of trade and other receivables included in the balance sheet represents the Company's maximum exposure to credit risk in relation to its financial assets. The Company has put in place policies to ensure that sales of products are made to customers with an appropriate credit history and the Company performs periodic credit evaluation of its customers. The Company's historical experience in collection of trade and other receivables falls within the recorded allowances and the Directors are of the opinion that adequate provision for uncollectible trade and other receivables has been made in the accounts.

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash level and the availability of funding through an adequate amount of committed credit facilities.

3 Financial risk management (Continued)

3.2 Fair value estimation

The carrying amounts of the Company's financial assets including cash and cash equivalents, bank deposits, trade and other receivables; and financial liabilities including trade payables, short-term borrowings and other payables, approximate their fair values due to their short maturities.

The face values less any estimated credit adjustments for financial assets and liabilities with a maturity of less than one year, if any, are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Company for similar financial instruments.

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.

The Company makes estimates and judgements 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.

(a) Estimated impairment of purchased technical know-how

The Company assesses annually whether purchased technical know-how has suffered any impairment, in accordance with the accounting policy stated in Note 2.6. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require estimation on future cash flow generated from these purchased technical know-how.

(b) Taxation

The Company is subject to PRC enterprise income tax and value-added tax. Since PRC tax rules are complicated and there may be new PRC tax rules and regulations from time to time, the Company recognises tax liabilities based on estimates of taxes liabilities. Where the final tax outcome is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

5 Turnover and revenue

The principal activities of the Company are manufacturing and selling of pharmaceutical products. No business or geographical segment analysis is presented as all operations, assets and liabilities of the Company during the year are related to manufacturing and selling of pharmaceutical products, and all assets and customers are located in the PRC.

Revenues recognised are as follows:

	2005 RMB'000	2004 RMB'000
Turnover		
Sales of manufactured goods	**249,689**	169,000
Other revenue		
Interest income on bank deposits	**1,548**	2,007
Total revenue	**251,237**	171,007

6 Expenses by nature

	2005 RMB'000	2004 RMB'000
Raw materials and consumables used	**132,613**	74,233
Changes in inventories of finished goods and work in progress	**(2,538)**	(13,244)
Depreciation	**5,027**	4,215
Loss on disposal of property, plant and equipment	**460**	2,475
Amortisation of prepaid lease payment	**40**	40
Amortisation of purchased technical know-how (included in cost of sales)	**882**	740
Provision for obsolete and slow-moving inventories (included in cost of sales)	**817**	289
Provision for impairment of trade receivables	**1,347**	274
Employee benefit expense *(Note 10)*	**27,009**	25,010
Research and development costs	**5,806**	2,783
Advertising costs	**2,819**	8,965
Auditors' remuneration	**676**	600

7 Finance costs

	2005	2004
	RMB'000	RMB'000
Interest on short-term bank loans	**7,142**	5,626

8 Income tax expense

(i) No provision for Hong Kong profits tax has been made as the Company did not carry out any business in Hong Kong during the year.

(ii) The Company is subjected to the PRC enterprise income tax at a rate of 33%.

(iii) The PRC value-added tax

The Company is subjected to the PRC value-added tax ("VAT") at 17% of revenue from sale of goods in the PRC. Input VAT paid on purchases can be used to offset output VAT levied on sales to determine the net VAT recoverable/payable.

(iv) The amount of taxation charged to the income statement represents:

	2005	2004
	RMB'000	RMB'000
Current taxation — Enterprise income tax	**19,820**	18,927
Deferred taxation *(Note 19)*	**(334)**	(549)
	19,486	18,378

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

	2005	2004
	RMB'000	RMB'000
Profit before taxation	**56,416**	46,611
Calculated at a taxation rate of 33%	**18,617**	15,382
Expenses not deductible for taxation purposes	**869**	2,996
Taxation charge	**19,486**	18,378

9 Dividends

A dividend in respect of 2005 of RMB0.02 per share, amounting to a total dividend of RMB12,192,000 is to be proposed at the Annual General Meeting on 26 May 2006. These accounts do not reflect this dividend payable.

	2005 RMB'000	2004 RMB'000
Interim dividend paid of Nil (2004: RMB1.047) per ordinary share	**—**	48,182
Proposed final dividend of RMB0.02 (2004: Nil) per ordinary share	**12,192**	—
	12,192	48,182

These accounts do not reflect this dividend payable.

10 Employee benefit expense

	2005 RMB'000	2004 RMB'000
Salaries and wages	**8,887**	7,453
Sales commission	**14,199**	14,427
Pension costs — defined contribution plans	**2,398**	1,790
Other staff benefits	**1,525**	1,340
	27,009	25,010

11 Pension and retirement benefit costs

The Company has provided for pension and retirement benefit costs to all qualified employees in the PRC in accordance with the regulations set by the PRC local government which is calculated based on 29% on the employees' salary or the monthly average salaries set out by the PRC local government.

Commencing 2003, the Company has participated in a Mandatory Provident Fund Scheme (the "MPF Scheme") in Hong Kong for all qualified Hong Kong employees, which is a defined contribution scheme managed by independent trustees. Monthly contributions are made to the MPF Schemes based on 5% of the Hong Kong employees' relevant income as defined under the Mandatory Provident Fund Schemes Ordinance. Both the Company's and the employees' contributions are subject to a cap of RMB1,040 (equivalent to HK$1,000) per month and thereafter contributions are voluntary.

During the year ended 31 December 2005, the Company has contributed approximately RMB9,000 (2004: RMB7,000) to the MPF Scheme.

12 Directors', supervisors' and senior management's emoluments

(i) The aggregate amounts of emoluments paid and payable to the Directors and supervisors of the Company are as follows:

	2005 RMB'000	2004 RMB'000
Basic salaries and allowances	**596**	370
Retirement benefit costs	**63**	36
	659	406

Individual emoluments paid and payable to the Directors and Supervisors for the year are as follows:

	2005 RMB'000	2004 RMB'000
Executive directors		
Liu Baoqi	**130**	130
Liu Zhenhai	**106**	106
Li Minghua	**127**	127
Wang Qingyu	**67**	6
Non-executive directors		
Zhou Wuxian	**2**	—
Yin Chuangui	**2**	—
Liu Yuxin	**2**	—
Independent non-executive directors		
Foo Tin Chung Victor	**91**	—
Fu Hongzheng	**2**	—
Shao Youmei	**2**	—
Supervisors		
Sun Song	**84**	6
Zhu Engiang	**34**	31
Li Yonggang	**5**	—
Gao Xiaoling	**5**	—
	659	406

None of the directors waived any emoluments during the year.

12 Directors', supervisors' and senior management's emoluments (Continued)

(ii) The five individuals whose emoluments were the highest in the Company for the year include four (2004: three) directors whose emoluments are reflected in the analysis presented above. The emoluments payable (excluding amounts paid or payable by way of commissions on sales generated by the individual) to the remaining one (2004: two) individual during the year are as follows:

	2005 **RMB'000**	2004 RMB'000
Basic salaries and allowances	**341**	287
Retirement benefit costs	**9**	24
	350	311

The emoluments fell within the following bands:

	Number of individuals	
	2005 **RMB'000**	2004 RMB'000
Emolument bands		
Nil - RMB1,040,000 (equivalent to Nil - HK$1,000,000)	**1**	2

(iii) During the year, no emoluments have been paid to the Directors of the Company or the five highest individuals as an inducement to join or as compensation for loss of office (2004: Nil).

13 Earnings per share

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

	2005	2004
Profitable attributable to shareholders of the Company (RMB'000)	**36,930**	28,233
Weighted average number of ordinary shares in issue ('000)	**469,427**	460,000
Basic earnings per share (RMB per share)	**0.079**	0.061

Diluted earnings per share has not been presented as there were no dilutive potential ordinary shares outstanding during the year ended 31 December 2005.

14 Purchased technical know-how

	RMB'000
Cost	
At 1 January 2004	12,450
Additions	400
At 31 December 2004	12,850
Additions	1,500
At 31 December 2005	14,350
Accumulated amortisation and impairment losses	
At 1 January 2004	9,820
Charge for the year	740
At 31 December 2004	10,560
Charge for the year	882
At 31 December 2005	11,442
Net book value	
At 31 December 2004	2,290
At 31 December 2005	2,908

15 Prepayments to acquire technical know-how

As at 31 December 2005, included in prepayments to acquire technical know-how were amounts prepaid to a shareholder and a related company and details are as follows:

	2005	2004
	RMB'000	RMB'000
— Shenyang Pharmacy University, a shareholder	**4,500**	4,400
— Shenyang Bohong Pharmaceutical Technology Development Co., Ltd., a company owned by a shareholder	**1,700**	1,700
	6,200	6,100

As at 31 December 2005, the Company entered into agreements with Shenyang Pharmacy University, a shareholder, and Shenyang Bohong Pharmaceutical Technology Development Co., Ltd., a company owned by a shareholder, to purchase technical know-how in relation to production of pharmaceutical products at a total consideration of RMB9,300,000 (2004: RMB9,300,000).

16 Property, plant and equipment

	Buildings	Plant and machinery	Motor vehicles	Office equipment	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2004					
Cost	17,243	26,460	2,840	3,493	50,036
Accumulated depreciation	(1,594)	(4,158)	(792)	(1,058)	(7,602)
Net book amount	15,649	22,302	2,048	2,435	42,434
Year ended 31 December 2004					
Opening net book amount	15,649	22,302	2,048	2,435	42,434
Additions	1,216	1,562	23	452	3,253
Transfer from construction-in-progress *(Note 17)*	3,921	—	—	—	3,921
Disposals	(2,204)	(266)	(5)	—	(2,475)
Depreciation	(470)	(2,546)	(499)	(700)	(4,215)
Closing net book amount	18,112	21,052	1,567	2,187	42,918
At 31 December 2004					
Cost	19,172	26,866	2,788	3,945	52,771
Accumulated depreciation	(1,060)	(5,814)	(1,221)	(1,758)	(9,853)
Net book amount	18,112	21,052	1,567	2,187	42,918
Year ended 31 December 2005					
Opening net book amount	18,112	21,052	1,567	2,187	42,918
Additions	1,891	4,218	2,475	424	9,008
Transfer from construction-in-progress *(Note 17)*	2,964	17,580	—	108	20,652
Disposals	(489)	—	—	(37)	(526)
Depreciation	(517)	(2,997)	(774)	(739)	(5,027)
Closing net book amount	21,961	39,853	3,268	1,943	67,025
At 31 December 2005					
Cost	23,346	48,664	5,263	4,413	81,686
Accumulated depreciation	(1,385)	(8,811)	(1,995)	(2,470)	(14,661)
Net book amount	21,961	39,853	3,268	1,943	67,025

16 Property, plant and equipment (Continued)

Plant and machinery with net book value of approximately RMB33,166,000 (2004: RMB7,729,000) were pledged as collateral to secure bank loans (Note 29).

As at 31 December 2005, all buildings of the Company are located in the PRC.

Depreciation expense of RMB3,782,000 (2004: RMB3,191,000) have been expensed in cost of sales and RMB1,245,000 (2004: RMB1,024,000) have been included in administrative expenses for the year.

17 Construction-in-progress

	RMB'000
At 1 January 2004	153
Additions	3,768
Transfer to property, plant and equipment *(Note 16)*	(3,921)
At 31 December 2004	—
Additions	36,716
Transfer to property, plant and equipment *(Note 16)*	(20,652)
At 31 December 2005	16,064

Analysis of construction-in-progress:

	2005 **RMB'000**	2004 RMB'000
Construction cost of buildings	**15,979**	—
Cost of plant and machinery	**85**	—
	16,064	—

18 Land use rights

Land use rights represent 50-year land use rights in the PRC expiring from March 2052 to May 2055. This payment is recognised as an expense over the leasehold period.

	RMB'000
At 1 January 2004	1,932
Amortisation of prepaid operating lease payments	(40)
At 31 December 2004	1,892
Amortisation of prepaid operating lease payments	(40)
At 31 December 2005	1,852

19 Deferred tax assets

Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 33%.

The movement in the deferred tax assets is as follows:

	2005 RMB'000	2004 RMB'000
Beginning of the year	**4,260**	3,711
Deferred taxation credited to income statement *(Note 8)*	**334**	549
End of the year	**4,594**	4,260

19 Deferred tax assets (Continued)

The movements in deferred tax assets are as follows:

	Provisions RMB'000	Amortisation charge on purchased technical know-how RMB'000	Others RMB'000	Total RMB'000
At 1 January 2004	1,245	2,240	226	3,711
Credited/(charged) to income statement	245	(180)	484	549
At 31 December 2004	1,490	2,060	710	4,260
Credited/(charged) to income statement	722	(158)	(230)	334
At 31 December 2005	2,212	1,902	480	4,594

All deferred tax assets are to be recovered after more than 12 months.

There was no unprovided deferred taxation during the year.

20 Inventories

	2005 RMB'000	2004 RMB'000
Raw materials	**13,795**	11,966
Work-in-progress	**9,093**	8,201
Finished goods	**15,915**	14,097
	38,803	34,264

The cost of inventories recognised as expense and included in cost of sales amounted to RMB144,289,000 (2004: RMB71,676,000).

21 Trade and bills receivables

Details of the ageing analysis are as follows:

	2005 RMB'000	2004 RMB'000
1 to 90 days	**20,196**	11,944
91 to 180 days	**4,721**	3,217
181 to 365 days	**2,882**	1,185
Over 365 days	**2,668**	1,727
	30,467	18,073
Less: Provision for impairment of receivables	**(2,917)**	(1,891)
	27,550	16,182

The fair values are based on cash flows discounted using a rate based on the average borrowing rate of 7.23% (2004: 6.64%) during the year. The carrying amount of trade receivables approximate their fair value.

Customers are generally granted with credit terms ranging from 30 to 180 days.

Trade and bills receivables as at 31 December 2005 are denominated in Renminbi.

22 Pledged bank deposits/cash and cash equivalents

As at 31 December 2005, Company's bank deposits of approximately RMB7,478,000 (2004: RMB44,129,000) were pledged as collateral for facilities granted by banks.

The effective interest rate on pledged bank deposits were 0.72% (2004: 0.72%) and have an average maturity of 6 months during the year.

The carrying amount of pledged bank deposits approximate their fair value.

All cash and cash equivalents and pledged deposits of the Company are denominated in Renminbi and bank deposits are placed with banks in the PRC. The remittance of these funds out of the PRC is subject to the exchange control restrictions imposed by the PRC government.

23 Trade and bills payables

Details of the ageing analysis are as follows:

	2005 RMB'000	2004 RMB'000
1 to 90 days	**10,026**	29,402
91 days to 180 days	**7,851**	7,791
181 days to 365 days	**374**	494
Over 365 days	**1,697**	1,304
	19,948	38,991

Trade and bills payables as at 31 December 2005 are denominated in Renminbi.

24 Short-term bank loans

	2005 RMB'000	2004 RMB'000
Short-term bank loans		
— secured *(Note 29)*	**20,000**	39,490
— unsecured	**85,700**	64,700
	105,700	104,190

Short-term bank loans are denominated in Renminbi and bear interest at approximately 6.14% to 8.31% per annum.

The fair value are based on cash flows discounted using a rate based on the average borrowing rate of 7.23% (2004: 6.64%) during the year.

The carrying amount of short-term bank loans approximate their fair value.

25 Deferred income

During the years ended 31 December 2002 and 2003, the Company received government subsidies in cash of RMB20,380,000 pursuant to an approval obtained from the local government authority. The grants were to enable the Company to construct new manufacturing plant to produce Chinese medicines. As at 31 December 2005, the Company has not commenced the construction of the new manufacturing plant.

26 Share capital

	Number of shares	Nominal value Domestic shares	H shares	Total
	'000	RMB'000	RMB'000	RMB'000
Registered, issued and fully paid				
At 1 January 2004 (nominal value of RMB1.00 each)	46,000	46,000	—	46,000
Sub-division of share *(Note (i))*	414,000	—	—	—
At 31 December 2004 (nominal vale of RMB0.10 each)	460,000	46,000	—	46,000
Domestic shares converted into H shares *(Note (ii))*	—	(1,496)	1,496	—
Issue of new shares upon listing *(Note (iii))*	149,600	—	14,960	14,960
At 31 December 2005	609,600	44,504	16,456	60,960

Notes:

(i) On 6 September 2004, each of the Company's shares with par value of RMB1.00 each was sub-divided into 10 shares with par value of RMB0.10 each.

(ii) The 14,960,000 H Shares to be converted from Domestic Shares ("Sale H Shares") are being offered for sale by the Vendors under the Placing in compliance with the Temporary Administrative Measures for Reduction of State-owned Shares. Pursuant to the Temporary Administration Measures for reduction of State-owned Shares, holders of State-owned shares of a joint stock limited company in the PRC shall offer for sale such number of its State-owned shares equivalent to 10% of the funds to be raised under the initial public offering of the joint stock limited company. Accordingly, an aggregate of 14,960,000 Sale H Shares (to be converted from Domestic Shares) are offered for sale at the Placing Price by the Vendors under the Placing. These Sale H Shares rank pari passu with the new H Shares in all respects to be offered for subscription. The net proceeds arising from the sale of the Sale H Shares by the Vendors will be remitted to the National Social Security Fund.

(iii) The Company's H shares were listed on the GEM Board on 9 December 2005 and 164,560,000 H shares, consisting of 149,600,000 new shares and 14,960,000 shares converted from Domestic shares, with a nominal value of RMB0.10 each were sold to the public by way of placing at HK$0.26 (equivalent to RMB0.27) each.

The Company raised net proceeds of approximately RMB32,759,000 from the sales of 149,690,000 new shares, of which paid-up share capital was approximately RMB14,960,000 and share premium was approximately RMB17,799,000.

The net proceeds from the sales of 14,960,000 H shares converted from Domestic shares were approximately RMB3,277,000, after deducting the relevant portion of share issuing expenses of approximately RMB768,000 which were borne by the National Social Security Funds in connection with the sales of these shares. Such net proceeds were payable to the National Social Security Funds as at 31 December 2005.

27 Reserves

The movements of reserves of the Company are as follows:

	Share Premium	Statutory surplus reserve fund *(Note (i))*	Statutory public welfare fund *(Note (ii))*	Retained earnings	New shares issuance costs	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2004	13,340	5,550	2,775	46,119	—	67,784
Profit attributable to shareholders	—	—	—	28,233	—	28,233
Transfer from retained earnings to statutory funds	—	2,823	1,412	(4,235)	—	—
Dividend paid	—	—	—	(48,182)	—	(48,182)
At 31 December 2004	13,340	8,373	4,187	21,935	—	47,835
Profit attributable to shareholders	—	—	—	36,930	—	36,930
Transfer from retained earnings to statutory funds	—	3,693	1,846	(5,539)	—	—
Issue of new shares	25,492	—	—	—	—	25,492
New share issuance cost	—	—	—	—	(7,693)	(7,693)
Share issuance costs charged against share premium	(7,693)	—	—	—	7,693	—
At 31 December 2005	31,139	12,066	6,033	53,326	—	102,564
Representing:						
Proposed 2005 final dividends				12,192		
Others				41,134		
Retained earnings as at 31 December 2005				53,326		

27 Reserves (Continued)

Notes:

(i) Pursuant to the PRC regulations and the Company's Articles of Association, the Company is required to transfer 10% of its net profit, as determined under the PRC accounting regulations, to statutory surplus reserve fund until the fund aggregates to 50% of the Company's registered capital. The transfer to this reserve must be made before distribution of dividends to shareholders.

The statutory surplus reserve fund shall only be used to make good previous years' losses, to expand the Company's production operations, or to increase the capital of the Company. Upon approval by a resolution of shareholders' general meeting, the Company may transform its statutory surplus reserve fund into share capital and issue bonus shares to existing shareholders in proportion to their original shareholdings or to increase the nominal value of each share currently held by them, provided that the balance of the reserve fund after such issue is not less than 25% of the registered capital.

(ii) Pursuant to the PRC regulations and the Company's Articles of Association, the Company is required to transfer 5% to 10% of its net profit, as determined under the PRC accounting regulations, to the statutory public welfare fund. This fund can only be used to provide staff welfare facilities and other collective benefits to the Company's employees. This fund is non-distributable other than in liquidation.

28 Note to the cash flow statements

(i) Reconciliation of profit before taxation to net cash inflow/(outflow) generated from/(used in) operations:

	2005 **RMB'000**	2004 RMB'000
Profit before taxation	**56,416**	46,611
Interest income	**(1,548)**	(2,007)
Interest expense	**7,142**	5,626
Depreciation	**5,027**	4,215
Loss on disposal of property, plant and equipment	**460**	2,475
Amortisation of prepaid operating lease payments	**40**	40
Amortisation of purchased technical know-how	**882**	740
Operating profit before working capital changes	**68,419**	57,700
Increase in inventories	**(4,539)**	(21,743)
Increase in trade and bills receivables	**(11,368)**	(5,398)
Increase in other receivables, deposits and prepayments	**(3,720)**	(14,248)
Decrease in trade and bills payables	**(19,043)**	(18,403)
Increase/(decrease) in other payables and accruals	**16,799**	(2,108)
Net cash inflow/(outflow) generated from/(used in) operations	**46,548**	(4,200)

28 Note to the cash flow statements (Continued)

(ii) Analysis of changes in financing:

	Bank loans RMB'000
At 1 January 2004	60,000
New bank loans	141,263
Repayment of bank loans	(97,073)
At 31 December 2004	104,190
New bank loans	118,800
Repayment of bank loans	(117,290)
At 31 December 2005	105,700

29 Banking facilities

The Company had aggregate banking facilities of RMB113,123,000 (2004: RMB131,264,000) which were fully utilised as at 31 December 2005.

As at 31 December 2005, approximately RMB93,123,000 (2004: RMB106,265,000) of the banking facilities were secured by:

(i) pledge of the Company's property, plant and equipment with net book value of approximately RMB33,166,000 (2004: RMB7,729,000); and

(ii) pledge of bank deposits of RMB7,478,000 (2004: RMB44,129,000).

30 Commitments

The Company had the following significant capital commitments:

	2005 **RMB'000**	2004 RMB'000
Contracted but not provided for:		
— Purchase of technical know-how	**4,115**	4,765
— Property, plant and machinery	**12,331**	—

As at 31 December 2005, approximately RMB3,100,000 (2004: RMB3,200,000) of the above commitments are related to acquisition of technical know-how from a shareholder and a company owned by a shareholder (see Note 15).

31 Related party transactions

Key management compensation for the year ended 31 December 2005 were disclosed in Note 12(i).

Apart from those disclosed under Notes 15 and 30, the Company had no material transactions with related parties during the year.

THREE YEARS FINANCIAL SUMMARY

	For the Year ended 31 December 2005		
	2005	2004	2003
	RMB'000	RMB'000	RMB'000
Results			
Turnover	**249,689**	169,000	151,057
Cost of sales	**(144,289)**	(71,676)	(71,383)
Gross profit	**105,400**	97,324	79,674
Other revenue	**1,548**	2,007	1,078
Selling and distribution expenses	**(21,879)**	(27,091)	(14,707)
General and administrative expenses	**(21,511)**	(20,003)	(15,701)
Operating profit	**63,558**	52,237	50,344
Finance costs	**(7,142)**	(5,626)	(5,064)
Profit before taxation	**56,416**	46,611	45,280
Income tax expense	**(19,486)**	(18,378)	(15,555)
Profit attributable to shareholders	**36,930**	28,233	29,725
Dividends	**12,192**	48,182	—
Earnings per share (RMB)	**0.079**	0.061	0.065

	As at 31 December		
	2005	2004	2003
	RMB'000	RMB'000	RMB'000
Assets & Liabilities			
Total assets	**353,210**	283,458	279,614
Total liabilities	**(189,686)**	(189,623)	(165,830)
Equity attributable to equity holders of the Company	**163,524**	93,835	113,784