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

2006
Annual Report

* *For identification purposes only*

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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.*

** For identification purpose only*

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CORPORATE INFORMATION

Directors	**Executive Directors** Liu Baoqi Liu Zhenhai Li Minghua Han Fengsheng **Non-executive Directors** Zhou Wuxian Yin Chuangui Liu Yuxin **Independent Non-executive Directors** Foo Tin Chung, Victor Fu Hongzheng Li Hongjian
Supervisors	Li Yonggang Gao Xiaoling Sun Song Zhu Enqiang
Compliance officer	Liu Baoqi
Qualified accountant	Lau Hon Kee (FCPA, CPA (Aust.))
Company secretary	Lau Hon Kee (FCPA, CPA (Aust.))
Authorised representatives	Liu Baoqi Lau Hon Kee (FCPA, CPA (Aust.))
Registered office	Luoqi Road, High and New Technology Experimental Zone, Linyi City, Shandong Province PRC
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 Li Hongjian

CORPORATE INFORMATION

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	HLB Hodgson Impey Cheng 31/F., Gloucester Tower The Landmark 11 Pedder St., 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

During the year of 2006 under review, our Company made great success through dedication and sustained effort of the management and employees, enabling our company to move another sound stride. Looking forward to 2007, we have set off and are well positioned to meet any new challenges and to capitalize on any opportunities. We firmly believe that our Company will attain a more speedy and steady growth and our results will hit another record.

Over the past year, we completed the second phase of our extension project and completed the research and management center building, with the addition of various production facilities. As a result, our dose forms became more diversified and our production capacity was enhanced as well as the product quality. Leveraging on the cooperation with our research and development partners and our own strength in scientific research, we have consolidated the scientific research and development, procuring the constant launching of various new products. This laid a solid foundation for our thriving and sustainable development. By extending our sales channels, perfecting the sales networks, increasing the number of sales staff, and upgrading the overall quality of the sales team, we have strengthened and expanded the market network, thereby forming five channels to deal with aspects of merchandising, logistics, end users, over-the-counter trades and raw materials. Our product brands have been more popular. We persist to focus on human resources, including active recruitment and training of our staff, promotion on learning, training and skills. We also strive for perfection, and insist in hiring, employing and managing staff with high calibre. As a result, the overall quality of our employees, management level and their commitment and dedication can further be enhanced. Obviously, our employees are more loyal to the Company with a motivated team spirit. In general, we had achieved better results during the year 2006, thus enabling our company to take a large stride once again.

Considering certain emerging facts such as: population growth in China, pursuit of a well-off society from the society merely solving basic needs, gradual fulfilment of basic medical insurance, the acceleration of urbanization that marks the pace of modernization, the speeding up of industrial modernization which results in a remarkable and abrupt change of disease spectrum, growth of aging population and epidemic globalization, the pharmaceutical industry is expected to grow more rapidly in 2007. Our Company will continue to pursue the value of "rewarding the shareholders, benefiting the employees, repaying the society and strengthening the enterprise" and the philosophy of "Cohesion For Building an Enterprise with Technology". In light of this, our Company will accelerate our pace in building up the brand of Luoxin, speeding up the establishment of our sales networks and enhancing the market share of its products. Our Company has being created for itself various competitive edges, and enhanced the core competitiveness of our enterprise. Our Company will also expedite to commence the production of patented 3-H products, namely high-tech, high quality and high-value added products, as well as the high-end and systematic production of antibiotics. In addition, our Company will also strengthen the innovation in the following 7 aspects, including concepts, systems, technology, management, mechanism, market development and human resources development, so as to secure a strategic position for the sustainable development of its own. I firmly believe that our business will deliver continuous and rapid growth and thus 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 incessant 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 those who have being devoting their efforts to facilitate the growth of the Company and have being made tremendous support for the advancement of the Company.

Liu Baoqi
Chairman

13 March 2007

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS

Mr. Liu Baoqi (劉保起), aged 45, is an executive Director and the chairman of the Company. He is responsible for the overall management of the board of Directors of the Company (the "Board"). 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 Pharmacy Company Limited ("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 31, 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 41, is an executive Director, the general manager and head of research and development department of the Company. She is responsible for the overall strategic planning, business development and operation of the Company. 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. Han Fengsheng (韓風生), aged 31, was appointed by he Board as an executive Director on 30 November 2006 and he is also 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).

NON-EXECUTIVE DIRECTORS

Mr. Zhou Wuxian (周武先), aged 49, is a non-executive Director and the legal representative of Qingdao Guofeng Group Jiaozhou Pharmacy Limited ("Qingdao Guofeng Jiaozhou"), a promoter and an initial management shareholder of the Company. 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. Mr. Zhou became a non-executive Director of the Company in November 2004 .

Mr. Yin Chuangui (尹傳貴), aged 50, is a non-executive Director, and the authorized representative of Linyi People Hospital, a promoter and an initial management shareholder of the Company. 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 48, 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, a promoter and an initial management shareholder of the Company, 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 37, 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 43, 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. Li Hongjian (李宏健), aged 53, has been appointed as independent non-executive Director on 30 November 2006. Ms. Li graduated from the Faculty of Pharmacy of Shandong Medical University (山東醫學院藥學系) in 1976. Since her graduation, Ms. Li has been engaging in pharmacy works in hospital. She is currently person in charge of pharmacy department and the Chief Pharmacist in Shandong Qian Fo Shan Hospital (山東千佛山醫院), as well as a part-time professor and a mentor to the graduate school students of Shandong University (山東大學).

SUPERVISORS

Mr. Li Yonggang (李永剛), aged 45, is the supervisor and the chairman of Linyi Municipal Pharmacy Group Limited ("Linyi Municipal Pharmacy"), a promoter and an initial management shareholder of the Company. In June 2001, Mr. Li was nominated by Linyi Municipal Pharmacy as a member of the supervisory board of the Company.

Ms. Gao Xiaoling (高小玲), aged 43, is the Supervisor and the vice general manager of Lijun Group Limited Liability Company (the "Lijun Group") (Sales Company), a promoter and an initial management shareholder of the Company. In May 2001, Ms. Gao was nominated by Lijun Group as a member of the supervisory board.

Mr. Sun Song (孫松), aged 36, a supervisor of the Company 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 43, a 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. Ji Honghai (季紅海), aged 32, 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 71, 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 in 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), FCPA, CPA (Aust.), aged 36, is the 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 Fellow 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 positions in several service and manufacturing companies.

MANAGEMENT DISCUSSION AND ANALYSIS

Business Review

During the Period, the profits attributable to the shareholders of the Company recorded a tremendous increase over the corresponding period of last year, and achieved satisfactory results. The Company has carried on its strategy of sustainable development and attained distinguished advancement and progress in various aspects. The above achievements are the result of the great support and assistance from all the shareholders, customers, suppliers and business partners and friends, as well as the sustainable concerted effort of the management and employees. There were five key factors attributable to the sustainable development of the Company and the rapid enhancement of results.

1. The newly expanded capacities of the Company were put into operation: The products of the Company had been in short supply since April 2005 due to limited capacities. The Company, therefore, decided promptly on the second phase of its construction project. By installing 5 new production lines, the number of the production lines for powder for injection increased from 2 to 7, and the annual production capacity increased from 150 million doses to currently 500 million doses. The new workshop for production of Cephalosporin products for oral consumption provided a new production capacity and formed a growth sector. By the construction of a new workshop for production of bulk medicines, the annual productivity of bulk medicines amounted to 1,200 tons. The new workshop for production of lyophilized powder for injection was put into operation in September 2006. With the new capacities put into operation, the Company better served the market demand and created strong, new growth sectors. The enlargement of production scale significantly reduced costs of purchase and production, effectively facilitating the growth of the Company's results and laying a solid foundation for the development in 2007.

2. The technological development of the Company expedited the launch of new products and the new growth sectors contributed to the growth of operating results: The rapid and persistent growth of the Company's results depended largely on the increasing efforts made in technology innovation, the active cooperation between scientific research units, professional educational institutions and the Company with the solid technological backing from the Shenyang Pharmacy University and the strong scientific research capability of the Company, the timely adjustment of the product mix, the strengthening of antibiotics products and the speeding up of the research and development of new antibiotics as well as the exploration of various specialized medicines. For examples: (1) The Company speeded up the launch of new-generation antibiotics products ("3-H" antibiotics products), so as to avoid the impacts arising from the price reduction of existing antibiotics products. The sales of newly launched new-generation antibiotics products, such as Luoshan (Cefathiamidine for Injection), Luoxinwei (Cefepime Hydrochloride for Injection), Luohang (Cefpiramide Sodium for Injection), increased rapidly. (2) The newly launched specialized medicines, "3-H" products (namely high-tech, high quality and high-value added products), contributed to the growth of results and secured the sustainable development of the Company. For the year ended 31 December 2006, the Company had many new products in various specifications, including drugs for digestive system, circulatory system, and respiratory system, and antineoplastic drugs, approved for production by the State Food and Drug Administration. Specialized medicines accounted for half of the products of the Company. The diversification of products further optimized our product mix. The launching of those new products gave significant impetus

to the growth of the Company's results. Our effective and high added-value products with great market potential generated higher gross profit margin, resulting in a considerable growth in the results of the Company. (3) The Company will speed up the progress of launching the Rhodiola for Injection, a patented traditional Chinese medicine product for cardiovascular diseases, which has been granted a patent certificate valid for 20 years. With the launching of the said product, the Company will achieve sustained development at a rapid pace. Besides, the Company will strive to launch dozens of new products this year so as to further boost the momentum of our growth. Such newly launched products will, in turn, create our new economic growth sectors, and secure the future development of the Company as well as the persistent growth of results.

3. The increase of market share of our products and the results of sales facilitated by the sound and accessible sales network of the Company fostered the growth in efficiency: The Company had placed emphasis on the establishment of a sales network for many years. The Company took a series of feasible measures in the face of the more intense market competition in 2006: On the one hand, the Company speeded up the establishment of a sales team with enhanced overall quality and improved skills. As a result, the Company formed a sales team with more than 300 staff who were capable enough to deal with the market competition. On the other hand, the Company constantly adjusted marketing strategies and channels to establish sales channels for merchandising, logistics, end-user marketing, OTC and bulk medicines. Furthermore, the Company had developed special products based on individual product line for market segmentation. The Company had established intensive and accessible sales channels to secure greater product market share and rapid corporate development.

4. The effective strengthening of the brand name of the Company became a stronger competitive advantage: The Company strengthened its Luoxin brand name by technological innovation, technical improvement, enhanced GMP management, quality upgrade and integrity promotion. Our brand names stimulated the sales, and the sales in turn strengthened our brand names. Meanwhile, the strengthening of our brand names led to the increase of price and cost efficiency. For example: (1) The Company launched Cefepime Dihydrochloride for Injection, the fourth and latest generation of Cephalosporin antibiotics, in 2005. As the Company employed the latest production technology to upgrade the quality of the product, the product was well received by patients and healthcare professionals and recorded a sharp increase in sales. A new brand was gradually building up. (2) The Company launched Omeprazole Capsules, a kind of anti-ulcer drugs, for digestive system. Currently, our Omeprazole Capsules drawn the attention of our counterparts in the PRC because of their high quality and effectiveness, and were well received by distributors, patients and healthcare professionals. The sales volume of the product was in the top rank in China. Following Omeprazole, Lansorazole, the second proton pump inhibitor for anti-ulcer in the world, was developed. The launching of which brought about considerable returns to the results. (3) The Company first launched Gatifloxacin for Injection and Gatifloxacin Capsules under class 1 of State class new medicine in China in 2003. The sales of Gatifloxacin for Injection ranked No.1 among the sales of lyophilized powder for injection in China, and Gatifloxacin Capsules ranked No.3 among the sales of mixed preparation products in China last year. Such products were produced under lyophilization and vacuum/pressure processes, which are the most advanced technology in the country, providing the product with higher stability and better quality. In March 2003, Gatifloxacin for Injection was awarded the certificate of Technological Advancement Awards (2nd Prize) by the Science and Technology Reward Committee of Shandong Province, which in turn promoted and established the brand name of the Company.

The enhancement of the goodwill and brand name of the Company fostered the market development. The penetration of Luoxin products into the market, accompanied by advertisements, led to the rapid enhancement of the goodwill and brand name of Luoxin, thereby fueling the enlargement of market share.

5. Low costs and diversification turned into stronger competitive edges of the Company: The Company had established a comprehensive production model, which covered the production of bulk medicines to medicine production. The comprehensive product chain, together with the fast expansion of scale of production, further lowered our production costs and operating costs. In addition, the continuous launching of high-tech products and the establishment of brand name achieved a competitive edge originated from diversification, resulting in the improvement in results.

   Based on the aforesaid, upon the all round progression of various aspects of the Company, the overall reputation of the brand was effectively boosted. “Luoxin” brand was recognized as a famous brand in Shandong province. In the “Power Ranking of Medicine Enterprises in China 2006” sponsored by State Food and Drug Administration, the Southern Economic Research Institute of Medicine and Medicine Economic News, the Company was awarded the honorable title of “2006 Top Ten Growing Medicine Enterprises”. The Company, accompanied by a growing reputation within the pharmaceutical industry of China, is gradually evolving into a renowned top-brand enterprise.

Financial Review

For the year ended 31 December 2006, the Company’s audited turnover was approximately RMB317,868,000, representing an increase of approximately 27.31% when compared with approximately RMB249,689,000 for the year ended 31 December 2005.

For the year ended 31 December 2006, the audited cost of sales was approximately RMB175,905,000, representing an increase of approximately 21.91% when compared with approximately RMB144,289,000 for the year ended 31 December 2005.

For the year ended 31 December 2006, the audited gross profit margin was 44.66%, representing an increase of 2.45% when compared with approximately 42.21% for the year ended 31 December 2005.

For the year ended 31 December 2006, the audited operating expenditure were approximately RMB48,592,000, representing an increase of approximately 11.99% when compared with approximately RMB43,390,000 for the year ended 31 December 2005. This represents a usual growth in operating expenditure driven by the turnover growth of the Company.

For the year ended 31 December 2006, the audited profits attributable to the shareholders was approximately RMB60,169,000, representing an increase of approximately 62.93% when compared with approximately RMB36,930,000 for the year ended 31 December 2005. Weighted average earnings per share were RMB0.099.

Liquidity and Financial Resources

The Company's working capital is generally financed by its internally generated cash flow.

As at 31 December 2006, the Company's cash and cash equivalents were approximately RMB117,391,000 (as at 31 December 2005: RMB155,503,000). As at 31 December 2006, its short term loan was RMB78,700,000 (as at 31 December 2005: RMB105,700,000). The Company's bank borrowings were mainly secured by certain equipment and buildings of the Company.

The Company's gearing ratio as at 31 December 2006 was 19.73% (as at 31 December 2005: 29.9%), as calculated by dividing the amount of bank borrowings as at 31 December 2006 by the total asset value as at 31 December 2006 and then multiplied by 100%.

Pledged Bank Deposits, Cash and Cash Equivalents

As at 31 December 2006, the Company's property, plant and equipment of RMB32,898,000 and bank deposits of RMB22,233,000 were respectively pledged to secure the banking facilities of the Company.

Major Acquisitions and Disposals

For the year ended 31 December 2006, the Company did not make any major acquisition or disposal.

Significant Investments

For the year ended 31 December 2006, the Company did not have any significant investment.

Contingent Liabilities

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

Exchange Risk

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

All the Company's cash and cash equivalents and pledged deposits are denominated in Renminbi, while bank deposits are placed with banks in the PRC. Any remittances from the PRC are subject to the restrictions on exchange control implemented by the PRC Government.

Employees and Remuneration Policies

The Directors believe that employees' quality is the most important factor in maintaining the sustained development and growth of the Company and raising its profitability. The Company determines employees' salaries based on their performance, working experience and the prevailing salaries in the market, while other remuneration and fringe benefits are at appropriate levels.

The Company has established a remuneration committee to make recommendations on the overall strategy of remuneration policies.

Prospects

The Company will continue to focus on the scientific research, production and sales of pharmaceutical products. The Company will implement the strategy of sustained development and adhere to its guiding principles of becoming a “Technology-driven enterprise with determination and efforts” by constantly developing new patented products, exploring new areas of potential growth, expanding more mature market networks, enhancing its brand name and upgrading its core competitiveness so as to bring about continuous flow of revenue to the Company.

The Company will continue to strengthen the cooperation with its research and development partners and to enhance the capacity of its own research team in order to launch high quality and technologically advanced new products with high added value. The Company will speed up the progress of launching the Rhodiola for Injection, a patented traditional Chinese medicine product for injection, and over thirty new products to the market. Through the one-stop vertically integrated process of production, from bulk medicine to medicine products, the Company will capitalize on its competitiveness from product diversification and low cost, which will drive and ensure a sustainable development of the Company.

The Directors believe that the pharmaceutical industry will grow even faster in 2007 as a result of the expanding population, growth of elderly population, accelerating pace in urbanization and industrial modernization and the influence of globalized disease in the PRC. The Company holds on to its philosophy of “rewarding the shareholders, benefiting the staff, repaying the society and strengthening the enterprise” so as to establish an environment with good faith, innovation, harmony and autonomy for its development. Under the upward trend of the pharmaceutical industry, the Company is equipped with the prerequisites for rapid and continued development to bring about substantial and rapid growth which in turn will generate substantial profits and returns. As a result, the Company is trying its best to realize the business objectives as stated in its prospectus.

CORPORATE GOVERNANCE REPORT

Pursuant to Rule 18.44(2) of the GEM Listing Rules, the Board presents 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. During the year, the Company has complied with all the code provisions of the Code on Corporate Governance Practices contained in Appendix 15 of the GEM Listing Rules (the "Code").

The Board

The Board comprises 4 executive Directors, namely, Mr. Liu Baoqi, Mr. Liu Zhenhai, Ms. Li Minghua and Mr. Han Fengsheng 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. Li Hongjian. As the Company was 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 supervisors and their respective relationships (if any) have been set out in the section "Profiles of Directors, supervisors 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 current term of the Directors (including non-executive Directors) is for a period of 3 years running from 30 November 2004, being the date of the general meeting approving the appointments of Directors in respect of the second session of the Board.

The Board is responsible for the overall strategic development and overall management and operation 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, results of each reporting 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 are given reasonable time to review information and sufficient time for consideration. The Chairman is responsible for preparing the agenda of the Board meetings.

Moreover, the Board also meets regularly to discuss the daily operation issue of the Company. For those non-executive and independent non-executive Directors who are not personally present at such Board meetings, conference calls are used so as to enable the Company take advice actively from them.

Appointment of directors

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

Executive Directors were appointed based on their expertise and are responsible for different areas of the Company's business. The non-executive Directors and supervisors were mostly appointed as a result of the nominations made by certain initial management shareholders, promoters or staff union, who could monitor to the decisions of the Board and operation of the Company.

The independent non-executive directors also serve important roles 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 GEM 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 and are entitled to access to independent professional advice pursuant to the internal policies of the Company. During the year, the Board approved the appointments of Mr. Han Fengsheng as executive Director, Ms. Li Hongjian as independent non-executive Director and the resignation of Ms. Shao Youmei as independent non-executive Director.

Board Meetings

During year 2006, the Board has held 5 meetings. Directors were given sufficient time to review documents and information relating to matters that which had been discussed during such meetings.

Details of Directors' attendance at Board meetings held in 2006 are as follows:

Board Meetings			**Dates of meetings**		
Executive Directors	22 March 2006	9 May 2006	8 August 2006	24 October 2006	30 November 2006
Mr. Liu Baoqi	✓	✓	✓	✓	✓
Mr. Liu Zhenhai	✓	✓	✓	✓	✓
Ms. Li Minghua	✓	✓	✓	✓	✓
Mr. Wang Qingyu (Note A)	✓	N/A	N/A	N/A	N/A
Mr. Han Fengsheng (Note B)	N/A	N/A	N/A	N/A	N/A
Non-executive Directors					
Mr. Zhou Wuxian	✓	✓	✓	✓	×
Mr. Yin Chuangui	✓	✓	✓	✓	✓
Mr. Liu Yuxin	✓	✓	✓	✓	✓

Board Meetings			**Dates of meetings**		
Independent non-executive Directors	22 March 2006	9 May 2006	8 August 2006	24 October 2006	30 November 2006
Mr. Foo Tin Chung, Victor	✓	✓	✓	✓	×
Mr. Fu Hongzheng	✓	✓	✓	✓	✓
Ms. Shao Youmei (Note C)	×	×	×	×	×
Ms. Li Hongjian (Note D)	N/A	N/A	N/A	N/A	N/A

Notes:

A. *Mr. Wang Qingyu passed away on 2 May 2006.*

B. *Mr. Han Fengsheng was only appointed as executive Director on 30 November 2006.*

C. *Ms. Shao Youmei was unable to attend the meetings for health reason.*

D. *Ms. Li Hongjian was only appointed as independent non-executive Director on 30 November 2006.*

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 year ended 31 December 2006.

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". During the year ended 31 December 2006, Mr. Liu Baoqi served as the chairman of the Board and Ms. Li Minghua served as the general manager and chief executive officer of the Company.

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 November 2005 and its members during the year ended 31 December 2006 include:

Mr. Foo Tin Chung, Victor *(Chairman)*
Mr. Fu Hongzheng
Ms. Shao Youmei (Resigned on 30 November 2006)
Ms. Li Hongjian (Appointed on 30 November 2006)

The Company established an audit committee (the "Audit Committee") with written terms of reference in compliance with paragraph C3 of the Code. 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 bridge of communication between the Board and the auditors in relation to the planning and scope of audit work. During the year, the Audit Committee reviewed the audited results of the Company for the year ended 31 December 2005 and three unaudited interim results for periods ended 31 March, 30 June and 30 September 2006. The audited results of the Company for the year have been reviewed by the Audit Committee.

During the year ended 31 December 2006, the Audit Committee held five meetings and details of attendances of the meetings are shown below:

Audit Committee Meetings			**Dates of meetings**		
	23 January	15 March	8 May	7 August	23 October
Mr. Foo Tin Chung, Victor	✓	✓	✓	✓	✓
Mr. Fu Hongzheng	✓	✓	✓	✓	✓
Ms. Shao Youmei (Note A)	×	×	×	×	×
Ms. Li Hongjian (Note B)	N/A	N/A	N/A	N/A	N/A

Notes:

A. *Ms. Shao Youmei was unable to attend the Audit Committee meetings on 23 January, 15 March, 8 May, 7 August and 23 October 2006 for health reasons.*

B. *Ms. Li Hongjian was only appointed on 30 November 2006*

Remuneration Committee

The Remuneration Committee is established in December 2005 and its members during the year ended 31 December 2006 include:

Mr. Foo Tin Chung, Victor *(Chairman)*
Mr. Fu Hongzheng
Ms. Shao Youmei (Resigned on 30 November 2006)
Ms. Li Hongjian (Appointed on 30 November 2006)

The Company established a remuneration committee (the "Remuneration Committee") with written terms of reference in compliance with paragraph B1 of the Code. 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 both Fu Hongzheng and Ms. Li Hongjian are both experienced medical professionals in the PRC.

During the year ended 31 December 2006, the Remuneration Committee held 3 meetings and details of the attendances of the meetings are shown below:

Remuneration Committee Meetings		**Dates of meeting**	
	8 May	7 August	23 October
Mr. Foo Tin Chung, Victor	✓	✓	✓
Mr. Fu Hongzheng	✓	✓	✓
Ms. Shao Youmei (Note A)	×	×	×
Ms. Li Hongjian (Note B)	N/A	N/A	N/A

Notes:

A. Ms. Shao Youmei was unable to attend the Remuneration Committee meetings on 8 May, 7 August and 23 October 2006 for health reasons.

B. Ms. Li Hongjian was only appointed on 30 November 2006.

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 has appointed the IR division of Quam (H.K.) Limited as the company's investor relationship service provider. All of the company's investor relationship information could be found on:

http://www.quamir.com/JSOD/jsp/e/ipo.jsp?lang=e&code=8058

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 year ended 31 December 2006, the Board has reviewed the engagement of auditors and their remuneration. The auditor of the Company would receive approximately HK$390,000 for audit and audit related services and HK$260,000 for other services.

Internal Control

The Board is also responsible for the regular review of the internal control policies of the Company. Senior Management are required to work in accordance with the internal control policies and procedures implemented by the Company. The Company has developed and established the Internal Control Policies and Procedures prior to the listing of the H Shares of the Company on GEM in December 2005. This set of policies and procedures monitors the operation of the Company in 3 areas, namely: sales and accounts receivables cycles, purchase & accounts payables cycles, and other policies & procedures, including statutory and regulatory reporting and disclosure requirements. Emphasis has been placed on the level of approval on the utilization of the Company resources and compliance with financial reporting and disclosure requirements. 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.

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 is pleased to present the report of the Directors for the year ended 31 December 2006 (the “year”).

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 34 of this annual report.

The directors recommended the payment of a final dividend of RMB0.02 per ordinary share, totalling RMB12,192,000. Such recommendation is subject to the approval of the shareholders of the Company at the forthcoming annual general meeting of the Company.

Reserves

Movements in the reserves of the Company during the year are set out in note 28 to the accounts.

Property, plant and equipment

Details of the movements in property, plant and equipment of the Company are set out in note 17 to the accounts.

Share capital

Details of the movements in share capital of the Company are set out in note 27 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 2006, amounted to RMB95,260,000 (2005: RMB53,326,000).

Four years financial summary

A summary of the results and of the assets and liabilities of the Company for the last four financial years is set out on page 66 of this annual report.

Comparison between business objectives and actual business progress

Set out below is a summary of comparison between objectives and actual business progress:

Business objectives as states in the Prospectus for the year	**Actual business progress as at 31 December 2006**
Enhance and upgrade production facilities	
1. Complete the construction and submit the application if GMP accreditation for the new extraction workshop for herbal medicines	Not yet commenced, due to stricter steps and longer time to obtain production permit from relevant authorities
2. Install new production equipment utilising the solvent crystalisation technology in its bulk medicines workshop	Under planning and expected to be finished by the second half year of 2007.
3. Expand the production capacity of the powder for injection workshop through the installation of a new production line and ancillary production equipment	Completed and has commenced production since September 2006
4. Obtain the GMP accreditation for the new extraction workshop for herbal medicines	Not yet commenced as the Company is still arranging adjacent piece of land for this worshop.
5. Expand the production capacity of the lyophilized powder for injection workshop through the installation of a new production line and ancillary production equipment	Completed and has commenced production since September 2006.

Business objectives as states in the Prospectus for the year	**Actual business progress as at 31 December 2006**
Increase the coverage of its marketing and sales network and its customer base in the PRC	
1. Enlarge sales and marketing team by employing additional 50 sales and marketing staff from different cities in the PRC	The 50 sales and marketing staff are now carrying out their duty in the market
2. Participate in National Pharmacy Exchange Fairs (國家藥品交流會) in the fist quarter of 2006	Participated in National Pharmacy Exchange Fairs (國家藥品交流會) in Zhengzhou in Henan Province.
3. Promote the Company's medicine products in different cities in the PRC through advertising in multi-media channels and participating some target customer oriented promotion activities, including trade fairs, seminars, exhibitions for medicine products and press conferences	Promoted the Company's medicine products in different cities in the PRC through advertising in the multi-media channels and participating some target customer oriented promotion activities, including trade fairs, seminars, exhibitions for medicine products and press conferences.
4. Provide training seminars to sales and marketing staff to enhance their knowledge on the Company's new medicine products and latest market information	Provided training seminars to sales and marketing staff to enhance their knowledge on the Company's new medicine products and latest market information
5. Employ marketing experts to help promote the Company's medicine products	Recruited two marketing experts to help promote the Company's medicine products
6. Participate in National Pharmacy Exchange Fairs (國家藥品交流會) in the last quarter of 2006	Participated in National Pharmacy Exchange Fairs (國家藥品交流會)in Harbin in Heilongjiang Province and Shenzhen in Guangdong Province, PRC
7. Promote the corporate image of the Company through advertising in multi-media channels and charity activities	Promoted the corporate image of the Company through advertising on medicine newspaper and local TV weather news report.
8. Evaluate and design promotion strategies for company's medicine products	Commenced to employ consultants to give advice on promotion strategies for Company's medicine products.

Business objectives as states in the Prospectus for the year	**Actual business progress as at 31 December 2006**
Broaden its product range	
1. Commence the clinical research for Rhodiola for Injection and submit the application for the production approval of Rhodiola for Injection	Patent in respect of Rhodiola for injection was obtained by the Group on 10 May 2006. The Company is in the process of obtaining the production approval for Rhodiola for Injection
2. Obtain the production approval of Rhodiola for Injection	Not yet commenced, due to stricter steps and longer time to obtain production permit from relevant authorisations.

Use of proceeds

The net proceeds raised from the placing of the company's H Shares on GEM on 9 December 2005 were approximately HK$31.5 million. The planned usage of proceeds stated in prospectus were based on placing price of HK$0.35 with 164,560,000 H shares issued of which 14,960,000 H shares were converted from domestic shares of the Company. The final placing price of the H Shares was determined at HK$0.26. Therefore, the proceeds form the placing were reduced.

The revised total cost of implementation of business plan was RMB32.76 million (or HK$31.5 million at exchange rate of 1.04 with RMB). With this total, RMB25.42 million will be spent on the enhancement and upgrading of production facilities; RMB4.59 million will be spent on increasing the coverage of its marketing and sales network and its customers base in the PRC; and RMB2.75 million will be spent on the broadening its product range. Insufficient funds will be supported with the Company's internal resources. The Directors are of the view that the current retained earnings level and support from the banks will provide sufficient resources to pay the said deficient funds.

		Costs for the implementation of business plan as at 31 December 2006 as set out in the prospectus HK$' million/ RMB million	**Amount of net proceeds to be used as at 31 December 2006 as revised** RMB million	**Actual amount of net proceeds spent as at 31 December 2006** RMB million	**Company's contribution on the implementation of business plan** RMB million
1.	Enhance and upgrade production facilities	26.80/27.87	25.42	4.6	9.39
2.	Increase the coverage of its marketing and sales network and its customer base in the PRC	4.6/4.78	4.59	4.59	0.26
3.	Broaden its product range	2.8/2.9	2.75	0.47	0.29

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) (Deceased on 2 May 2006)
Han Fengsheng (韓風生) (Appointed on 30 November 2006)

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) (Resigned on 30 November 2006)
Foo Tin Chung, Victor (傅天忠)
Li Hongjian (李宏健) (Appointed on 30 November 2006)

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 running from 30 November 2004, being the date of the general meeting of the Company which approved the appointments of the Directors of the second session of the Board.

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. Wang passed away on 2 May 2006.

Mr. Han Fengsheng (韓風生), an executive Director was appointed on 30 November 2006

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, had retired and been re-elected on 30 November 2004. Ms. Shao resigned on 30 November 2006.

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

Ms. Li Hongjian (李宏建), an independent non-executive Director, was appointed on 30 November 2006.

Directors' service contracts

Each of the executive Directors, non-executive 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 2006, 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 2006

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. 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 2006, 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 2006

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 (曹婷婷), Liu Zhendong (劉振東), Chen Weiwei (陳偉偉), 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.

Contracts of Significance

During the year, no contract of significance was entered into between the Company and its controlling shareholder.

Management Contracts

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

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	23.6%
— five largest suppliers combined	55.4%
Sales	
— the largest customer	16.6%
— five largest customers combined	31.9%

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

During the year ended 31 December 2006, the Company did not engage in or enter into any transaction which will constitute connected transaction under the 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 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

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

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 2006, as notified by the Company's compliance adviser, Kingsway Capital Limited (the "Compliance Adviser") pursuant to Rule 6A.32 of the GEM Listing Rules, neither the Compliance Adviser nor any of its directors, employees or associates 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.

Change of Auditors

There has been change in the auditors of the Company on 26 May 2006. The terms of service with PricewaterhouseCoopers as auditors of the Company expired upon the conclusion of the annual general meeting of the Company held on 26 May 2006 (the "Annual General Meeting") and PricewaterhouseCoopers did not seek re-appointment at the Annual General Meeting. PricewaterhouseCoopers did not seek re-appointment by the Company due to the fact that PricewaterhouseCoopers and the Board could not reach a consensus on the audit fee for the year ending 31 December 2006. PricewaterhouseCoopers had provided the Company a confirmation stating that there were no circumstances connected with the expiry of their term of service that they considered should be brought to the notice of the shareholders of the Company or the Stock Exchange. Prior to the expiry of their term of service, PricewaterhouseCoopers did not engage in any audit work in respect of the accounts of the Company for the year ending 31 December 2006.

The Board has then appointed HLB Hodgson Impey Cheng as new auditors of the Company at the Annual General Meeting. The appointment will expire upon the conclusion of the Company's forthcoming general meeting.

REPORT OF THE DIRECTORS

Auditors

The accounts have been audited by HLB Hodgson Impey Cheng who retire and, being eligible, offer themselves for re-appointment at the forthcoming annual general meeting.

On behalf of the Board
Liu Baoqi
Chairman

Hong Kong, 13 March 2007

INDEPENDENT AUDITORS' REPORT

HLB 國衛會計師事務所
Hodgson Impey Cheng

Chartered Accountants
Certified Public Accountants

31/F Gloucester Tower
The Landmark
11 Pedder Street
Central
Hong Kong

INDEPENDENT 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 financial statements of Shandong Luoxin Pharmacy Stock Co., Ltd (the "Company") set out on pages 34 to 65 which comprise the balance sheet as at 31 December 2006, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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

AUDTIORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

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

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

INDEPENDENT AUDITORS' REPORT

OPINION

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

HLB Hodgson Impey Cheng
Chartered Accountants
Certified Public Accountants

Hong Kong, 13 March 2007

INCOME STATEMENT

For the year ended 31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
Turnover, net	*6*	**317,868**	249,689
Cost of sales		**(175,905)**	(144,289)
Gross profit		**141,963**	105,400
Other revenue	*6*	**2,565**	1,548
Other income	*7*	**2,961**	—
Selling and distribution expenses		**(23,637)**	(21,879)
General and administrative expenses		**(24,955)**	(21,511)
Profit from operations	*7*	**98,897**	63,558
Finance costs	*8*	**(7,679)**	(7,142)
Profit before taxation		**91,218**	56,416
Income tax expense	*9*	**(31,049)**	(19,486)
Profit attributable to shareholders		**60,169**	36,930
Dividends	*10*	**12,192**	12,192
Earnings per share (RMB)			
— Basic and diluted	*14*	**0.099**	0.079

All of the company's operations are classed as continuing.

The accompanying notes form an integral part of these financial statements.

BALANCE SHEET

As at 31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
Non-current assets			
Purchased technical know-how	*15*	**2,719**	2,908
Prepayments to acquire technical know-how	*16*	**11,260**	8,155
Property, plant and equipment	*17*	**110,716**	67,025
Construction-in-progress	*18*	**—**	16,064
Land use rights	*19*	**1,812**	1,852
Deferred tax assets	*20*	**3,309**	4,594
		129,816	100,598
Current assets			
Inventories	*21*	**74,926**	38,803
Trade and bills receivables	*22*	**38,119**	27,550
Other receivables, deposits and prepayments		**16,438**	23,278
Pledged bank deposits	*23*	**22,233**	7,478
Cash and cash equivalents	*23*	**117,391**	155,503
		269,107	252,612
Current liabilities			
Trade and bills payables	*24*	**43,001**	19,948
Other payables and accruals		**34,096**	37,006
Deposits received		**5,940**	4,918
Taxation payable		**5,305**	1,734
Short-term bank loans	*25*	**78,700**	105,700
		167,042	169,306
Net current assets		**102,065**	83,306
Total asset less current liabilities		**231,881**	183,904
Non-current liabilities			
Deferred income	*26*	**20,380**	20,380
Total assets and liabilities		**211,501**	163,524
Capital and reserves			
Share capital	*27*	**60,960**	60,960
Reserves (including proposed final dividend of RMB12,192,000 (2005: RMB12,192,000)	*28*	**150,541**	102,564
Total equity		**211,501**	163,524

Approved by the Board of Directors on 13 March 2007 and signed on as behalf by:

Liu Baoqi
Director

Liu Zhenhai
Director

The accompanying notes form an integral part of these financial statements.

STATEMENTS OF CHANGES IN EQUITY

For the year ended 31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
Total equity, beginning of the year		**163,524**	93,835
Profit attributable to shareholders		**60,169**	36,930
Net proceeds from issuance of new shares	*27, 28*	**—**	32,759
Dividend paid		**(12,192)**	—
Total equity, end of the year		**211,501**	163,524

The accompanying notes form an integral part of these financial statements.

CASH FLOW STATEMENT

For the year ended 31 December 2006

	Notes	2006 RMB'000	2005 RMB'000
Cash flows from operating activities			
Profit before taxation		**91,218**	56,416
Interest income		**(1,263)**	(1,548)
Interest expense		**(1,678)**	—
Reversal of impairment loss recognised in respect of trade receivables		**7,679**	7,142
Reversal of impairment loss recognised in respect of obsolute and slow moving inventories		**1,283**	—
Depreciation		**7,628**	5,027
Loss on disposal of property, plant and equipment		**66**	460
Impairment loss recognised in respect of obsolute and slow moving inventories		**742**	1,635
Impairment loss recognised in respect of trade receivables		**489**	1,026
Amortisation of prepaid operating lease payments		**40**	40
Amortisation of purchased technical know-how		**1,139**	882
Operating profit before working capital changes		**107,343**	71,080
Increase in inventories		**(38,148)**	(6,174)
Increase in trade and bills receivables		**(9,820)**	(12,394)
Decrease/(increase) in other receivables, deposits and prepayments		**7,280**	(3,720)
Increase/(decrease) in trade and bills payables		**23,053**	(19,043)
(Decrease)/increase in other payables and accruals		**(1,888)**	16,799
Net cash generated from operating activities		**87,820**	46,548
Interest received		**1,263**	1,548
Interest paid		**(7,679)**	(7,142)
PRC income tax paid		**(26,193)**	(19,023)
Net cash generated from operating activities		**55,211**	21,931
Cash flows from investing activities			
Purchase of property, plant and equipment		**(35,437)**	(9,008)
Additions of construction-in-progress		**—**	(36,716)
Proceeds from sales of property, plant and equipment		**116**	66
Purchase of technical know-how		**(950)**	(1,500)
Decrease/(increase) in prepayments to acquire technical know-how		**(3,105)**	850
Net cash used in investing activities		**(39,376)**	(46,308)
Cash flows from financing activities			
Proceeds from issue of shares		**—**	40,452
Shares issuance costs		**—**	(7,693)
Dividend paid		**(12,192)**	—
New bank loans	29	**86,000**	118,800
Repayment of bank loans	29	**(113,000)**	(117,290)
(Increase)/decrease in pledged bank deposits		**(14,755)**	36,651
Net cash (used in)/generated from financing activities		**(53,947)**	70,920
Net (decrease)/increase in cash and cash equivalents		**(38,112)**	46,543
Cash and cash equivalents, beginning of the year		**155,503**	108,960
Cash and cash equivalents, end of the year		**117,391**	155,503
Analysis of the balances of cash and cash equivalents Cash and bank balances		**117,391**	155,503

The accompanying notes form an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2006

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 reorganization and was transformed into a joint stock limited liability 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 GEM since 9 December 2005.

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

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

The financial statements are presented in thousands of units of Renminbi (RMB'000), unless otherwise stated.

2. ADOPTION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

The Hong Kong Institute of Certified Public Accountants (the "HKICPA") has issued certain new standards, amendments and interpretations to existing standards have been published that are mandatory for accounting periods beginning on or after 1 January 2006. A summary of the effect on initial adoption of these new and revised HKFRSs is set out below:

HKAS 19 (Amendment)	Employee Benefits
HKAS 21 (Amendment)	Net Investment in a Foreign Operation
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 (Amendment)	The Fair Value Option
HKAS 39 & HKFRS 4 (Amendments)	Financial Guarantee Contracts
HKFRSs 1 & 6 (Amendments)	First-time Adoption of Hong Kong Financial Reporting Standards and Exploration for and Evaluation of Mineral Resources
HKFRS 6	Exploration for and Evaluation of Mineral Resources
HKFRS-Int 4	Determining whether an Arrangement contains a Lease
HKFRS-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
HK(IFRIC)-Int 6	Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment

2. ADOPTION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs") (Continued)

The adoption of above new/revised HKFRSs did not result in substantial changes to the Company's accounting policies and has no material impact on the Company's financial statements.

No early adoption of the following new standards or interpretations that have been issued but are not yet effective.

HKAS 1 (Amendment)	Capital Disclosures[1]
HKFRS 7	Financial Instruments: Disclosures[1]
HK(IFRIC) — Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies[2]
HK(IFRIC) — Int 8	Scope of HKFRS 2[3]
HK(IFRIC) — Int 9	Reassessment of Embedded Derivatives[4]
HK(IFRIC) — Int 10	Interim Financial Reporting and Impairment[5]
HK(IFRIC) — Int 11	HKFRS 2 — Group and Treasury Share Transactions[6]

1 Effective for annual periods beginning on or after 1 January 2007
2 Effective for annual periods beginning on or after 1 March 2006
3 Effective for annual periods beginning on or after 1 May 2006
4 Effective for annual periods beginning on or after 1 June 2006
5 Effective for annual periods beginning on or after 1 November 2006
6 Effective for annual periods beginning on or after 1 March 2007

The Company expects that the adoption of the other pronouncements listed above will not have any significant impact on the Company's financial statements in the period of initial application.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of preparation

The financial statements have been prepared in accordance with all applicable HKFRSs, which is a collective term that includes all applicable individual HKFRSs, Hong Kong Accounting Standards ("HKASs"), and interpretations ("Ints") issued by the HKICPA, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. In addition, the financial statements comply with the applicable disclosure provisions of the GEM Listing Rules of the Stock Exchange.

The financial statements have been prepared on the historical cost basis except for certain financial assets and financial liabilities, which are measured at fair values.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Property, plant an 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 3(e)).

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

(c) 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Purchased technical know-how

Purchased technical know-how is stated at cost less accumulated amortization 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.

(e) 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 amortization 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.

(f) 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.

(g) 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 application variable selling expenses.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) 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.

(i) 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.

(j) 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.

(k) 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(l) 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.

(m) Deferred income tax

Deferred income tax is provided in full, suing 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 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.

(n) 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.

(o) 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) 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.

(q) 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.

(r) Foreign and presentation currency

(i) 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.

(ii) 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.

(s) 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(t) 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.

(u) Related Party transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals (being member of key management personnel, significant shareholders and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties.

4. FINANCIAL RISK MANAGEMENT

4.1 Financial risk factors

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

The risk management is carried out by the Company's Directors. They identify, evaluate and minimize 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.

4. FINANCIAL RISK MANAGEMENT (Continued)

4.1 Financial risk factors (Continued)

(b) Credit risk

As at 31 December 2005 and 2006, approximately 32.8% and 31.5% 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 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.

(d) Interest rate risk

The Company has significant interest-bearing assets mainly in the form of cash and cash equivalents. As a result, the Company is exposed to changes in market interest rate.

4.2 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 and bills payables, short-term borrowings, deposit received and other payables and accruals approximately 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.

5. 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 asset 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(e). 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 tax 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.

(c) Useful lives of property, plant and equipment

In accordance with HKAS 16, the Company estimates the useful lives of fixed assets in order to determine the amount of depreciation expenses to be recorded. The useful lives are estimated at the time the asset is acquired based on historical experience, the expected usage, wear and tear of the assets, as well as technical obsolescence arising from changes in the market demands. The Company also performs annual reviews on whether the assumptions made on useful lives continue to be valid.

(d) Trade and other receivables

The aged debt profile of trade and other receivables are reviewed on a regular basis to ensure that the trade and other receivables balances are collectible and follow up actions are promptly carried out if the agreed credit periods have been exceeded. However, from time to time, the Company may experience delays in collection. Where recoverability of trade debtor balances are called into doubts, specific provisions for bad and doubtful debts are made based on credit status of the customers, the aged analysis of the trade receivables may be initially identified as collectible, yet subsequent write-off of the related receivable to the income statement. Changes in the collectibility of trade and other receivables for which provisions are not made could affect our results of operations.

6. TURNOVER AND OTHER 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.

Turnover and other revenue recognised are as follows:

	2006	2005
	RMB'000	RMB'000
Turnover, net		
Sales of manufactured goods	**317,868**	249,689
Other revenue		
Interest income on bank deposits	**1,263**	1,548
Sundry income	**1,302**	—
	2,565	1,548
Total revenue	**320,433**	251,237

7. PROFIT FROM OPERATIONS

	2006 RMB'000	2005 RMB'000
Operating profit of the Company was determined after charging (crediting) the following:		
Raw materials and consumables used	**174,564**	132,613
Changes in inventories of finished goods and work in progress	**(17,025)**	(2,538)
Depreciation (Note 17)	**7,628**	5,027
Loss on disposal of property, plant and equipment	**66**	460
Amortisation of prepaid lease payment (Note 19)	**40**	40
Amortisation of purchased technical know-how (included in cost of sales) (Note 15)	**1,139**	882
Impairment loss recognised in respect of obsolete and slow-moving inventories (included in cost of sales)	**390**	817
Impairment loss recognised in respect of trade receivables (Note 22)	**489**	1,347
Impairment loss recognised in respect of other receivables, deposits and prepayments	**1,253**	—
Employees benefit expenses (Note 11)	**29,811**	27,009
Research and development costs	**4,490**	5,806
Advertising costs	**2,236**	2,819
Auditors' remuneration	**390**	676
Other income:		
Reversal of impairment loss recognised in respect of obsolete and slow-moving inventories	**1,283**	—
Reversal of impairment loss recognised in respect of on trade receivables (Note 22)	**1,678**	—
	2,961	—

8. FINANCE COSTS

	2006 RMB'000	2005 RMB'000
Bank loans wholly repayable within five years	**7,679**	7,142

9. 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 subject to the PRC enterprise income tax at a rate of 33%.

(iii) The PRC value-added tax

The Company is subject 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:

	2006 **RMB'000**	2005 RMB'000
Current taxation — Enterprise income tax	**29,764**	19,820
Deferred taxation (Note 20)	**1,285**	(334)
	31,049	19,486

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:

	2006 **RMB'000**	2005 RMB'000
Profit before taxation	**91,218**	56,416
Calculated at a taxation rate of 33%	**30,102**	18,617
Income not subject to tax	**(902)**	—
Expenses not deductible for taxation purposes	**1,849**	869
Taxation charge	**31,049**	19,486

10. DIVIDENDS

A dividend in respect of 2006 of RMB0.02 per share, amounting to a total dividend of RMB12,192,000 (2005: RMB12,192,000) is to be proposed at the annual general meeting of the Company on 22 May 2007. These financial statements do not reflect this dividend payable.

	2006	2005
	RMB'000	RMB'000
Proposed final dividend of RMB0.02 (2005: RMB0.02) per ordinary share	**12,192**	12,192

11. EMPLOYEES BENEFIT EXPENSES

	2006	2005
	RMB'000	RMB'000
Salaries and wages	**14,257**	8,887
Sales commission	**9,500**	14,199
Pension costs — defined contribution plans	**2,725**	2,398
Other staff benefits	**2,536**	1,525
	29,013	27,009

12. 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 2006, the Company has contributed approximately RMB24,000 (2005: RMB9,000) to the MPF Scheme.

13. 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:

	2006 **RMB'000**	2005 RMB'000
Basic salaries and allowances	**682**	596
Retirement benefit costs	**88**	63
	770	659

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

	2006 **RMB'000**	2005 RMB'000
Executive directors		
Liu Baoqi	**130**	130
Liu Zhenhai	**106**	106
Li Minghua	**127**	127
Wang Qingyu	**28**	67
Han Fengsheng	**7**	—
Non-executive directors		
Zhou Wuxian	**24**	2
Yin Chuangui	**24**	2
Liu Yuxin	**24**	2
Independent non-executive directors		
Foo Tin Chung Victor	**120**	91
Fu Hongzheng	**24**	2
Shao Youmei	**22**	2
Li Hongjian	**2**	—
Supervisors		
Sun Song	**60**	84
Zhu Enqiang	**24**	34
Li Yonggang	**24**	5
Gao Xiaoling	**24**	5
	770	659

None of the directors waived any emoluments during the year.

13. DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

(Continued)

(ii) The five individuals whose emoluments were the highest in the Company for the year include one (2005: four) director 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 four (2005: one) individuals during the year are as follows:

	2006 RMB'000	2005 RMB'000
Basic salaries and allowances	**1,312**	341
Retirement benefit costs	**95**	9
	1,407	350

The emoluments fell within the following bands:

	Number of individuals	
	2006	2005
Emolument bands		
Nil — RMB1,030,000 (equivalent to Nil — HK$1,000,000)	**4**	1

(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 (2005: Nil).

14. 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.

	2006	2005
Profitable attributable to shareholders of the Company (RMB'000)	**60,169**	36,930
Weighted average number of ordinary shares in issue ('000)	**609,000**	469,427
Basic earnings per share (RMB per share)	**0.099**	0.079

Diluted earnings per share has been presented even though there were no dilutive potential ordinary shares outstanding during the year ended 31 December 2006.

15. PURCHASED TECHNICAL KNOW-HOW

	RMB'000
Cost	
At 1 January 2005	12,850
Additions	1,500
At 31 December 2005 and at 1 January 2006	14,350
Additions	950
At 31 December 2006	**15,300**
Accumulated amortisation and impairment losses	
At 1 January 2005	10,560
Charge for the year	882
At 31 December 2005 and at 1 January 2006	11,442
Charge for the year	1,139
At 31 December 2006	**12,581**
Net book value	
At 31 December 2006	**2,719**
At 31 December 2005	2,908

16. PREPAYMENTS TO ACQUIRE TECHNICAL KNOW-HOW

As at 31 December 2006, included in prepayments to acquire technical know-how were amounts prepaid to a shareholder and a related company and details are as follows:

	2006 **RMB'000**	2005 RMB'000
— Shenyang Pharmacy University, a shareholder	**4,500**	4,500
— Shenyang Bohong Pharmaceutical Technology Development Co., Ltd., a company owned by a shareholder	**1,700**	1,700
	6,200	6,200

As at 31 December 2006, 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 (2005: RMB9,300,000).

17. PROPERTY, PLANT AND EQUIPMENT

	Buildings RMB'000	Plant and machinery RMB'000	Motor vehicles RMB'000	Office equipment RMB'000	Total RMB'000
Cost:					
At 1 January 2005	19,172	26,866	2,788	3,945	52,771
Additions	1,891	4,218	2,475	424	9,008
Disposals	(681)	—	—	(64)	(745)
Transfer from construction in progress (Note 18)	2,964	17,580	—	108	20,652
At 31 December 2005 and 1 January 2006	23,346	48,664	5,263	4,413	81,686
Additions	2,590	3,201	1,451	1,458	8,700
Disposals	—	(634)	(173)	—	(807)
Transfer from construction in progress (Note 18)	36,534	6,740	—	—	43,274
At 31 December 2006	**62,470**	**57,971**	**6,541**	**5,871**	**132,853**
Accumulated depreciation and impairment:					
At 1 January 2005	1,060	5,814	1,221	1,758	9,853
Charge for the year	517	2,997	774	739	5,027
Written back on disposals	(192)	—	—	(27)	(219)
At 31 December 2005 and 1 January 2006	1,385	8,811	1,995	2,470	14,661
Charge for the year	776	4,915	1,086	851	7,628
Written back on disposals	—	(56)	(96)	—	(152)
At 31 December 2006	**2,161**	**13,670**	**2,985**	**3,321**	**22,137**
Net book value:					
At 31 December 2006	**60,309**	**44,301**	**3,556**	**2,550**	**110,716**
At 31 December 2005	21,961	39,853	3,268	1,943	67,025

Plant and machinery with net book value of approximately RMB32,898,000 (As at 31 December 2005: RMB33,166,000) were pledged as collateral to secure bank loans.

As at 31 December 2006, all buildings of the Company are located in the PRC.

Depreciation expense of RMB5,785,000 (2005: RMB3,782,000) have been expensed in cost of sales and RMB1,843,000 (2005: RMB1,245,000) have been included in administrative expenses for the year.

18. CONSTRUCTION-IN-PROGRESS

	RMB'000
At 1 January 2005	—
Additions	36,716
Transfer to property, plant and equipment (Note 17)	(20,652)
At 31 December 2005 and at 1 January 2006	16,064
Additions	27,210
Transfer to property, plant and equipment (Note 17)	(43,274)
At 31 December 2006	**—**

Analysis of construction-in-progress:

	2006 **RMB'000**	2005 RMB'000
Construction cost of buildings	**—**	15,979
Cost of plant and machinery	**—**	85
	—	16,064

19. 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 2005	1,892
Amortisation of prepaid operating lease payments	(40)
At 31 December 2005 and at 1 January 2006	1,852
Amortisation of prepaid operating lease payments	(40)
At 31 December 2006	**1,812**

20. 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:

	2006 **RMB'000**	2005 RMB'000
Beginning of the year	**4,594**	4,260
Deferred taxation credited to income statement (Note 9)	**(1,285)**	334
End of the year	**3,309**	4,594

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 2005	1,490	2,060	710	4,260
Credited/(charged) to income statement	722	(158)	(230)	334
At 31 December 2005 and at 1 January 2006	2,212	1,902	480	4,594
Charged to income statement	(800)	(411)	(74)	(1,285)
At 31 December 2006	**1,412**	**1,491**	**406**	**3,309**

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

There was no unprovided deferred taxation during the year.

21. INVENTORIES

	2006 RMB'000	2005 RMB'000
Raw materials	**33,513**	13,795
Work-in-progress	**26,560**	9,093
Finished goods	**15,595**	17,550
	75,668	40,438
Less: Impairment loss in respect of absolute and slow-moving inventories	**(742)**	(1,635)
	74,926	38,803

The cost of inventories recognised as expense and included in cost of sales amounted to RMB157,359,000 (2005: RMB144,289,000).

Movements on the provision for impairment recognised in respect of obsolete and slow-moving inventories

	2006 RMB'000	2005 RMB'000
Balance at beginning of the year	**1,635**	818
Impairment loss recognised during the year	**390**	817
Reversal of impairment loss in respect of obsolete and slow-moving inventories	**(1,283)**	—
Balance at end of the year	**742**	1,635

The directors of the Company had considered the net realisable values and conditions of the Company's inventories as at 31 December 2006 and considered provision for impairment loss in values should be made in respect of the net realisable value.

22. TRADE AND BILLS RECEIVABLES

Details of the aging analysis are as follows:

	2006 RMB'000	2005 RMB'000
1 to 90 days	**31,709**	20,196
91 to 180 days	**5,451**	4,721
181 to 365 days	**1,103**	2,882
Over 365 days	**1,584**	2,668
	39,847	30,467
Less: Provision for impairment of receivables	**(1,728)**	(2,917)
	38,119	27,550

The fair values are based on cash flows discounted using a rate based on the average borrowing rate of 7.47% (2005: 7.23%) 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 2006 are denominated in Renminbi.

Movements on the provision for impairment of trade receivables

	2006 RMB'000	2005 RMB'000
Balance at beginning of the year	**2,917**	1,891
Impairment loss recognised during the year	**489**	1,026
Reversal of impairment loss in respect of trade receivables (note 7)	**(1,678)**	—
Balance at end of the year	**1,728**	2,917

In determining the recoverability of trade receivables, the Company considers any change in the credit quality of the trade receivables from the date credit were initially granted up to the reporting date. Accordingly, the directors considered provision for impairment in values be made in respect of trade receivables to their recoverable values and believe that there is no further credit provision required in excess of the allowance for doubtful debts.

23. PLEDGED BANK DEPOSITS/CASH AND CASH EQUIVALENTS

As at 31 December 2006, the Company's bank deposits of approximately RMB22,233,000 (2005: RMB7,478,000) were pledged as collateral for facilities granted by banks.

The effective interest rate on pledged bank deposits were 0.72% (2005: 0.72%) and have an average maturity of 6 months during the year.

The carrying amount of pledged bank deposits approximately 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.

24. TRADE AND BILLS PAYABLES

Details of the aging analysis are as follows:

	2006 **RMB'000**	2005 RMB'000
1 to 90 days	**31,438**	10,026
91 to 180 days	**6,582**	7,851
181 to 365 days	**1,003**	374
Over 365 days	**3,978**	1,697
	43,001	19,948

Trade and bills payables as at 31 December 2006 are denominated in Renminbi.

The carrying amount of trade and bills payables approximate their fair value.

25. SHORT-TERM BANK LOANS

	2006 **RMB'000**	2005 RMB'000
Short-term bank loans		
— secured (Note 29)	**78,700**	85,700
— unsecured	**—**	20,000
	78,700	105,700

Short-term bank loans are denominated in Renminbi and bear interest at approximately 7.34% to 7.96% per annum (2005: 6.14% to 8.31%).

The fair value are based on cash flows discounted using a rate based on the average borrowing rate of 7.47% (2005: 7.23%) during the year.

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

26. 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 2006, the Company has not commenced the construction of the new manufacturing plant.

27. SHARE CAPITAL

		Nominal value		
	Number of shares	**Domestic shares**	**H shares**	**Total**
	'000	RMB'000	RMB'000	RMB'000
Registered, issued and fully paid				
At 1 January 2005 (nominal value of RMB0.10 each)	460,000	46,000	—	46,000
Domestic shares converted into H shares (Note (i))	—	(1,496)	1,496	—
Issue of new shares upon listing (Note (ii))	149,600	—	14,960	14,960
At 31 December 2005	609,600	44,504	16,456	60,960
At 31 December 2006	**609,600**	**44,504**	**16,456**	**60,960**

Notes:

(i) 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 Stated-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.

(ii) 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.

28. 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 2005	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 and at 1 January 2006	31,139	12,066	6,033	53,326	—	102,564
Profit attributable to shareholders	—	—	—	60,169	—	60,169
Transfer from retained earnings to statutory funds	—	6,043	—	(6,043)	—	—
Dividend paid	—	—	—	(12,192)	—	(12,192)
At 31 December 2006	**31,139**	**18,109**	**6,033**	**95,260**	**—**	**150,541**

Representing:	
Proposed 2006 final dividends	12,192
Others	83,068
Retained earnings as at 31 December 2006	95,260

28. 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.

29. NOTE TO THE CASH FLOW STATEMENTS

Analysis of changes in financing:

	Bank loans
	RMB'000
At 1 January 2005	104,190
New bank loans	118,800
Repayment of bank loans	(117,290)
At 31 December 2005 and at 1 January 2006	105,700
New bank loans	86,000
Repayment of bank loans	(113,000)
At 31 December 2006	**78,700**

30. BANKING FACILITIES

The Company had aggregate banking facilities of RMB100,878,000 (2005: RMB113,123,000) which were fully utilised as at 31 December 2006.

As at 31 December 2006, approximately RMB100,878,000 (2005: RMB93,123,000) of the banking facilities were secured by:

(i) pledge of the Company's property, plant and equipment with net book value of approximately RMB32,898,000 (2005: RMB33,166,000); and

(ii) pledge of bank deposits of RMB22,233,000 (2005: RMB7,478,000).

31. COMMITMENTS

The Company had the following significant capital commitments:

	2006 **RMB'000**	2005 RMB'000
Contracted but not provided for:		
— Purchase of technical know-how	**4,580**	4,115
— Property, plant and machinery	**—**	12,331

As at 31 December 2006, no commitment (2005: RMB3,100,000) are related to acquisition of technical know-how from a shareholder and a company owned by a shareholder (see Note 15).

32. RELATED PARTY TRANSACTIONS

Key management compensation for the year ended 31 December 2006 were disclosed in Note 13(i).

Apart from those disclosed under Notes 16, the Company had no material transactions with related parties during the year.

33. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 13 March 2007.

FOUR YEARS FINANCIAL SUMMARY

	For the Year ended 31 December			
	2006	2005	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000
Results				
Turnover	**317,868**	249,689	169,000	151,057
Cost of sales	**(175,905)**	(144,289)	(71,676)	(71,383)
Gross profit	**141,963**	105,400	97,324	79,674
Other revenue	**2,565**	1,548	2,007	1,078
Other income	**2,961**	—	—	—
Selling and distribution expenses	**(23,637)**	(21,879)	(27,091)	(14,707)
General and administrative expenses	**(24,955)**	(21,511)	(20,003)	(15,701)
Operating profit	**98,897**	63,558	52,237	50,344
Finance costs	**(7,679)**	(7,142)	(5,626)	(5,064)
Profit before taxation	**91,218**	56,416	46,611	45,280
Income tax expense	**(31,049)**	(19,486)	(18,378)	(15,555)
Profit attributable to shareholders	**60,169**	36,930	28,233	29,725
Dividends	**12,192**	12,192	48,182	—
Earnings per share (RMB)	**0.099**	0.079	0.061	0.065

	As at 31 December			
	2006	2005	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000
Assets & Liabilities				
Total assets	**398,923**	353,210	283,458	279,614
Total liabilities	**(187,422)**	(189,686)	(189,623)	(165,830)
Equity attributable to equity holders of the Company	**211,501**	163,524	93,835	113,784