山東羅欣藥業股份有限公司

Shandong Luoxin Pharmacy Stock Co., Ltd.*

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

Stock Code: 8058




ANNUAL REPORT 2007

* For identification purposes only

CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET ("GEM") OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE "STOCK EXCHANGE")

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

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the Main Board and no assurance is given that there will be a liquid market in the securities traded on GEM.

The principal means of information dissemination on GEM is publication on the internet website operated by the Stock Exchange. Listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website in order to obtain up-to-date information on GEM-listed issuers.

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

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

CONTENTS

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 (resigned on 30 November 2007)
Gao Xiaoling
Sun Song
Zhu Enqiang
Guan Yonghua (appointed on 30 November 2007)

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, the 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

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 2007 under review, our Company made great success through dedication and sustained effort of the management and employees. Rapid improvement in results and healthy growth enable our company to move another sound stride. Looking forward to 2008, 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.

In the past year, the Company's development reached its record high in terms of pace and efficiency. Our capability in, among others, management, market network development, technology development, capital operation, elite team building, spiritual civilization development, brand building and goodwill have been improved rapidly, which further strengthened our ability to withstand risks as well as our overall capacity. Upon the imminent commencement of the third phase production capacity expansion project, our products' market share would increase, leading the Company to the development of economies of scale. Since 2006, the Company has been awarded the "Top Ten Medicine Growing Enterprises", and has been one among the top 100 enterprises in the pharmaceutical industry in China for two consecutive years. All in all, our Company achieved bettered results last year, and we showed predominance in various aspects to enable our rapid sustainable development. Our advantages include: 1. attaining remarkable results in successful research and development as well as marketing of state level new medicine; 2. retaining our competitive edge through persistent development of new medicine; 3. management having tremendous experience in operating pharmaceutical enterprises in the PRC; 4. the research and development team of our Company having rich experience and strength in self-research and development, and their collaboration with domestic universities and research institutes constitute a strong backyard for research and development activities; 5. huge marketing network covering 27 provinces and 4 municipalities; 6. the prominent cost advantage achieved by our advance technology, one-stop vertical production from bulk pharmaceutical to finished products and economies of scale. Looking ahead, our Company will capitalized on the above advantages to reinforce innovation, expand capacity and increase market share so as to enhance our profitability and bring fruitful return to our shareholders.

The Directors believe that, as a result of the expansion and growing affluence of the population, the disease spectrum changes accelerated by the rapid pace in urbanization and industrial modernization, the increase in aging population and the influence of globalized disease in the PRC, the pharmaceutical industry will grow even faster in 2008. Particularly with the PRC speeding up her medical system reform, actively introducing new cooperative medical initiatives and sparing no effort in raising people's livelihood will all effectively boost medical treatment and pharmaceutical spending. Such huge market potential will enable well-established enterprises enter into a new period of rapid development. The Ministry of Health has laid down the "2020 Healthy China" (健康中國2020年) plan, which is divided into three stages: in the first stage in 2010, the PRC should establish a systematic sanitary service system covering urban and rural areas; in the second stage, the PRC should have good ranking amongst developing countries in terms of sanitary services by 2015; in the third stage, the PRC's sanitary service should maintain a high standard among developing countries by 2020, and it is hoped that she can match the standard of those medium level developed countries. At present, the population of the PRC is over 1.3 billion, which is about 4.5 times of that of the United States. The current level of medical consumption in the PRC only accounts for 1% of the GDP, whereas that of the United States accounts for 15% of the GDP. If the three-stage plan is materialised, the PRC's pharmaceutical consumption will move into a surging period, which will enable the rapid development of those pharmaceutical enterprises which have potential.

CHAIRMAN'S STATEMENT

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 increasing the market share of its products. Our Company will further enhance its competitive edges in terms of differentiation and core competitiveness of our enterprise. Our Company will also step up the production of patented products with 3-high features, namely high-tech, high quality and high-value added products, as well as the high-end and large-scale 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 been devoting their efforts to facilitate the growth of the Company and have been giving tremendous support for the advancement of the Company.

Liu Baoqi
Chairman

4 March 2008

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS

Mr. Liu Baoqi (**劉保起**), aged 46, is an executive Director and the chairman of the Company. He is responsible for the strategic planning and overall management of the Company. Mr. Liu completed his tertiary education 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 a pharmacist. He has about 18 years of experience in the medical and pharmaceutical industry in the PRC. Mr. Liu joined Shandong Luoxin Factory (the predecessor of the Company) in1995. Before joining Shandong Luoxin Factory, Mr. Liu worked for Linyi Luozhuang Pharmacy Company ("Linyi Luozhuang", the predecessor of Linyi Luoxin Pharmacy Company Limited ("Linyi Luoxin")) from 1988 to 1995. Mr. Liu was named an 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 32, 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 12 years of experience in the medical and pharmaceutical industry in the PRC. Before joining the Company in 2001, Mr. Liu Zhenhai had over 7 years' experience working in the accounting and finance department of Linyi Luozhuang. Mr. Liu Zhenhai is also a delegate of the Linyi City People's Congress. Mr. Liu Zhenhai is the nephew of Mr. Liu Baoqi.

Ms. Li Minghua (**李明華**), aged 42, is an executive Director, the general manager and head of the research and development department of the Company. She is responsible for assisting the Chairman in the Company's overall business development and operation. She graduated from Shenyang Pharmacy University (瀋陽藥科大學) with a bachelor's degree in Pharmacy. Ms. Li is a senior professional engineer in medicine in the PRC certified by Hei Long Jiang Human Resource Department (黑龍江人事廳) and a registered practising pharmacist. Before joining the Company in 2001, Ms. Li had over 15 years' experience working in several pharmaceutical enterprises in the PRC.

Mr. Han Fengsheng (**韓風生**), aged 32, was appointed 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.

NON-EXECUTIVE DIRECTORS

Mr. Zhou Wuxian (**周武先**), aged 50, is a non-executive Director and the legal representative of Qingdao Guofeng Group Jiaozhou Pharmacy Limited ("Qingdao Guofeng Jiaozhou"). Mr. Zhou completed his tertiary education in Shandong Chinese Medicine College (山東中醫學院). Mr. Zhou has over 24 years' experience in the medical and pharmaceutical industry in the PRC. In November 2004, Mr. Zhou became a non-executive Director of the Company.

Mr. Yin Chuangui (**尹傳貴**), aged 51, is a non-executive Director, and the authorized representative of Linyi City People's Hospital ("Linyi People Hospital"), a promoter and an initial management shareholder of the Company. Mr. Yin graduated from 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.

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Mr. Liu Yuxin (劉玉欣), aged 49, is a non-executive Director. Mr. Liu completed his tertiary education in Yishui Medical College (沂水醫學專科學校). In May 2001, Mr. Liu was nominated by Pingyi County People's Hospital ("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

Mr. Foo Tin Chung, Victor (傅天忠), aged 39, was appointed as the independent non-executive Director in April 2005. Mr. Foo has over 10 years' experience in the finance and accounting fields. Mr. Foo has been the executive director, 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 also currently serves as an independent non-executive director of RBI Holdings Limited, a company listed on the Stock Exchange. Mr. Foo holds a bachelor's degree in Accounting and Information System from the University of New South Wales in Australia and holds a master degree in business administration in Australia Graduate School of Management. He is a CPA of the Hong Kong Institute of Certified Public Accountants and a CPA of CPA Australia. Mr. Foo held senior management positions in listed companies in Hong Kong and was an auditor of an international audit firm.

Mr. Fu Hongzheng (付宏征), aged 44, was appointed as an 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 54, was appointed as an 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 the person in charge of the 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 46, was a 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 the chairman of the supervisory board of the Company. Mr. Li resigned on 30 November 2007.

Ms. Gao Xiaoling (高小玲), aged 44, is a supervisor and the vice general manager of Lijun Group Limited Liability Company ("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 board of supervisors of the Company.

Mr. Sun Song (孫松), aged 37, is a supervisor and the manager of the Company's bulk medicine workshop. Mr. Sun graduated from the University of Hei Long Jiang (黑龍江大學) in 1993 majoring in Organic Chemistry.

Mr. Zhu Enqiang (祝恩強), aged 44, is 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.

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Mr. Guan Yonghua (管永華), aged 45, is the director and deputy general manger of Linyi Municipal Pharmacy. On 30 November 2007, Mr. Guan was nominated by Linyi Municipal Pharmacy and appointed as a supervisor of the Company.

SENIOR MANAGEMENT

Mr. Ji Honghai (季紅海), aged 33, 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 in 1997. Before joining Shandong Luoxin Factory, he worked for Linyi Luozhuang from 1996 to 1997.

Mr. Zhao Xuekun (趙學昆), aged 72, 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 education in Shenyang Pharmacy College (瀋陽藥學院). Before joining Shandong Luoxin Factory in 1996, Mr. Zhao had over 39 years experience working in a hospital, drug control and inspection center and the health department of Linyi City.

Mr. Lau Hon Kee (劉漢基), *FCPA, CPA (Aust.)*, aged 37, 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 and accounting field and held senior management positions in several service and manufacturing companies.

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW

In the review of the year 2007, the profits attributable to the shareholders of the Company recorded a tremendous increase over the corresponding period of last year, and the Company 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 shareholders, customers, suppliers and business partners and public, as well as the sustainable concerted effort of the management and employees.

Last year, the Company's development reached its record pace and efficiency. The Company focused on technology innovation, improving the quality of its products, accelerating the development of sales network, increasing its product's market share, expanding its sales team and improving its qualification and skills, increasing production capacity to alleviate the problem of supply shortfall, enhancing the competitive edge of the Company's products, speeding up the development of elite team, establishing brand names and accelerating the improvement on seven aspects including management, culture, corporate organization, capital operation, scientific innovation, human resources and marketing, etc., which have effectively boosted the Company's development as well as further enhanced the ability to resist risks and the overall strength. Upon the imminent commencement of the third phase production capacity expansion project, its products' market share would increase, therefore leading the Company to the development of economies of scale.

Since 2006, the Company has been awarded the "Top Ten Medicine Growing Enterprises", and has been one of the top 100 enterprises in the pharmaceutical industry in China for two consecutive years. All these achievements demonstrate that the Company, with a growing reputation within the pharmaceutical industry in China and its strength in various respects, is gradually evolving into a renowned top-brand corporation.

FINANCIAL REVIEW

For the year ended 31 December 2007, the Company's audited turnover was approximately RMB509,092,000, representing an increase of approximately 60.2% when compared with approximately RMB317,868,000 for the corresponding period of last year.

For the year ended 31 December 2007, the audited cost of sales was approximately RMB260,628,000, representing an increase of approximately 48.2% when compared with approximately RMB175,905,000 for the corresponding period of last year.

For the year ended 31 December 2007, the audited gross profit margin was 48.81%, representing an increase of approximately 4.15 percentage points when compared with 44.66% for the corresponding period of last year.

For the year ended 31 December 2007, the audited operating expenditure was approximately RMB66,642,000, representing an increase of approximately 37.1% when compared with approximately RMB48,592,000 for the corresponding period of last year. This represents a usual growth in operating expenditure driven by the turnover growth of the Company.

For the year ended 31 December 2007, the audited profit attributable to shareholders was approximately RMB121,943,000, representing an increase of approximately 102.7% when compared with approximately RMB60,169,000 for the corresponding period of last year. Weighted average earnings per share was RMB0.2 for the year ended 31 December 2007.

MANAGEMENT DISCUSSION AND ANALYSIS

LIQUIDITY AND FINANCIAL RESOURCES

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

As at 31 December 2007, the Company's cash and cash equivalents amounted to approximately RMB116,223,000 (as at 31 December 2006: RMB117,391,000). As at 31 December 2007, its short term loan amounted to approximately RMB30,500,000 (as at 31 December 2006: RMB78,700,000). The Company's bank borrowings were mainly secured by certain equipment and premises of the Company.

The Company's gearing ratio as at 31 December 2007 was 6.48% (as at 31 December 2006: 19.73%), which was calculated by dividing the amount of bank borrowings as at 31 December 2007 by total assets as at 31 December 2007 and then multiplied by 100%.

PLEDGED BANK DEPOSITS/CASH AND CASH EQUIVALENTS

As at 31 December 2007, the Company's property, plant and equipment of RMB18,098,000 were pledged to secure the banking facilities of the Company.

MAJOR ACQUISITION AND DISPOSAL

As at 31 December 2007, the Company did not have any major acquisition and disposal.

MAJOR INVESTMENT

Save for (i) an acquisition of land in Shandong Province for a consideration of RMB10,000,000 on 12 June 2007, (ii) a contract entered into by the Company on 28 August 2007 for the construction of production facilities at a total cost of approximately RMB27,200,000, and (iii) certain equipment purchase agreements for the acquisition of manufacturing and other equipment, details of all of which were set out in the announcement of the Company dated 29 August 2007, the Company did not make any major investment during the year ended 31 December 2007.

CONTINGENT LIABILITIES

As at 31 December 2007, 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 bank deposits are denominated in Renminbi, while bank deposits are placed in banks in the PRC. Any remittance from the PRC are subject to the restrictions on foreign exchange control implemented by the PRC Government.

MANAGEMENT DISCUSSION AND ANALYSIS

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 strengthening the co-operations with its research and development partners, enhancing the capability of its research and development teams, constantly developing high-tech, high quality and high-value added new patented products for the market, 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. Further, through the one-stop vertical production from bulk pharmaceutical to dose products, together with the enhancement of the competitive edge in cost control and differentiation, the Company will have the power and promise to continue its development.

The Directors believe that the pharmaceutical industry will grow even faster in 2008 as a result of the expanding population, aging population, accelerating pace in urbanization and industrial modernization and the influence of globalized disease in the PRC. Particularly with the PRC speeding up its pace in medical system reform, actively introducing new cooperative medical initiatives and sparing no effort in raising people's living standard will all effectively boost medical treatment and pharmaceutical spending. Such huge market potential will enable well-established enterprises to enter into a new period of rapid development. The Company will also take advantage of such opportunities to implement rapid, sustainable and healthy development. The Ministry of Health has laid down the "2020 Healthy China" (健康中國2020年) plan, which is divided into three stages: in the first stage in 2010, the PRC should establish a systematic sanitary service system covering urban and rural areas; in the second stage, the PRC should have good ranking amongst developing countries in terms of sanitary services by 2015; in the third stage, the PRC's sanitary service should maintain a high standard among developing countries by 2020, and it is hoped that she can match the standard of those medium level developed countries. If the three-stage plan is materialised, the PRC's pharmaceutical consumption will move into a surging period, which will enable the regulated and rapid development of those pharmaceutical enterprises which have potential, and in turn represents a valuable opportunity to the Company. The Company uphold its value of "rewarding the shareholders, benefiting the staff, repaying society and strengthening the enterprise", and will also grab new opportunities, accelerate the pace of development, improve the quality of its products, enhance its brand name, lower production costs and expand its scale of production and sale, so as to enjoy benefit from economies of scale, lower production cost and differentiation.

The Directors believe that, through the implementation of these measures and grasping new opportunities, the Company will achieve better and faster growth, and thereby enhance the results significantly. Given the upward trend of the pharmaceutical industry, coupled with the prerequisites necessary for rapid and sustainable development the Company possesses, this will bring substantial profits and returns to the Company.

CORPORATE GOVERNANCE REPORT

Pursuant to Rules 18.44 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 the key 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.

According to E.1.1 of the Code on Corporate Governance Practice contained in Appendix 15 of the GEM Listing Rules ("the Code"), a separate resolution should be proposed for the nomination of each person as a director. In the extraordinary general meeting of the Company held on 30 November 2007, resolutions were proposed for the re-election of multiple retiring directors and supervisors of the Company. Such deviation was to expedite the meeting procedures for the shareholders of the Company to consider various issues and resolutions proposed at the meeting, including continuing connected transactions of the Company and the appointment of a new supervisor of the Company. The Board is aware of the deviation and has taken step to improve compliance with the Code and to prevent such deviation from happening again.

Save and except for those derivations mentioned above, during the year, the Company has complied with all the code provisions of 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, Ms. Gao Xiaoling, Mr. Sun Song, Mr. Zhu Enqiang and Mr. Guan Yonghua (appointed on 30 November 2007 in replacement of Mr. Li Yonggang, who resigned on 30 November 2007) 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 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 2007, the date on which the above Directors were duly re-elected and appointed.

The Board is responsible for the overall strategic development and operation of the Company. The board is also responsible for 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 period and other matters of the Company that require 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 Board meetings.

Moreover, the Board meets regularly to discuss the daily operation issues of the Company. For those non-executive and independent non-executive Directors who are not personally present at such Board meetings, conference call will be used so as to enable the Company to 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 our their duties imposed by the Company Law, Companies Ordinances, 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 by nominations made by certain initial management shareholders, promoters or staff union, who could monitor the decision making of the Board and operation of the Company.

Two of the promoters of the Company, namely Linyi People Hospital and Pingyi People Hospital, sold their shares in the Company to independent investors and Linyi Luoxin during October 2007. As they played a role in the Company's performance and transactions in 2007 and will continue to play their role in subsequent events in 2008, the non-executive directors nominated by them will remain on the Board until further arrangement.

The independent non-executive directors also serve an important role in the Board. They bring independent judgment on issues of strategic direction and future development; opinion on connected transactions and risk management on audit issues. One of the independent non-executive Directors is a qualified accountant and the rest of them possess the qualification set out in the GEM Listing Rules. 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 have access to independent professional advice pursuant to the internal policies of the Company.

BOARD MEETINGS

During the year 2007, the Board held 4 meetings. Directors were given sufficient time to review documents and information relating to matters discussed during such meetings.

CORPORATE GOVERNANCE REPORT

Details of Directors' attendance at Board meetings held in 2007 are as follows:

Board Meetings	**Dates of meeting (2007)**			
Executive Directors	13 March	8 May	26 July	7 November
Mr. Liu Baoqi	✓	✓	✓	✓
Mr. Liu Zhenhai	✓	✓	✓	✓
Ms. Li Minghua	✓	✓	✓	✓
Mr. Han Fengsheng	✓	✓	✓	✓
Non-executive Directors				
Mr. Zhou Wuxian	✓	✓	✓	✓
Mr. Yin Chuangui	✓	✓	✓	✓
Mr. Liu Yuxin	✓	✓	✓	✓
Independent non-executive Directors				
Mr. Foo Tin Chung, Victor	✓	✓	✓	✓
Mr. Fu Hongzheng	✓	✓	✓	✓
Ms. Li Hongjian	✓	✓	✓	✓

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, that 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 2007.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Under A.2.1 of the Code, "the roles of chairman and chief executive officer should be separated and should not be performed by the same individual". During the year ended 31 December 2007, Mr. Liu Baoqi served as 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 by and comprise independent non-executive directors.

AUDIT COMMITTEE

The audit committee of the Company ("Audit Committee") was established on 20 November 2005 and its current members during the year ended 31 December 2007 include:

Mr. Foo Tin Chung, Victor *(Chairman)*
Mr. Fu Hongzheng
Ms. Li Hongjian

CORPORATE GOVERNANCE REPORT

The Company established 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 in the medicinal field and professional knowledge in financial reporting and management.

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

During the year ended 31 December 2007, the Audit Committee has held four meetings and details of attendances of the meetings are shown below:

Audit Committee Meetings	**Dates of meeting (2007)**			
	7 March	4 May	24 July	5 November
Independent non-executive Directors				
Mr. Foo Tin Chung, Victor	✓	✓	✓	✓
Mr. Fu Hongzheng	✓	✓	✓	✓
Ms. Li Hongjian	✓	✓	✓	✓

REMUNERATION COMMITTEE

The remuneration committee of the Company ("Remuneration Committee") was established in December 2005 and its members during the year ended 31 December 2007 include:

Mr. Foo Tin Chung, Victor *(Chairman)*
Mr. Fu Hongzheng
Ms. Li Hongjian

The Company established 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 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 in medicinal field and knowledge on financial management, in particular, the remuneration to local workforces, as Mr. Fu Hongzheng and Ms. Li Hongjian are both experienced medical professional in the PRC.

CORPORATE GOVERNANCE REPORT

During the year ended 31 December 2007, the Remuneration Committee has held four meetings and details of the attendances of the meetings are shown below:

Remuneration Committee Meetings	**Dates of meeting (2007)**			
	7 March	4 May	24 July	5 November
Independent non-executive Directors				
Mr. Foo Tin Chung, Victor	✓	✓	✓	✓
Mr. Fu Hongzheng	✓	✓	✓	✓
Ms. Li Hongjian	✓	✓	✓	✓

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 public investors. Information on 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 interested 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 can 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 2007, the Board has reviewed the engagement of auditors and their remuneration. The auditor of the Company would receive approximately HK$480,000 for audit and related service and HK$150,000 for other services.

INTERNAL CONTROL

The Board is also responsible for reviewing the internal control policies of the Company regularly. Senior Management members are required to work in accordance with the internal policies and procedures implemented by the Company. The Company has developed and established an 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 and accounts payables cycles, and other policies and 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 also gives advice on internal control issues and plays an 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 2007 (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 30 of this annual report.

The directors recommend 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.

CLOSURE OF REGISTER OF MEMBERS

The registers of members of the Company will be closed from 16 April 2008 to 16 May 2008 (both days inclusive). All properly completed H Shares transfer forms accompanied by the relevant share certificates must be lodged with the Registrar of H Shares in Hong Kong, Computershare Hong Kong Investor Services Limited at Shop 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, no later than 4:30 p.m. on 15 April 2008, for registration.

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 2007, amounted to RMB192,817,000 (2006: RMB95,260,000).

FIVE 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 72 of this annual report.

REPORT OF THE DIRECTORS

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 2007
Increase the coverage of its marketing and sales network and customer base in the PRC	
1. Participate in National Pharmacy Exchange Fairs (國家藥品交流會) in the first and the last quarters of 2007	Participated in the National Pharmacy Exchange Fairs (國家藥品交流會) held in Dailin, Kunming and Xiamen, PRC.
2. Provide training seminars to sales and marketing staff to enhance their knowledge of the Company's new medicine products and latest market information	Provided training seminars to sales and marketing staff to enhance their knowledge of the Company's new medicine products and latest market information
3. Finalise the new marketing strategies to increase the Company's market share	New marketing strategies have been finalized to cover various cities and 4 marketing channels, namely hospitals, distributors, raw material ad OTC
4. Commence the promotional activities for Rhodiola for Injection, including press release and other target customer oriented promotional activities	Promotional activities not yet officially commenced as the production approval has not been obtained. But the patent in respect of Rhodiola for Injection has been obtained by the Company on 10 May 2006 which was widely reported
5. Strengthen the advertising efforts to promote the corporate image and Rhodiola for Injection	Advertising not yet commenced as the production approval has not been obtained. But the patent in respect of Rhodiola for Injection has been obtained by the Company on 10 May 2006 which was widely reported
Broaden its product range	
1. Commence production of Rhodiola for Injection.	Promotion not yet commenced. 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

REPORT OF THE DIRECTORS

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 the 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 per H Share. Therefore, the proceeds from the placing was reduced. The revised total cost of implementation of business plan was RMB32.76 million (or HK$31.5 million at exchange rate of HK$1: RMB1.04). With this amount, 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 customer base in the PRC; and RMB2.75 million will be spent on broadening its product range. Insufficient funds will be made up by the Company's internal resources. The Directors are of the view that the current retained earnings level and support from banks will provide sufficient resources to pay the said deficient funds.

	Costs for the implementation of business plan as at 31 December 2007 as set out in the prospectus	**Amount of net proceeds to be used as at 31 December 2007 as revised**	**Actual amount of net proceeds spent as at 31 December 2007**	**Company's contribution on the implementation of business plan**
	HK$ million/RMB million	*RMB million*	*RMB million*	*RMB million*
1. Enhance and upgrade production facilities	31.00/32.24	25.42	8.94	10.54
2. Increase the coverage of its marketing and sales network and its customer base in the PRC	5.60/5.82	4.59	4.59	0.26
3. Broaden its product range	3.30/3.43	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 its establishment.

REPORT OF THE DIRECTORS

DIRECTORS

The directors during the year were:

Executive directors
Liu, Baoqi (劉保起)
Liu, Zhenhai (劉振海)
Li, Minghua (李明華)
Han Fengsheng (韓風生)

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)
Foo, Victor Tin Chung (傅天忠)
Li Hongjian (李宏健)

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 most of the Directors 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. The last term of the Directors' services expired and the Directors were re-elected as follows:

Mr. Liu, Baoqi (劉保起), Mr. Liu, Zhenhai (劉振海), Ms. Li, Minghua (李明華) being executive Directors, retired and were re-elected on 30 November 2007.

Mr. Han Fengsheng (韓風生), an executive Director was appointed on 30 November 2006. Mr. Han has entered into a service agreement with the Company for a term of three years commencing from 30 November 2006 subject to the retirement and re-election requirements of the Article of Association of the Company. Mr. Han retired and was re-elected on 30 November 2007.

Mr. Liu, Yuxin (劉玉欣), Mr. Yin, Chuangui (尹傳貴), Mr. Zhou, Wuxian (周武先), non-executive Directors, retired and were re-elected on 30 November 2007.

Mr. Fu, Hongzheng (付宏征), an independent non-executive Director, retired and was re-elected on 30 November 2007.

Mr. Foo, Victor Tin Chung (傅天忠), an independent non-executive Director, was appointed on 8 April 2005. Mr. Foo retired and was re-elected on 30 November 2007.

Ms. Li Hongjian (李宏建), an independent non-executive Director was appointed on 30 November 2006. Ms. Li has entered into a service agreement with the Company for a term of three years commencing from 30 November 2006 subject to the retirement and re-election requirements of the Article of Association of the Company. Ms. Li retired and was re-elected on 30 November 2007.

REPORT OF THE DIRECTORS

DIRECTORS' SERVICE CONTRACTS

Each of the executive Directors, non-executives Directors, independent non-executive Directors and supervisors of the Company has entered into a service contract with the Company commencing from various dates of their respective appointments 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 the 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 during the year.

DIRECTORS' AND SUPERVISORS' INTERESTS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY

As at 31 December 2007, 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 2007

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	238,639,949	53.62%	39.15%
Mr. Liu Zhenhai (劉振海)	Beneficial Owner	35,000,000	7.86%	5.74%

Note 1: These 238,639,949 domestic shares in the Company ("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. 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 238,639,949 Domestic Shares held by Linyi Luoxin. The total number of Domestic Shares deemed to be interested by Liu Baoqi (劉保起) as at 31 December 2006 was 230,000,000 (representing 51.68% of the total issued Domestic Shares and 37.73% of the Company's share capital). On 29 October 2007, Linyi Luoxin further acquired 8,639,949 shares, including 4,319,974.50 Domestic Shares from each of two promoters of the Company, i.e., the Linyi People Hospital and Pinyi People Hospital.

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 2007, 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 2007

Name	**Capacity/ Nature of Interest**	**Number of Domestic shares**	**% of total issued Domestic shares**	**% of Company's Share Capital**
Linyi Luoxin	Beneficial Owner	238,639,949	53.62%	39.15%
Zuo Hongmei (左洪梅)	Family interest *(Note 1)*	238,639,949	53.62%	39.15%
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%

Notes:

1. These 238,639,949 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 238,639,949 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 238,639,949 Domestic Shares held by Liu Baoqi (劉保起).

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

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

4. Each of Cao Tingting, Liu Zhendong and Chen Weiwei, is 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.

5. Linyi People Hospital was a significant shareholder of the Company as at 31 December 2006. On 29 October 2007, it transferred 4,319,974.50 Domestic Shares to Linyi Luoxin and 30,239,821.50 Domestic Shares to another independent investor.

6. Pinyi People Hospital was a significant shareholder of the Company as at 31 December 2006. On 29 October 2007, it transferred 4,319,974.50 Domestic Shares to Linyi Luoxin and 30,239,821.50 Domestic Shares to another independent investor.

REPORT OF THE DIRECTORS

CONTRACTS OF SIGNIFICANCE

During the year, there was a framework agreement of continuing connected transaction, which was a contract of significance, entered into with Linyi Luoxin, the controlling shareholder of the Company. Please refer to the section on Connected Transactions and Continuing Connected Transactions for details.

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	11.9%
–	five largest suppliers combined	40.9%

Sales

–	the largest customer	16.1%
–	five largest customers combined	26.4%

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.

REPORT OF THE DIRECTORS

CONNECTED TRANSACTIONS AND CONTINUING CONNECTED TRANSACTIONS

During the year ended 31 December 2007, the Company had the following non-exempt continuing connected transactions, details of which are set out below:

Nature of transaction

		Annual Cap for the financial years ending 31 December		
		2007	2008	2009
(a)	Sales of chemical medicines from the Company to Linyi Luoxin pursuant to a framework agreement on 16 September 2007	RMB20 million	RMB85 million	RMB120 million
(b)	Sales of chemical medicines from the Company to Linyi People Hospital pursuant to a framework agreement on 16 September 2007	RMB4 million	RMB16 million	RMB22 million
(c)	Sales of chemical medicines from the Company to Pingyi People Hospital pursuant to a framework agreement on 16 September 2007	RMB1.5 million	RMB6 million	RMB8 million

Linyi Luoxin is the single largest and a substantial shareholder of the Company. Linyi People Hospital and Pingyi People Hospital are promoters of the Company. They are therefore connected persons of the Company pursuant to Rule 20.11 of the GEM Listing Rules. The sale of chemical medicines from the Company to Linyi Luoxin, Linyi People Hospital and Pinyi People Hospital pursuant to the respective framework agreements constitute continuing connected transactions of the Company, details of which are set out in an announcement and a circular issued by the Company on 16 September 2007 and 6 October 2007 respectively.

During the year ended 31 December 2007, the sales of chemical medicines by the Company to Linyi Luoxin, Linyi People Hospital and Pingyi People Hospital amounted to RMB918,000, RMB1,007,000 and RMB Nil respectively, which did not exceed the annual cap for the relevant transactions. Further details are set out in note 32 to the financial statements.

The independent non-executive Directors, who are not interested in any of the above continuing connected transactions, have reviewed and confirmed that the above continuing connected transactions have been entered into by the Company:–

(a) in the ordinary and usual course of business of the Company;

(b) on terms no less favourable to the Company than terms available from independent third parties; and

(c) in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interest of the shareholders of the Company as a whole.

The Directors have received a letter from the auditors in respect of the continuing connected transactions as required by Rule 20.38 of the GEM Listing Rules.

REPORT OF THE DIRECTORS

COMPETING BUSINESS

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

LINYI LUOXIN

Linyi Luoxin is the controlling shareholder of the Company which holds 39.15% of the Company's issued share capital. And the chairman of the Company Mr. Liu Baoqi is also an executive director and chairman of Linyi Luoxin and a controlling shareholder holding 51.72% 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 established in the PRC with limited liability, and held 3.28% of the issued share capital of the Company. It is principally engaged in the sales of Chinese medicines, chemical medicines, bio-chemical medicines, medical equipment and health products. To the best knowledge of the Directors, Qingdao Guofeng Jiaozhou does not engage in the development and manufacturing of medicine products and it has no research and development 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.

These Domestic Shares held by Qingdao Guofeng Jiaozhou were sold in April 2007 to an independent third party whose business does not compete with that of the Company.

LIJUN GROUP LIMITED LIABILITY COMPANY ("LIJUN GROUP")

Lijun Group is a company with limited liability in the PRC and held 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.

REPORT OF THE DIRECTORS

These Domestic Shares held by Lijun Group were sold in June 2007 to an independent third party whose business does not compete with that of the Company.

LINYI MUNICIPAL PHARMACY

Linyi Municipal Pharmacy is a State-owned enterprise established in the PRC, holding approximately 1.42% of the registered share capital of the Company. Linyi Municipal Pharmacy is principally engaged in the sale of Chinese and chemical medicines, medical equipment and health products in Linyi City and nearby districts. To the best knowledge of the Directors, Linyi Municipal Pharmacy does not and will not engage in the development and manufacturing of medicine products and it has no research ad development 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.

Save as disclosed above, none of the Directors, the substantial shareholders of the Company or their respective associate (as defined in the GEM listing Rules) had any interest in a business which competes or is likely to compete, either directly or indirectly, with the business of the Company.

COMPLIANCE ADVISER'S INTERESTS

As at 31 December 2007, as notified by the Company's compliance adviser, Kingsway Capital Limited (the "Compliance Adviser"), neither the Compliance Adviser nor any of its directors, employees or associates 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.

AUDITORS

The accounts have been audited by HLB Hodgson Impey Cheng who will 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, 4 March 2008

INDEPENDENT AUDITORS' REPORT

HLB 國衛會計師事務所
Hodgson Impey Cheng

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

Chartered Accountants
Certified Public Accountants

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

We have audited the financial statements of Shandong Luoxin Pharmacy Stock Co., Limited (the "Company") set out on pages 30 to 71, which comprise the balance sheet as at 31 December 2007, and the income statement, the statement of changes in equity and the 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.

AUDITORS' 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.

INDEPENDENT AUDITORS' REPORT

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

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 2007 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, 4 March 2008

INCOME STATEMENT

For the year ended 31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
Turnover	6	**509,092**	317,868
Cost of sales		**(260,628)**	(175,905)
Gross profit		**248,464**	141,963
Other revenue	6	**3,323**	2,565
Other income	7	**2,368**	2,961
Selling and distribution expenses		**(33,585)**	(23,637)
General and administrative expenses		**(33,057)**	(24,955)
Profit from operations	7	**187,513**	98,897
Finance costs	8	**(4,554)**	(7,679)
Profit before taxation		**182,959**	91,218
Taxation	9	**(61,016)**	(31,049)
Profit for the year attributable to equity holders of the Company		**121,943**	60,169
Dividends	10	**12,192**	12,192
Earnings per share attributable to equity holders of the Company (RMB)			
– Basic and diluted	14	**0.200**	0.099

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 2007

	Notes	2007 RMB'000	2006 RMB'000
Non-current assets			
Purchased technical know-how	15	**1,625**	2,719
Prepayments to acquire technical know-how	16	**11,370**	11,260
Property, plant and equipment	17	**113,182**	110,716
Construction-in-progress	18	**82,429**	–
Land use rights	19	**11,721**	1,812
Deferred tax assets	20	**2,685**	3,309
		223,012	129,816
Current assets			
Inventories	21	**69,106**	74,926
Trade and bills receivables	22	**53,899**	38,119
Other receivables, deposits and prepayments		**8,329**	16,438
Pledged bank deposits	23	**–**	22,233
Cash and bank balances	23	**116,223**	117,391
		247,557	269,107
Current liabilities			
Trade and bills payables	24	**32,175**	43,001
Other payables and accruals		**47,621**	34,096
Deposits received		**7,463**	5,940
Taxation payable		**11,178**	5,305
Short-term bank loans	25	**30,500**	78,700
		128,937	167,042
Net current assets		**118,620**	102,065
Total asset less current liabilities		**341,632**	231,881
Non-current liabilities			
Deferred income	26	**20,380**	20,380
Net assets		**321,252**	211,501
Capital and reserves			
Share capital	27	**60,960**	60,960
Reserves (including proposed final dividend of RMB12,192,000 (2006: RMB12,192,000)	28	**260,292**	150,541
Total equity		**321,252**	211,501

Approved by the Board of Directors on 4 March 2008 and signed on as behalf by:

Liu Baoqi
Director

Liu Zhenhai
Director

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

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2007

	2007	2006
	RMB'000	*RMB'000*
Total equity, beginning of the year	**211,501**	163,524
Profit attributable to equity holders of the Company	**121,943**	60,169
Dividend paid	**(12,192)**	(12,192)
Total equity, end of the year	**321,252**	211,501

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

CASH FLOW STATEMENT

For the year ended 31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
Cash flows from operating activities			
Profit before taxation		**182,959**	91,218
Adjustments for:			
Interest income		**(1,392)**	(1,263)
Interest expense		**4,554**	7,679
Reversal of impairment loss recognised in respect of obsolete inventories		**(626)**	(1,283)
Reversal of impairment loss recognised in respect of trade and bills receivables		**(1,187)**	(1,678)
Reversal of impairment loss recognised in respect of other receivables, deposits and prepayments		**(555)**	–
Depreciation		**9,360**	7,628
Loss on disposal of property, plant and equipment		**15**	66
Impairment loss recognised in respect of obsolete inventories		**299**	742
Impairment loss recognised in respect of trade and bills receivables		**251**	489
Impairment loss recognised in respect of other receivables, deposits and prepayments		**354**	–
Amortisation of prepaid operating lease payments		**118**	40
Amortisation of purchased technical know-how		**1,094**	1,139
Operating profit before working capital changes		**195,244**	104,777
Decrease/(increase) in inventories		**6,147**	(35,582)
Increase in trade and bills receivables		**(14,844)**	(9,820)
Decrease in other receivables, deposits and prepayments		**8,310**	7,280
(Decrease)/increase in trade and bills payables		**(10,826)**	23,053
Increase/(decrease) in other payables and accruals		**15,048**	(1,888)
Cash generated from operations		**199,079**	87,820
Interest received		**1,392**	1,263
Interest paid		**(4,554)**	(7,679)
PRC income tax paid		**(54,519)**	(26,193)
Net cash inflow from operating activities		**141,398**	55,211

CASH FLOW STATEMENT

For the year ended 31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
Cash flows from investing activities			
Purchase of property, plant and equipment		**(11,986)**	(35,437)
Additions of land use right		**(10,027)**	–
Additions of construction-in-progress		**(82,429)**	–
Proceeds from disposal of property, plant and equipment		**145**	116
Purchase of technical know-how		**–**	(950)
Increase in prepayments to acquire technical know-how		**(110)**	(3,105)
Net cash outflow from investing activities		**(104,407)**	(39,376)
Cash flows from financing activities			
Dividend paid		**(12,192)**	(12,192)
New bank loans	29	**30,500**	86,000
Repayment of bank loans	29	**(78,700)**	(113,000)
Decrease/(increase) in pledged bank deposits		**22,233**	(14,755)
Net cash outflow from financing activities		**(38,159)**	(53,947)
Net decrease in cash and cash equivalents		**(1,168)**	(38,112)
Cash and cash equivalents, beginning of the year		**117,391**	155,503
Cash and cash equivalents, end of the year		**116,223**	117,391
Analysis of the balances of cash and cash equivalents			
Cash and bank balances		**116,223**	117,391

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

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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 by way of promotion with a registered capital of Renminbi ("RMB") 46 million. Subsequent to the above reorganisation, the name of the Company was changed to Shandong Luoxin Pharmacy Stock Co., Limited. The H shares of the Company have been listed on GEM of the Stock Exchange since 9 December 2005.

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

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

The financial statements are presented in RMB and all values are rounded to the nearest thousand (RMB'000), unless otherwise stated.

2. APPLICATION 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 2007. A summary of the effect on initial adoption of these new and revised HKFRSs is set out below.

HKAS 1 (Amendment)	Presentation of Financial Statements: Capital Disclosures
HKFRS 7	Financial Instruments: Disclosures
HK(IFRIC) – Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies
HK(IFRIC) – Int 8	Scope of HKFRS 2
HK(IFRIC) – Int 9	Reassessment of Embedded Derivatives
HK(IFRIC) – Int 10	Interim Financial Reporting and Impairment

The adoption of above new/revised HKFRSs except HKAS 1 (Amendment) and HKFRS 7 did not result in substantial changes to the Company's accounting policies and has no material impact on the Company's financial statements.

The Company has applied the disclosure requirements under HKAS 1 (Amendment) and HKFRS 7 retrospectively. Certain information presented in prior year under the requirements of HKAS 32 has been removed and the relevant comparative information based on the requirements of HKAS 1 (Amendment) and HKFRS 7 has been presented for the first time in the current year.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

The Company has not early applied the following new and revised standards or interpretations that have been issued but are not yet effective.

HKAS 1 (Revised)	Presentation of Financial Statements [1]
HKAS 23 (Revised)	Borrowing Costs [1]
HKFRS 8	Operating Segments [1]
HK(IFRIC) – Int 11	HKFRS 2 – Group and Treasury Share Transactions [2]
HK(IFRIC) – Int 12	Service Concession Arrangements [3]
HK(IFRIC) – Int 13	Customer Loyalty Programmes [4]
HK(IFRIC) – Int 14	HKAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction [3]

[1] Effective for annual periods beginning on or after 1 January 2009
[2] Effective for annual periods beginning on or after 1 March 2007
[3] Effective for annual periods beginning on or after 1 January 2008
[4] Effective for annual periods beginning on or after 1 July 2008

The Directors of the Company anticipate that the application of these new and revised standards or interpretations will have no material impact on the results and the financial position of the Company.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared in accordance with HKFRSs (which also include Hong Kong Accounting Standards ("HKASs") and Interpretations) issued by the HKICPA, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance and applicable disclosure provisions of The Rules Governing the Listing of Securities on GEM of the Stock Exchange (the "GEM Listing Rules").

The preparation of financial statements in conformity with HKFRSs requires management to make judgments, estimates and assumption that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustments in the next year are discussed in Note 4 to the financial statements.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Basis of preparation

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.

Property, plant and equipment

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

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

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

Buildings	20 – 40 years
Plant and machinery	10 years
Motor vehicles	5 years
Office equipment	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 4).

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

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.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Purchased technical know-how

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

Impairment of non-financial assets

Where an indication of impairment exists, or when annual impairment testing for an asset is required, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the income statement in the period in which it arises.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill and certain financial assets is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation) had no impairment loss been recognised for the asset in prior years. A reversal of such impairment loss is credited to the income statement in the period in which it arises.

Investments and other financial assets

Financial assets in the scope of HKAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, and available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Company considers whether a contract contains an embedded derivative when the Company first becomes a party to it. The embedded derivatives are separated from the host contract which is not measured at fair value through profit or loss when the analysis shows that the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract.

The Company determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Investments and other financial assets *(Continued)*

All regular way purchases and sales of financial assets are recognised on the trade date, that is, the date that the Company commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the market place.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading. Financial assets are classified as held for trading if they are acquired for the purpose of sale in the near term. Gains or losses on investments held for trading are recognised in the income statement.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are subsequently carried at amortised cost using the effective interest method. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets in listed and unlisted equity securities that are designated as available-for-sale or are not classified in any of the other two categories. After initial recognition, available-for-sale financial assets are measured at fair value, with gains or losses recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement.

When the fair value of unlisted equity securities cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such securities are stated at cost less any impairment losses.

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business at the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; a discounted cash flow analysis; and other valuation models.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Impairment of financial assets

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate, being the effective interest rate computed at initial recognition. The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the impairment loss is recognised in the income statement.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Company will not be able to collect all of the amounts due under the original terms of an invoice. The carrying amount of the receivables is reduced through the use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

Assets carried at cost

If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Impairment of financial assets *(Continued)*

Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the income statement, is transferred from equity to the income statement. Impairment losses on equity instruments classified as available-for-sale are not reversed through the income statement.

Derecognition of financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Company retains the rights to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Company has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Company has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Company's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Company could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Company's continuing involvement is the amount of the transferred asset that the Company may repurchase, except in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, where the extent of the Company's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities and equity

Financial liabilities and equity instruments issued by the Company are classified accordingly to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is a contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities. The Company's financial liabilities are generally classified into financial liabilities at fair value through profit or loss and financial liabilities at amortised costs.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss are classified into (i) financial liabilities held for trading and (ii) those designated as at fair value through profit or loss on initial recognition.

A financial liability other than a financial liability held for trading may be designated as at fair value through profit or loss upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial liability forms part of a group of financial assets or financial liabilities or both which is managed and its performance is evaluated on a fair value basis, in accordance with the Company's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and HKAS 39 permits the entire combined contract (asset or liability) to be designated as at fair value through profit or loss.

At each balance sheet date subsequent to initial recognition, financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value recognised directly in the income statement in the period in which they arise.

Financial liabilities at amortised cost

Financial liabilities including trade and other payables and interest-bearing loans advanced from shareholders are initially stated at fair value less directly attributable transaction costs and are subsequently measured at amortised cost, using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

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.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

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 the estimated costs of completion and the estimated costs necessary to make the sale.

Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised costs less impairment loss for bad and doubtful debts, except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts.

Trade and other payables

Trade and other payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

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.

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.

Provisions and contingent liabilities

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefit is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Income tax

Income tax for the year comprises current tax and deferred tax. Income tax is recognised in the income statement or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax credits and unused tax losses can be utilised except:

- where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Income tax *(Continued)*

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

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.

Employee benefits

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.

Pension obligations

The Company's contributions to defined contribution retirement schemes are expensed as incurred.

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.

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.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Foreign and presentation currency

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.

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.

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.

Related parties

A party is considered to be related to the Company if:

(a) the party, directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Company; (ii) has an interest in the Company that gives it significant influence over the Company; or (iii) has joint control over the Company;

(b) the party is an associate;

(c) the party is a jointly-controlled entity;

(d) the party is a member of the key management personnel of the Company or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d);

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or

(g) the party is a post-employment benefit plan for the benefit of the employees of the Company, or of any entity that is a related party of the Company.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Estimates and judgments 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 judgments 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.

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 3. 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.

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 recognised 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.

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.

Provision for obsolete inventories

The management of the Company reviews an aging analysis at each balance sheet date, and makes provision for obsolete and slow-moving inventory items. The management estimates the net realisable value for such finished goods based primarily on the latest invoice prices and current market conditions. The Company carries out an inventory review on a product-by-product basis at each balance sheet date and makes provision for obsolete items.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Trade and other receivables

The debt profile of trade debtors is reviewed on a regular basis to ensure that the trade debtor 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 trade receivable are made based on credit status of the customers, the aged analysis of the trade receivable balances and write-off history. Certain receivables may be initially identified as collectible, yet subsequently become uncollectible and result in a subsequent write-off of the related receivable to the income statement. Changes in the collectibility of trade receivables for which provision are not made could affect the results of operations.

Fair value of financial instruments

The fair value of financial instruments that are not traded in an active market is determined by valuation techniques. The Company uses its judgment to select a variety of methods and make assumptions that are primarily based on market conditions existing at each balance sheet date.

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(a) Categories of financial instruments

	As at 31 December	
	2007	2006
	RMB'000	*RMB'000*
Financial assets		
Loan and receivables (including cash and cash equivalents)	**173,632**	194,181
Financial liabilities		
Amortised cost	**128,937**	167,042

(b) Financial risk management objectives and policies

The main risks arising from the Company's financial instruments are market risk (including interest rate risk, foreign exchange risk and price risk), credit risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

Market risk

The Company's activities expose it primarily to the financial risks of changes in interest rates and foreign currency exchange rates.

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT *(Continued)*

(b) Financial risk management objectives and policies *(Continued)*

Market risk *(Continued)*

Market exposures are measured by sensitivity analysis

There has been no change to the Company's exposure to market risks or the manner in which it manages and measures the risk.

Interest rate risk management

The Company's interest rate risk arises from interest-bearing borrowings. Borrowings issued at fixed rates expose the Company to fair value interest rate risk. The Company did not enter into interest rate swap to hedge against its exposures to changes in fair values of the borrowings.

The Company considers that there is no significant cash flow interest rate risk as the Company does not have variable rate borrowings.

The Company's exposures to interest rates on financial liabilities are detailed in the liquidity risk management section of this note.

Foreign exchange risk

The Company operates and conducts business in the PRC and all the Company's transactions, assets and liabilities are primarily denominated in RMB and Hong Kong Dollars ("HKD"), which expose the Company to foreign currency risk. The Company does not have any formal hedging policy.

The carrying amounts of the Company's foreign currency denominated assets are as follows:

	As at 31 December	
	2007	2006
	RMB'000	*RMB'000*
Assets		
HKD	**39**	51

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT *(Continued)*

(b) Financial risk management objectives and policies *(Continued)*

Market risk *(Continued)*

Sensitivity analysis on foreign exchange risk

The following table details the Company's sensitivity to a 5% increase and decrease in RMB against the relevant foreign currencies. 5% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes outstanding foreign currency denominated monetary items and adjusts their translation at the year end for a 5% change in foreign currency rates. A negative number below indicates a decrease in profit where RMB strengthen 5% against the relevant currency. For a 5% weakening of RMB against the relevant currency, there would be an equal and opposite impact on the profit, and the balance below would be positive.

	As at 31 December	
	2007	2006
	RMB'000	*RMB'000*
Impact of HKD		
Profit or loss#	**(2)**	(3)

\# This is mainly attributable to the exposure outstanding on cash and bank balances denominated in HKD not subject to cash flow hedge at year end.

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.

Credit risk

As at 31 December 2006 and 2007, the Company's maximum exposure to credit risk which will cause a financial loss to the Company due to failure to discharge an obligation by the counterparties is arising from the carrying amount of trade and other receivables included in the balance sheet.

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. In this regard, the Directors of the Company consider that the Company's credit risk is significantly reduced.

Other than concentration of credit risk on liquid funds which are deposited with several banks with high credit ratings, the Company does not have any other significant concentration of credit risk. Trade receivables consist of a large number of customers.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT *(Continued)*

(b) Financial risk management objectives and policies *(Continued)*

Credit risk *(Continued)*

The table below shows the balance of 5 major counterparties (including liquid funds) at the balance sheet date.

	As at 31 December	
	2007	2006
Counterparty	***RMB'000***	*RMB'000*
Bank A	**2,440**	4,634
Bank B	**11,865**	5,307
Bank C	**1,400**	19
Bank D	**100,005**	106,921
Bank E	**449**	445

Liquidity risk

The Company's liquidity risk management includes diversifying the funding sources. Internally generated cash flow and funds raising from bank loans during the year are the general source of funds to finance the operation of the Company. The Company regularly reviews its major funding positions to ensure that it has adequate financial resources in meeting its financial obligations.

The following table details the Company's remaining contractual maturity for its financial liabilities which are included in the maturity analysis provided internally to the key management personnel for the purpose of managing liquidity risk. For non-derivative financial liabilities, the table reflects the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to pay. The tables include both interest and principal cash flows.

	Weighted average effective interest rate	**Within 1 year**	**Over 1 year**	**Total undiscounted cash flows**	**Total carrying amount**
	%	***RMB'000***	***RMB'000***	***RMB'000***	***RMB'000***
As at 31 December 2007					
Non-derivative financial liabilities					
Trade and bills payables	**–**	**29,261**	**2,914**	**32,175**	**32,175**
Other payables and accruals	**–**	**33,439**	**14,182**	**47,621**	**47,621**
Short-term bank loans	**6.38**	**30,500**	**–**	**30,500**	**30,500**

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT *(Continued)*

(b) Financial risk management objectives and policies *(Continued)*

Liquidity risk *(Continued)*

	Weighted average effective interest rate	Within 1 year	Over 1 year	Total undiscounted cash flows	Total carrying amount
	%	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
As at 31 December 2006					
Non-derivative financial liabilities					
Trade and bills payables	–	39,023	3,978	43,001	43,001
Other payables and accruals	–	20,005	14,091	34,096	34,096
Short-term bank loans	7.47	78,700	–	78,700	78,700

Fair value estimation

The fair value of financial assets and financial liabilities are determined as follows:

(i) the fair value of financial assets and financial liabilities (including derivative instruments) with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market bid prices and ask prices respectively; and

(ii) the fair value of other financial assets and financial liabilities (including derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices or rates from observable current market transactions as input.

The Directors consider that the carrying amounts of financial assets and financial liabilities recorded in the financial statements approximate their fair values.

(c) Capital risk management

The Company's objectives when managing capital are to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The capital structure of the Company consists of debt (which includes bank borrowings) and equity attributable to equity holders of the Company, comprising issued share capital, reserves and retained earnings.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT *(Continued)*

(c) Capital risk management *(Continued)*

Gearing ratio

The Directors review the capital structure regularly. As part of this review, the Directors consider the cost of capital and the risk associated with each class of capital. During the year ended 31 December 2007, the Company's strategy, which was unchanged from previous years, was to reduce the gearing ratio. This ratio is calculated base on total debt and total assets.

The gearing ratio as at 31 December 2006 and 2007 are as follows:

	As at 31 December	
	2007	2006
	RMB'000	*RMB'000*
Total debt *(Note (i))*	**30,500**	78,700
Total assets	**470,569**	398,923
Gearing ratio	**6.48%**	19.73%

Note (i): Total debt comprises short-term bank loans as detailed in Note 25.

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:

	2007	2006
	RMB'000	*RMB'000*
Turnover		
Sales of manufactured goods	**509,092**	317,868
Other revenue		
Interest income on bank deposits	**1,392**	1,263
Sundry income	**1,931**	1,302
	3,323	2,565
Total revenue	**512,415**	320,433

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

7. PROFIT FROM OPERATIONS

	2007	2006
	RMB'000	*RMB'000*
Operating profit of the Company was determined after charging/(crediting) the following:		
Raw materials and consumables used	**240,980**	174,564
Changes in inventories of finished goods and work-in-progress	**(7,597)**	(17,025)
Depreciation *(Note 17)*	**9,360**	7,628
Loss on disposal of property, plant and equipment	**15**	66
Amortisation of prepaid operating lease payment *(Note 19)*	**118**	40
Amortisation of purchased technical know-how (included in cost of sales) *(Note 15)*	**1,094**	1,139
Impairment loss recognised in respect of obsolete inventories *(Note 21)*	**299**	390
Impairment loss recognised in respect of trade and bills receivables *(Note 22)*	**251**	489
Impairment loss recognised in respect of other receivables, deposits and prepayments	**354**	1,253
Employees benefit expenses*(Note 11)*	**42,010**	29,013
Research and development costs	**3,381**	4,490
Advertising costs	**3,725**	2,236
Auditors' remuneration	**480**	390
and other crediting:		
Other income:		
Reversal of impairment loss recognised in respect of obsolete inventories *(Note 21)*	**626**	1,283
Reversal of impairment loss recognised in respect of trade and bills receivables *(Note 22)*	**1,187**	1,678
Reversal of impairment loss recognised in respect of other receivables, deposits and prepayments	**555**	–
	2,368	2,961

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

8. FINANCE COSTS

	2007	2006
	RMB'000	*RMB'000*
Bank loans wholly repayable within five years	**4,554**	7,679

9. TAXATION

(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 (2006: Nil).

(ii) The Company is subjected to the PRC enterprise income tax at a rate of 33% (2006: 33%).

(iii) The PRC value-added tax

The Company is subjected to the PRC value-added tax ("VAT") at 17% (2006: 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:

	2007	2006
	RMB'000	*RMB'000*
Current taxation – Enterprise income tax	**60,392**	29,764
Deferred taxation	**624**	1,285
	61,016	31,049

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:

	2007	2006
	RMB'000	*RMB'000*
Profit before taxation	**182,959**	91,218
Calculated at a taxation rate of 33%	**60,376**	30,102
Income not subject to tax	**(308)**	(902)
Expenses not deductible for taxation purpose	**948**	1,849
Taxation charge	**61,016**	31,049

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

10. DIVIDENDS

A dividend in respect of 2007 of RMB0.02 per share, amounting to a total dividend of RMB12,192,000 (2006: RMB12,192,000) is to be proposed at the annual general meeting of the Company on 16 May 2008. These financial statements do not reflect this dividend payable.

	2007	2006
	RMB'000	*RMB'000*
Proposed final dividend of RMB0.02 (2006: RMB0.02) per ordinary share	**12,192**	12,192

11. EMPLOYEE BENEFIT EXPENSES

	2007	2006
	RMB'000	*RMB'000*
Salaries and wages	**23,371**	14,257
Sales commission	**11,506**	9,500
Pension costs – defined contribution plans	**3,686**	2,720
Other staff benefits	**3,447**	2,536
	42,010	29,013

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 RMB970 (equivalent to HK$1,000) per month and thereafter contributions are voluntary.

During the year ended 31 December 2007, the Company has contributed approximately RMB23,280 (2006: RMB24,000) to the MPF Scheme.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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:

	2007 RMB'000	2006 RMB'000
Basic salaries and allowances	711	682
Retirement benefit costs	91	88
	802	770

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

	2007 RMB'000	2006 RMB'000
Executive directors		
Liu Baoqi	130	130
Li Minghua	127	127
Liu Zhenhai	106	106
Han Fengsheng	67	7
Wang Qingyu (Deceased on 2 May 2006)	–	28
Non-executive directors		
Zhou Wuxian	24	24
Yin Chuangui	24	24
Liu Yuxin	24	24
Independent non-executive directors		
Foo Tin Chung Victor	120	120
Fu Hongzheng	24	24
Li Hongjian	24	2
Shao Youmei (Resigned on 30 November 2006)	–	22
Supervisors		
Sun Song	60	60
Zhu Enqiang	24	24
Li Yonggang (Resigned on 30 November 2007)	22	24
Gao Xiaoling	24	24
Guan Yonghua (Appointed on 30 November 2007)	2	–
	802	770

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

13. DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS *(Continued)*

(i) The number of Directors and supervisors whose emoluments fell within the following bands is as follows:

	Number of individuals	
	2007	2006
Nil – RMB 970,000 (equivalent to Nil – HK$1,000,000)	**14**	16

None of the Directors waived any emoluments during the year.

(ii) The five individuals whose emoluments were the highest in the Company for the year include four (2006: four) Directors whose emoluments are reflected in the analysis presented above. The emoluments payable (excluding amounts paid or payable by way of commissions on sales generated by the individual) to the remaining one (2006: one) non-director, highest paid individual during the year are as follows:

	2007	2006
	RMB'000	*RMB'000*
Basic salaries and allowances	**610**	500
Retirement benefit costs	**12**	12
	622	512

The number of non-director, highest paid individuals whose emoluments fell within the following bands is as follows:

	Number of individuals	
	2007	2006
Nil – RMB 970,000 (equivalent to Nil – HK$1,000,000)	**1**	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 (2006: Nil).

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

14. EARNINGS PER SHARE

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

	2007	2006
Profit attributable to equity holders of the Company (RMB'000)	**121,943**	60,169
Weighted average number of ordinary shares in issue ('000)	**609,600**	609,600
Basic and diluted earnings per share (RMB)	**0.200**	0.099

15. PURCHASED TECHNICAL KNOW-HOW

	RMB'000
Cost:	
At 1 January 2006	14,350
Additions	950
At 31 December 2006 and at 31 December 2007	15,300
Accumulated amortisation and impairment:	
At 1 January 2006	11,442
Charge for the year	1,139
At 31 December 2006 and at 1 January 2007	12,581
Charge for the year	1,094
At 31 December 2007	13,675
Net book value:	
At 31 December 2007	**1,625**
At 31 December 2006	2,719

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

16. PREPAYMENTS TO ACQUIRE TECHNICAL KNOW-HOW

As at 31 December 2007, none was paid to third parties to acquire technical know-how. Details of amounts included in prepayments to acquire technical know-how to related parties are as follows:

	2007	2006
	RMB'000	*RMB'000*
– Shenyang Pharmacy University	**–**	4,500
– Shenyang Bohong Pharmaceutical Technology Development Co., Ltd.	**–**	1,700
	–	6,200

During the year ended 31 December 2007, the agreement with 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 RMB3,600,000 was transferred to Shenyang Pharmacy University.

Shenyang Pharmacy University, an ex-shareholder of the Company, sold all its shares in the Company to an independent third party and is no longer the shareholder of the Company as at 31 December 2007.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

17. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Plant and machinery	Motor vehicles	Office equipment	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Cost:					
At 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 and at 1 January 2007	62,470	57,971	6,541	5,871	132,853
Additions	1,290	8,100	1,849	747	11,986
Disposals	–	–	(509)	–	(509)
At 31 December 2007	63,760	66,071	7,881	6,618	144,330
Accumulated depreciation and impairment:					
At 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 and at 1 January 2007	2,161	13,670	2,985	3,321	22,137
Charge for the year	1,548	5,832	1,044	936	9,360
Written back on disposals	–	–	(349)	–	(349)
At 31 December 2007	3,709	19,502	3,680	4,257	31,148
Net book value:					
At 31 December 2007	**60,051**	**46,569**	**4,201**	**2,361**	**113,182**
At 31 December 2006	60,309	44,301	3,556	2,550	110,716

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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

Plant and machinery with net book value of approximately RMB18,098,000 (2006: RMB32,898,000) were pledged as collateral to secure bank loans.

As at 31 December 2007, all buildings of the Company are located in the PRC.

Depreciation expense of RMB6,933,000 (2006: RMB5,785,000) have been expensed in cost of sales and RMB2,427,000 (2006: RMB1,843,000) have been included in administrative expenses for the year.

18. CONSTRUCTION-IN-PROGRESS

	RMB'000
At 1 January 2006	16,064
Additions	27,210
Transfer to property, plant and equipment *(Note 17)*	(43,274)
At 31 December 2006 and at 1 January 2007	–
Additions	82,429
At 31 December 2007	**82,429**

Analysis of construction-in-progress:

	2007	2006
	RMB'000	*RMB'000*
Construction cost of buildings	**54,737**	–
Cost of plant and machinery	**27,692**	–
	82,429	–

19. LAND USE RIGHTS

Land use rights represent 50-year land use rights in the PRC expiring from November 2050 to May 2055. This payment is recognised as an expense over the leasehold period.

	RMB'000
At 1 January 2006	1,852
Amortisation of prepaid operating lease payments	(40)
At 31 December 2006 and at 1 January 2007	1,812
Additions	10,027
Amortisation of prepaid operating lease payments	(118)
At 31 December 2007	**11,721**

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

20. DEFERRED TAX ASSETS

Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 33% (2006: 33%).

The movements in the deferred tax assets are as follows:

	2007	2006
	RMB'000	*RMB'000*
Beginning of the year	**3,309**	4,594
Deferred taxation charged to income statement *(Note 9)*	**(624)**	(1,285)
End of the year	**2,685**	3,309

	Provisions	**Amortisation charge on purchased technical know-how**	**Others**	**Total**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
At 1 January 2006	2,212	1,902	480	4,594
Charged to income statement	(800)	(411)	(74)	(1,285)
At 31 December 2006 and at 1 January 2007	1,412	1,491	406	3,309
Charged to income statement	(512)	(112)	–	(624)
At 31 December 2007	**900**	**1,379**	**406**	**2,685**

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

There was no unprovided deferred taxation during the year.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

21. INVENTORIES

	2007	2006
	RMB'000	*RMB'000*
Raw materials	**19,769**	33,513
Work-in-progress	**26,484**	26,560
Finished goods	**23,268**	15,595
	69,521	75,668
Less: Write down of inventories	**(415)**	(742)
	69,106	74,926

The cost of inventories recognised as expense and included in cost of sales amounted to approximately RMB233,384,000 (2006: RMB157,359,000).

Movements in the write down of inventories are as follows:

	2007	2006
	RMB'000	*RMB'000*
Balance at beginning of the year	**742**	1,635
Write down of inventories during the year	**299**	390
Reversal of write down of inventories	**(626)**	(1,283)
Balance at end of the year	**415**	742

The reversal of write down of inventories arose due to sales of obsolete inventories recognised during the year.

The Directors of the Company had considered the net realisable values and conditions of the Company's inventories as at 31 December 2007 and considered write down 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:

	2007 RMB'000	2006 RMB'000
1 to 90 days	**38,443**	31,709
91 to 180 days	**11,761**	5,451
181 to 365 days	**3,695**	1,103
Over 365 days	**784**	1,584
	54,683	39,847
Less: Provision for impairment loss recognised in respect of trade and bills receivables	**(784)**	(1,728)
	53,899	38,119

The fair values are based on cash flows discounted using a rate based on the average borrowing rate of 6.38% (2006: 7.47%) during the year. The Directors consider that the carrying amounts of trade and bills receivables approximate their fair values.

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

Trade and bills receivables as at 31 December 2007 are denominated in RMB.

As at 31 December 2007, amounts of approximately RMB1,067,000 and RMB1,178,000 were receivables from a shareholder of the Company and a related company (Note 32). The amounts were unsecured, interest free and repayable within 180 days.

(a) Included in the Company's trade and bills receivables balance are debtors with a carrying amount of RMB3,695,000 (2006: RMB959,000) which are past due at the reporting date for which the Company has not provided for impairment loss. The Company does not hold any collateral over these balances.

Details of the aging analysis of trade and bills receivables which are past due but not impaired are as follows:

	2007 RMB'000	2006 RMB'000
181 to 365 days	**3,695**	959
Over 365 days	**–**	–
	3,695	959

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

22. TRADE AND BILLS RECEIVABLES *(Continued)*

(b) Movements in the provision for impairment loss recognised in respect of trade and bills receivables are as follows:

	2007	2006
	RMB'000	*RMB'000*
Balance at beginning of the year	**1,728**	2,917
Bad debt written off	**(8)**	–
Impairment loss recognised during the year *(Note 7)*	**251**	489
Reversal of impairment loss recognised in respect of trade and bills receivables *(Note 7)*	**(1,187)**	(1,678)
Balance at end of the year	**784**	1,728

In determining the recoverability of trade and bills 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 is values be made in respect of trade and bills 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 BANK BALANCES

As at 31 December 2007, none of the Company's bank deposits (2006: RMB22,233,000) were pledged as collateral for facilities granted by banks.

The effective interest rate on pledged bank deposits were 0.72% (2006: 0.72%).

All cash and cash equivalents of the Company are denominated in RMB 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.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

24. TRADE AND BILLS PAYABLES

Details of the aging analysis are as follows:

	2007	2006
	RMB'000	*RMB'000*
1 to 90 days	**25,082**	31,438
91 to 180 days	**3,295**	6,582
181 to 365 days	**884**	1,003
Over 365 days	**2,914**	3,978
	32,175	43,001

Trade and bills payables as at 31 December 2007 are denominated in RMB.

The Directors consider that the carrying amounts of trade and bills payables approximate their fair values.

25. SHORT-TERM BANK LOANS

	2007	2006
	RMB'000	*RMB'000*
Short-term bank loans		
– secured *(Note 30)*	**30,500**	78,700

Short-term bank loans are denominated in RMB and bear interest at approximately 6.12% to 7.34% per annum (2006: 7.34% to 7.96%).

The fair value is based on cash flows discounted using a rate based on the average borrowing rate of 6.38% (2006: 7.47%) during the year.

The Directors consider that the carrying amounts of short-term bank loans approximate their fair values.

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 2007, the Company has not commenced the construction of the new manufacturing plant.

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

27. SHARE CAPITAL

	Number of shares	Nominal value Domestic shares	H shares	Total
	'000	*RMB'000*	*RMB'000*	*RMB'000*
Registered, issued and fully paid:				
At 31 December 2006 (nominal value of RMB0.10 each)	609,600	44,504	16,456	60,960
At 31 December 2007 (nominal value of RMB0.10 each)	**609,600**	**44,504**	**16,456**	**60,960**

28. RESERVES

The movements of reserves of the Company are as follows:

	Share premium	Statutory surplus reserve fund	Statutory public welfare fund	Retained earnings	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
		(Note (i))	*(Note (ii))*		
At 1 January 2006	31,139	12,066	6,033	53,326	102,564
Profit attributable to equity holders of the Company	–	–	–	60,169	60,169
Transfer from retained earnings to statutory surplus reserve fund	–	6,043	–	(6,043)	–
Dividend paid	–	–	–	(12,192)	(12,192)
At 31 December 2006 and at 1 January 2007	31,139	18,109	6,033	95,260	150,541
Profit attributable to equity holders of the Company	–	–	–	121,943	121,943
Transfer from retained earnings to statutory surplus reserve fund	–	12,194	–	(12,194)	–
Dividend paid	–	–	–	(12,192)	(12,192)
At 31 December 2007	**31,139**	**30,303**	**6,033**	**192,817**	**260,292**
Representing:					
Proposed 2007 final dividends				12,192	
Others				180,625	
Retained earnings as at 31 December 2007				192,817	

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

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 contribution to statutory public welfare fund by the Company is voluntary. 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. The Directors consider that no provision to be made for the years ended 31 December 2006 and 2007.

29. NOTE TO THE CASH FLOW STATEMENT

Analysis of changes in financing:

	Bank loans
	RMB'000
At 1 January 2006	105,700
New bank loans	86,000
Repayment of bank loans	(113,000)
At 31 December 2006 and at 1 January 2007	78,700
New bank loans	30,500
Repayment of bank loans	(78,700)
At 31 December 2007	**30,500**

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

30. BANKING FACILITIES

The Company had aggregate banking facilities of RMB30,500,000 (2006: RMB100,878,000) which were fully utilised as at 31 December 2007.

As at 31 December 2007, RMB30,500,000 (2006: RMB100,878,000) of the banking facilities were secured by:

(i) pledge of the Company's property, plant and equipment with net book value of approximately RMB18,098,000 (2006: RMB32,898,000); and

(ii) none of bank deposits was pledged (2006: RMB22,233,000).

31. COMMITMENTS

The Company had the following significant capital commitments:

	2007	2006
	RMB'000	*RMB'000*
Contracted but not provided for:		
– Purchase of technical know-how	**4,800**	4,580
– Property, plant and machinery	**28,426**	–

As at 31 December 2007, no commitment (2006: RMB3,100,000) are related to acquisition of technical know-how from related parties (Note 16).

32. RELATED PARTY TRANSACTIONS

Key management compensation for the year ended 31 December 2007 was disclosed in Note 13(i).

Apart from those disclosed under Notes 16 and 22, the Company had the following material transactions with related party during the year:

	2007	2006
	RMB'000	*RMB'000*
Sales of finished goods to Linyi Luoxin Pharmacy Company Limited ("Linyi Luoxin") *(Note (i))*	**918**	–
Sales of finished goods to Linyi City People's Hospital ("Linyi People Hospital") *(Note (ii))*	**1,007**	–

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2007

32. RELATED PARTY TRANSACTIONS *(Continued)*

Note:

(i) Linyi Luoxin is the shareholder and promoter of the Company. Mr. Liu Baoqi is the Director for both Linyi Luoxin and the Company. An amount of approximately RMB1,067,000 due from Linyi Luoxin was included in trade and bills receivables as at 31 December 2007. The terms of the outstanding balance is set out in Note 22.

(ii) Linyi People Hospital is the ex-shareholder and promoter of the Company, who disposed all its shares in the Company as at 29 October 2007. Mr. Yin Chuangui, a non-executive Director of the Company, is also the Director of Linyi People Hospital during the year ended 31 December 2007. An amount of approximately RMB1,178,000 due from Linyi People Hospital was included in trade and bills receivables as at 31 December 2007. The terms of the outstanding balance is set out in Note 22.

The above transactions constitute connected transactions under GEM Listing Rules.

33. CONTINGENT LIABILITIES

The Company has no material contingent liabilities as at 31 December 2007.

34. SUBSEQUENT EVENTS

On 12 November 2007, the Company entered into a placing agreement with KGI Capital Asia Limited in relation to a placing of not more than 100,000,000 new H shares to independent advisors at a price of not more than HK$3.60 and of not less than the higher of (i) HK$2.60, and (ii) the latest audited consolidated net asset value per share. The placing has not been completed at 31 December 2007. The net proceeds will be used for (i) expanding the production facilities and product lines and sales network, (ii) enhancing the research and development capabilities, and (iii) increasing general working capital of the Company.

For further details, please refer to the Company's announcement dated 13 November 2007.

35. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 4 March 2008.

FIVE YEARS FINANCIAL SUMMARY

	For the year ended 31 December				
	2007	2006	2005	2004	2003
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Results					
Turnover	**509,092**	317,868	249,689	169,000	151,057
Cost of sales	**(260,628)**	(175,905)	(144,289)	(71,676)	(71,383)
Gross profit	**248,464**	141,963	105,400	97,324	79,674
Other revenue	**3,323**	2,565	1,548	2,007	1,078
Other income	**2,368**	2,961	–	–	–
Selling and distribution expenses	**(33,585)**	(23,637)	(21,879)	(27,091)	(14,707)
General and administrative expenses	**(33,057)**	(24,955)	(21,511)	(20,003)	(15,701)
Profit from operations	**187,513**	98,897	63,558	52,237	50,344
Finance costs	**(4,554)**	(7,679)	(7,142)	(5,626)	(5,064)
Profit before taxation	**182,959**	91,218	56,416	46,611	45,280
Taxation	**(61,016)**	(31,049)	(19,486)	(18,378)	(15,555)
Profit attributable to equity holders of the Company	**121,943**	60,169	36,930	28,233	29,725
Dividends	**12,192**	12,192	12,192	48,182	–
Earnings per share attributable to equity holders of the Company (RMB)	**0.200**	0.099	0.079	0.061	0.065

	As at 31 December				
	2007	2006	2005	2004	2003
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Assets & Liabilities					
Total assets	**470,569**	398,923	353,210	283,458	279,614
Total liabilities	**(149,317)**	(187,422)	(189,686)	(189,623)	(165,830)
Equity attributable to equity holders of the Company	**321,252**	211,501	163,524	93,835	113,784