山東羅欣藥業股份有限公司

Shandong Luoxin Pharmacy Stock Co., Ltd.*

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

Stock Code: 8058

ANNUAL REPORT 2010

* For identification purposes only

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This report, for which the directors (the "Directors") of Shandong Luoxin Pharmacy Stock Co., Ltd. (the "Company") collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on GEM of the Stock Exchange (the "GEM Listing Rules") for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in this report is accurate and complete in all material respects and is not misleading or deceptive, and there are no other matters the omission of which would make any statement herein or this report misleading.

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CORPORATE INFORMATION

DIRECTORS

Executive Directors

Liu Baoqi
Liu Zhenhai
Li Minghua
Han Fengsheng
Chen Yu

Non-executive Directors

Yin Chuangui
Liu Yuxin

Independent non-executive Directors

Foo Tin Chung, Victor
Fu Hongzheng
Li Hongjian

SUPERVISORS

Gao Xiaoling (resigned on 30 November 2010)
Sun Song
Zhu Enqiang (resigned on 30 November 2010)
Guan Yonghua
Wan Jian (appointed on 30 November 2010)
Song Liang Wei (appointed on 30 November 2010)

COMPLIANCE OFFICER

Liu Baoqi

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

MEMBERS OF THE AUDIT COMMITTEE

Foo Tin Chung, Victor *(chairman of the audit committee)*
Fu Hongzheng
Li Hongjian

LEGAL ADVISER TO THE COMPANY

King & Wood
9th Floor, Hutchison House, Central, Hong Kong

AUDITORS

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

PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Unit 10. 11/F, Tower B
Southmark, 11 Yip Hing Street
Wong Chuk Hang, Hong Kong

STOCK CODE

8058

CHAIRMAN'S STATEMENT

Dear Shareholders,

On behalf of the board of Directors (the "Board"), it is my pleasure to present the annual report of Shandong Luoxin Pharmacy Stock Co., Ltd. (hereinafter referred to as the "Company") for the year ended 31 December 2010 (hereinafter referred to as the "year") for your review.

With an aim of maximizing shareholders' value, our Company is devoted to enhancing the capabilities in research and development, increasing the production capacity and consolidating the sales network development. The competitiveness of our core operations improved in an ongoing manner. Through dedication and concerted effort of the management and employees, the Company achieved rapid growth and healthy development. For the year ended 31 December 2010, turnover increased by 47.91% to RMB1,342,254,000, whereas profit attributable to shareholders increased by 42.66% to RMB383,122,000.

In the past year, our capabilities 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 enhanced our ability to withstand risks as well as our overall strength. To cope with business development and the ever increasing market demand, the Company began to construct a new factory for Yuxin, with an aim to expand the categories of products and rapidly increase the integrated production capability. A number of the Company's new products were derived from the successful research and development results, which were subsequently commercialized. Tens of products received Technological Invention Awards and Scientific and Technological Progress Awards granted by the State. "Jin Xin-Ambroxol Hydrochloride for Injection", a product of the Company, was included in the National Key Sci-Tech Special Project "Technological Transformation of Major Drug Categories" under the 2011 Twelfth Five-Year Plan of "Key New Drug Creation and Manufacturing". Upon the review by the Ministry of Human Resources and Social Security and National Post-Doctor Regulatory Commission, the Company was approved to establish the Post-Doctoral Research Workshop of the State, which will incubate, attract and deploy high level professionals and experts for the Company. This will enhance our capabilities in research and development, which will provide broader room for the creation of an innovative mechanism. The workshop will be significant to the Company in terms of building a platform for academic exchange with high schools, as well as motivating and enhancing the overall qualities in human resources. Upon the review by the Ministry of Science and Technology, the Company was among the first batch to be recognised as a "Key High-Tech Enterprise" under the State Torch Program since the implementation of the new Measures for the Administration of the Recognition of High-Tech Enterprises. The Technology Centre of the Company obtained the approval for the establishment of the Shandong Lyophilized Powder Injection Pharmaceutical Engineering Technology Research Centre (山東省凍干粉針劑藥物工程技術研究中心). The Company was recognised by the Department of Science and Technology at Shandong Province as an "Industrial Model Enterprise in the National Integrated Platform for New Pharmaceutical Research, Development and Technology (Shandong)" and the "Star Enterprise of Shandong" for patents registered in the PRC. These recognitions laid a solid foundation for the Group to develop and build a stronger platform for research and development, which will enhance the competence of the Group in research and development of technologies to a greater extent.

CHAIRMAN'S STATEMENT

As the Company gained predominance in various aspects, we can thus maintain our rapid and sustainable development. Our advantages include: 1. our remarkable results in successful research and development as well as marketing of State level new medicine; 2. our competitive edge arising from continuous development of new medicine; 3. our experienced management in the pharmaceutical industry; 4. our strength in research and development, and our strong support for research and development as a result of our collaboration with domestic universities and research institutes; 5. our extensive sales and marketing network; 6. our prominent cost advantage achieved by one-stop vertical production ranging from bulk pharmaceutical to finished products.

The Directors believe that the pharmaceutical industry will maintain rapid growth in 2011. Particularly with the acceleration of implementation of medical reform imposed by the State and the proactive introduction of new cooperative medical initiatives, the overall market expenses on medical and pharmaceutical treatment will dramatically increase. Such huge market potential will enable well-established enterprises to enter a new era of rapid development. China is one of the countries that consumes a lot of pharmaceuticals. The room for development is extensive. The pharmaceutical industry is already listed as one of the industries to receive support from the central government in the Twelfth Five-Year Plan. It is expected that the central government will devote more resources to the pharmaceutical manufacturing and medical equipment industries. Looking ahead to 2011, the Company has staged into a new horizon and will face new challenges as well as development opportunities. We strongly believe that the Company will be able to maintain faster and better development and achieve unprecedented accomplishments.

The rapid development and advancement of the Company always 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 to all those who have devoted their efforts to facilitate the growth of the Company and have been giving tremendous support for the advancement of the Company.

Liu Baoqi
Chairman
15 March 2011

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS

Mr. Liu Baoqi (劉保起), aged 49, is an executive Director and the chairman of the Company. He is responsible for the strategic planning and overall management of the Company. Mr. Liu completed his tertiary course in Economics and Management from the School of Shandong Provincial Communist Party (中共山東省委黨校) in 1996. Mr. Liu obtained the qualification of pharmacist. He has about 20 years of experience in the medical and pharmaceutical industry in the PRC. Mr. Liu joined Shandong Luoxin Factory (the predecessor of the Company) in 1995. Before joining Shandong Luoxin Factory, Mr. Liu worked for Linyi Luozhuang Pharmacy Company ("Linyi Luozhuang", the predecessor of Luoxin Pharmacy Group Co., Ltd. (Luoxin Pharmacy Group, previously know as Linyi Luoxin Pharmacy Company Limited ("Linyi Luoxin")) from 1988 to 1995. Mr. Liu was named as the Outstanding Young Entrepreneur in Linyi City (臨沂市優秀青年企業家) and one of the 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 35, 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 15 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 45, 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 of the Company 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 35, is an executive Director and the secretary of the Board. Mr. Han graduated from the Dalian University (大連大學) majoring in Computer Science. Before joining the Company in November 2001, Mr. Han had over 5 years' experience working in the information technology department of Linyi Luozhuang Pharmacy Company (the predecessor of Linyi Luoxin).

Mr. Chen Yu (陳雨), aged 42, is an executive Director and the vice general manager of the Company's production department. Mr. Chen completed post-graduate education in Nanjing Chemical Power College (南京化工動力專科學校), and was named a Heat Supply and Ventilation Engineer by Liaoning Province Human Resources Bureau. Mr. Chen has over 19 years of experience in the PRC medicine manufacturing industry.

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

NON-EXECUTIVE DIRECTORS

Mr. Yin Chuangui (尹傳貴), aged 54, 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 the Weifang Medical College (濰坊醫學院) with a bachelor's degree specialising in Health Management. In May 2001, Mr. Yin was nominated by Linyi People Hospital as a non-executive Director.

Mr. Liu Yuxin (劉玉欣), aged 52, is a non-executive Director. Mr. Liu completed his tertiary course in the Yishui Medical College (沂水醫學專科學校). In May 2001, Mr. Liu was nominated by Pingyi 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

Foo Tin Chung Victor (傅天忠), aged 42, has been appointed as an independent non-executive Director since 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 the Stock Exchange. During the past 3 years period, Mr. Foo had served as an independent non-executive director of Apollo Solar Energy Technology Holdings Limited (formally known as RBI Holdings Limited), a company listed on the Stock Exchange. Mr. Foo holds a bachelor's degree in Accounting and Information System in 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 position in listed companies in Hong Kong and was an auditor of an international audit firm.

Mr. Fu Hongzheng (付宏征), aged 47, was appointed as the independent non-executive Director in June 2001. Mr. Fu graduated from Pharmacy School of Yanbian University (延邊大學藥學院) in 1985 with a bachelors' degree and got his master's degree from the Shenyang Medical University (瀋陽醫科大學) in 1991.

Ms. Li Hongjian (李宏建), aged 57, has been appointed as independent non-executive Director since 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 hospitals. 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

Ms. Gao Xiaoling (高小玲), aged 47, was the 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 board of supervisors of the Company.

Ms. Gao Xiaoling resigned as supervisor of the Company with effect from 30 November 2010 as her representing party Lijun Group was no longer a shareholder of the Company.

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

Mr. Sun Song (孫松), aged 40, is the supervisor and the manager of the Company's bulk medicine workshop. Mr. Sun graduated from the University of Hei Long Jiang (黑龍江大學) in 1993 majoring in Organic Chemistry.

Mr. Zhu Enqiang (祝恩強), aged 47, was the supervisor and the staff representative of the Company. Before joining the Company in 2001, Mr. Zhu had over 9 years' experience working in Linyi Luozhuang.

Mr. Zhu Enqiang (祝恩強) resigned as supervisor of the Company with effect from 30 November 2010 due to his resignation as the staff representative of the Company which took effect on 1 December 2010.

Mr. Guan Yonghua (管永華), aged 48, 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 supervisor of the Company.

Mr. Wang Jian (王健), aged 50, was appointed as a supervisor of the Company with effect from 30 November 2010. Mr. Wang graduated with a Master's degree in research from Shenyang Pharmacy University (瀋陽藥科大學). Mr. Wang worked as the head of research and development department and the general manger of Guangzhiu Bidi Pharmacy Co., Ltd (廣州彼迪藥業有限公司) prior to 1999 and has been individually researching in new medicine since 1999. Mr. Wang currently holds 10,000,000 Domestic Shares, representing approximately 2.25% of all Domestic Shares or approximately 1.64% of all Domestic Shares and H Shares.

Ms. Song Liang Wei (宋良偉), aged 30, was nominated by the staff union of the Company and appointed as a supervisor of the Company with effect from 30 November 2010. Ms. Song is the manager of the New Medicine Research and Development Technical Centre of the Company. Ms. Song graduated with a diploma in professional pharmacy from Shandong University. Before joining the Company, Ms. Song worked at Linyi People Hospital.

SENIOR MANAGEMENT

Mr. Ji Honghai (季紅海), aged 36, is the vice general manager of the Company and is responsible for the sales and marketing operation of the Company. Mr. Ji graduated from the University of Jinan City Workers (濟南市職工大學) majoring in Financial Accounting. Mr. Ji joined Shandong Luoxin Factory (the predecessor of the Company) in 1997. Before joining Shandong Luoxin Factory, he worked for Linyi Luozhuang from 1996 to 1997.

Mr. Zhao Xuekun (趙學昆), aged 75, 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 40, is the financial controller and company secretary of the Company. Mr. Lau is responsible for accounting, financial reporting and corporate governance of the Company. Mr. Lau holds a Bachelor's degree in Commerce from Australian National University and Master's degree in Professional Accounting from Hong Kong Polytechnic University. Mr. Lau has also been serving as an independent non-executive director of Strong Petrochemical Holdings Limited since November 2008, a company listed on the Stock Exchange. Mr. Lau is a Fellow CPA of the Hong Kong Institute of Certified Public Accountants and a CPA of CPA Australia. Before joining the Company in March 2003, Mr. Lau has over 10 years' experience in finance & accounting field, and held senior management position in several service and manufacturing companies.

MANAGEMENT DISCUSSION AND ANALYSIS

INTRODUCTION

Global economy was gradually recovering during 2010. As to the PRC, it is facing the critical moment for a steady recovery after the international financial crisis. With the medical reform introduced proactively by the government, there will be further efforts in standardization. Medical expenses will also increase accordingly. Together with the trend of aging population, the development of the pharmaceutical industry in the PRC will continue to be promising.

As a leading modern pharmaceutical enterprise in the PRC, the Company has always insisted on the strategic core competencies of consolidating its capabilities in production, research and development and distribution. Best endeavours were used in the provision of reliable and high value added pharmaceutical products. In 2010, the Company fully leveraged on the opportunities arising from the expansion in the market and invested additional resources in enhancing production capabilities and technologies. Demand from market was fulfilled whilst the research and development in new products were accelerated. At the same time, the Company has been keen on tapping into a broader market in order to increase its market share. This in turn will allow satisfactory growth in both turnover and earnings, building a solid foundation for its sustainable development in future.

BUSINESS REVIEW

For the year ended 31 December 2010, the Group has been consistent in implementing the development strategies as formulated earlier, and continued to enhance its capabilities in research and development, production and distribution. A sound condition in operation has thus been sustained. Hence, the profit attributable to the shareholders of the Group recorded remarkable growth compared to the same period of the last year. There had been strong momentum driving the growth in the Group. The outstanding results were attributable to the support and cooperation of all shareholders, customers, suppliers, business partners and the public, as well as the concerted and unremitting efforts of the management and staff of the Group.

During the period under review, the Group continued to implement effective strategies on the seven integral parts of its operation, namely management, culture, business organisation, capital operation, science and technology innovation, and human resources and marketing. This had effectively contributed to the development of the Group and further enhanced its risk mitigating capabilities and overall competencies. Upon the review by the Ministry of Human Resources and Social Security and National Post-Doctor Regulatory Commission, the Company was approved to establish the Post-Doctoral Research Workshop (博士後科研工作站) of the State, which will incubate, attract and deploy high level professionals and experts for the Company. This will enhance our capabilities in research and development, providing broader room for the creation of an innovative mechanism. The workshop will be significant to the Company in terms of building a platform for academic exchange with high schools, as well as motivating and enhancing the overall qualities in human resources. Upon the review by the Ministry of Science and Technology, the Company was among the first batch to be recognised as a "Key High-Tech Enterprise" under the State Torch Program (國家火炬計劃重點高新技術企業) since the implementation of the new Measures for the Administration of the Recognition of High-Tech Enterprises. The Technology Centre of the Company obtained the approval for the establishment of the Shandong Lyophilized Powder Injection Pharmaceutical Engineering Technology Research Centre (山東省凍干粉針劑藥物工程技術研究中心). The Company was recognised by the Department of Science and Technology at

MANAGEMENT DISCUSSION AND ANALYSIS

Shandong Province as an "Industrial Model Enterprise in the National Integrated Platform for New Pharmaceutical Research, Development and Technology (Shandong)" (國家綜合性新製研發技術大平台(山東)產業化示範企業) and the "Star Enterprise of Shandong" (中國專利山東明星企業) for patents registered in the PRC. These recognitions laid a solid foundation for the Group to develop and build a stronger platform for research and development, which will enhance the competence of the Group in research and development of technologies to a greater extent.

Leveraging on its strength, the Company has been awarded the "Top Ten Pharmaceutical Enterprises with Growth Potential" in China and has been one of the "Top 100 Pharmaceutical Companies in China" consecutively since 2006. On the "List of Small and Medium-sized Enterprises in China with Most Potentials" (「中國最具潛力中小企業榜」), the first list published by Forbes in 2010, the Company was selected for the third consecutive year and our ranking jumped to the 29th place this year. The Company was selected by the Shandong Pharmaceutical Profession Association as an "Honourable Enterprise" in the Pharmaceutical Industry of Shandong Province at the 60th anniversary of the foundation of the PRC, and awarded various honorary titles such as an "Advanced Private Enterprise" by the Shandong Provincial People's Government. These recognitions demonstrated the growth in our overall corporate strength.

In addition, "Jin Xin – Ambroxol Hydrochloride for Injection", a product of the Company, was included in the National Key Sci-Tech Special Project "Technological Transformation of Major Drug Categories" (藥物大品種技術改造) under the 2011 Twelfth Five-Year Plan of "Key New Drug Creation and Manufacturing" (重大新藥創製). The National patent of the Company's invention of "Cefepime Hydrochloride Powder for Injection and its preparation method" was awarded First Class Award in the 11th Presentation of Patents in the Shandong Province. The Company ranked first in the "Linyi Mayor's Quality Award" in 2010. Li Minghua, the general manager of the Company, was awarded the "2010 Top Science and Technology Award of Linyi City".

During the period, the Group received 3 patents of invention in the PRC. It is now applying for 25 patents of invention in the PRC. 17 new drugs were approved to produce and register. By capitalizing on the successes already achieved, the Company will further strengthen its research and development and expand its market network to further enhance our brand recognition and competitiveness so as to build up a world-class pharmaceutical brand.

FINANCIAL REVIEW

For the year ended 31 December 2010, the Group's audited turnover was approximately RMB1,342,254,000, representing an increase of approximately 47.91% from approximately RMB907,453,000 for the corresponding period of last year. The increase was attributable to the Group's launch of products with high added values, upgrade of product portfolio and acceleration of the development of sales network to increase the market share of its products, which boosted an increase in turnover.

For the year ended 31 December 2010, the audited cost of sales was approximately RMB591,944,000, representing an increase of 23.39% from approximately RMB479,736,000 for the corresponding period of last year.

For the year ended 31 December 2010, the audited gross profit margin was 55.90%, representing an increase of 8.77% from 47.13% for the corresponding period of last year. The increase was attributable to the Group's launch of products with high added values and upgrade of product portfolio.

MANAGEMENT DISCUSSION AND ANALYSIS

For the year ended 31 December 2010, the audited operating expenditure was approximately RMB313,062,000, representing an increase of 155.47% from approximately RMB122,542,000 for the corresponding period of last year. The increase of operating expenditure was due to an increase in selling and distribution expenses, which were related to new products launched during the year with different marketing practices.

For the year ended 31 December 2010, the audited profit attributable to the shareholders was approximately RMB383,122,000, representing an increase of 42.66% from approximately RMB268,550,000 for the corresponding period of last year. Weighted average earnings per share were RMB0.63 for the year ended 31 December 2010. The increase of profit attributable to shareholders was due to enhanced sales and products mix incurred during the year.

LIQUIDITY AND FINANCIAL RESOURCES

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

As at 31 December 2010, the Group's cash and cash equivalents amounted to approximately RMB673,847,000 (as at 31 December 2009: RMB500,943,000). As at 31 December 2010, the Company did not have any borrowings (as at 31 December 2009: nil).

PLEDGED BANK DEPOSITS/CASH AND CASH EQUIVALENTS

As at 31 December 2010, the Group's bank deposits amounting to approximately RMB91,837,000 were pledged as security for remittance under acceptance (as at 31 December 2009: bank deposits amounting to approximately RMB237,194,000 were pledged as security for remittance under acceptance).

MAJOR ACQUISITION AND DISPOSAL

For the year ended 31 December 2010, the Group did not have any major acquisition or disposal.

SIGNIFICANT INVESTMENT

For the year ended 31 December 2010, the Group did not make any significant investment.

CONTINGENT LIABILITIES

As at 31 December 2010, the Group did not have any substantial contingent liabilities.

EXCHANGE RISK

The Group operates and conducts business in the PRC, and all the Group's transactions, assets and liabilities are denominated in RMB. Most of the Group's cash and cash equivalents and pledged deposits are denominated in RMB, while bank deposits are placed with banks in the PRC. Any remittance from the PRC is subject to the restrictions on foreign exchange control imposed by the PRC government.

MANAGEMENT DISCUSSION AND ANALYSIS

EMPLOYEES AND REMUNERATION POLICY

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

The Company has established a remuneration committee to make recommendations on the overall strategy for remuneration policy.

PROSPECTS

Looking ahead, since the development of the pharmaceutical industry is one of the focuses of the State's policies in future, the prospect of the pharmaceutical industry is still optimistic. The pharmaceutical industry has already been included as one of the industries that will be supported by the policies in the Twelfth Five-Year Plan published by the PRC central government. It is expected that the central government will allocate more resources to the pharmaceutical and medical equipment industries. A modern and liquid market system for pharmaceutical products will be established during the term of the Twelfth Five-Year Plan so as to enhance the concentration of the industry.

In addition, the Guiding Opinions on Speeding up the Restructuring of the Pharmaceutical Industry (the "Opinions") was jointly published by the Ministry of Information Industry, the Ministry of Health and the State Administration of Food and Drug in November 2010. The aims of the Opinions were to speed up the restructuring of the pharmaceutical industry, to cultivate independent innovation capacity and to enhance the concentration in production. The Opinions are beneficial to the development of innovative enterprises as a whole. This will give more room for competitive enterprises to develop.

In future, the Company will continue to pursue the strategic directions of "Technology-driven enterprise with determination and efforts" under the favourable operating environment. By fully leveraging on the opportunities arising from the integration of pharmaceutical industry, the Company will continue to expand its investment in research and development and enhance the standards in research and development as well as technologies. This will allow the Company to invent and develop more products of higher technology, better quality and higher added value. The Company also aims at cost reduction and expansion of production scale so as to achieve economies of scale, lower cost of production and diversified competition. As the Company has begun the construction of new plants for Yuxin and Hengxin, production capabilities will be increased to satisfy the growing demand for pharmaceutical products in the market. We can also increase the categories of pharmaceutical products, and expand its scope in research and development on new drugs more effectively. This will facilitate a more comprehensive development in business. The Company will also proactively establish a broader sales network so as to enhance the market share of its products. The core competencies in the Company will thus be improved in an ongoing manner.

With the implementation of the strategies above, it is anticipated by the Company that "Luoxin" will be transformed into a brand representing world-class pharmaceutical enterprise. With the rapid growth in production capabilities and the launch of more high value added products, the Company is confident to maintain a steady growth in its business so as to bring satisfactory return to our shareholders.

MANAGEMENT DISCUSSION AND ANALYSIS

WITHHOLDING OF CORPORATE INCOME TAX FOR NON-RESIDENT CORPORATE SHAREHOLDERS IN RESPECT OF THE PROPOSED 2010 FINAL DIVIDEND

Pursuant to the Law on Corporate Income Tax of the PRC and the relevant implementing regulations, which came into force on 1 January 2008, the Company is required to withhold corporate income tax at the rate of 10% before distributing the final dividend to non-resident enterprise shareholders whose names appear on the H Share register of members on 2 May 2011. Any H Shares registered in the name of non-individual shareholders, including HKSCC Nominees Limited, other nominees, trustees or other groups and organizations will be treated as being held by non-resident enterprise shareholders and the Company will distribute the final dividend to such non-individual shareholders after withholding a 10% corporate income tax. The 10% corporate income tax will not be withheld from the final dividend payable to any natural person shareholders whose names appear on the H Share register of members of the Company on 2 May 2011. Any natural person investor whose H Shares are registered under the name of any such non-individual shareholders and who does not wish any corporate income tax be withheld by the Company may consider transferring the legal title of the relevant H Shares into his or her name and duly lodge all transfer documents together with the relevant H Share certificates with the Company's H Share registrar for registration. In order to determine the list of holders of H Shares who are entitled to receive the final dividend, the H Share register of members of the Company will be closed from 2 May 2011 to 1 June 2011, both days inclusive, during which period no transfer of the Company's H Shares will be effected. In order for holders of H Shares to be qualified for the final dividend, all transfer documents accompanied by the relevant share certificates must be lodged with the Company's H Share registrar in Hong Kong, Computershare Hong Kong Investors Services Limited, at Shops 1712 -1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, no later than 4:30 p.m. on 29 April 2011, for registration.

The Company will strictly comply with the relevant PRC tax laws and regulations to withhold for payment such appropriate corporate income tax and the final dividend will only be payable to the shareholders whose names appear on the Company's H Share register of members on 2 May 2011. The Company will have no liability in respect of any claims arising from any delay in, or inaccurate determination, of the status of the shareholders or any disputes over the mechanism of withholding.

By order of the Board
Shandong Luoxin Pharmacy Stock Co., Ltd*
Liu Baoqi
Chairman

PRC, 15 March 2011

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

THE BOARD

The Board currently comprises of 5 executive Directors, namely, Mr. Liu Baoqi, Mr. Liu Zhenhai, Ms. Li Minghua, Mr. Han Fengsheng and Mr. Chen Yu with Mr. Liu Baoqi acting as chairman of the Board, currently 2 non-executive Directors, namely, 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 established in the PRC, 4 supervisors namely, Ms. Gao Xiaoling (resigned on 30 November 2010), Mr. Sun Song, Mr. Zhu Enqiang (resigned on 30 November 2010) Mr. Guan Yonghua, Mr. Wang Jian (appointed on 30 November 2010) and Ms. Song Liang Wei (appointed on 30 November 2010) 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 2010, 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.

CORPORATE GOVERNANCE REPORT

COMMITMENTS

The full Board will meet every quarter, to review the overall development, operation and financial performance of such period and other matters of the Company that require the approval of the Board. All Board members are given access to board materials and are given reasonable time to review information and sufficient time for consideration. The chairman of the Board is responsible for preparing the agenda of the 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 arranged so as to enable the Company to take advice actively from them.

APPOINTMENT OF DIRECTORS

The Directors all carried out their duties 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 passed at 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 through the 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, Linyi People's Hospital and Pingyi People Hospital, sold their shares in the Company to independent investors and Linyi Luoxin (or known as "Luoxin Pharmacy Group" today) during October 2007. But as they played a role in the Company's performance and transactions in 2008 and 2009, and will continue to play their role in subsequent events in 2011, the non-executive Directors nominated by them will remain on the Board until further arrangement.

The independent non-executive Directors also serve important role in the Board. They bring independent judgment on issues of strategic direction and future development; opine 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 GEM Listing Rules as at the date of this report. 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.

CORPORATE GOVERNANCE REPORT

BOARD MEETINGS

During the year 2010, the Board has held 4 meetings. Directors were given sufficient time to review documents and information relating to matters discussed during such meetings.

Details of Directors' attendance at Board meetings held in 2010 are as follows:

	Dates of meeting			
Board Meetings	**23 March**	**11 May**	**10 August**	**9 November**
Executive Directors	✓	✓	✓	✓
Mr. Liu Baoqi	✓	✓	✓	✓
Mr. Liu Zhenhai	✓	✓	✓	✓
Ms. Li Minghua	✓	✓	✓	✓
Mr. Han Fengsheng	✓	✓	✓	✓
Mr. Chen Yu	✓	✓	✓	✓
Non-executive Directors				
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, 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 2010.

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 2010, 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.

CORPORATE GOVERNANCE REPORT

COMMITTEES

As part of the corporate governance practices, the Board has established the following committees which are all chaired by and comprise of the 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 2010 include:

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

The Company has 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 of 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 2010, the Audit Committee has held four meetings and details of attendances of the meetings are shown below:

	Dates of meeting			
Audit Committee Meetings	**22 March**	**10 May**	**9 August**	**8 November**
Independent non-executive Directors				
Mr. Foo Tin Chung, Victor	✓	✓	✓	✓
Mr. Fu Hongzheng	✓	✓	✓	✓
Ms. Li Hongjian	✓	✓	✓	✓

CORPORATE GOVERNANCE REPORT

REMUNERATION COMMITTEE

The remuneration committee of the Company ("Remuneration Committee") was established in December 2005 and its members during the year ended 31 December 2010 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 the Directors and senior management and the evaluation and making of recommendations on other employee benefit arrangements.

The appointments of the Remuneration Committee members are based on their broad experience in the medicinal field and knowledge of 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.

During the year ended 31 December 2010, the Remuneration Committee has held four meetings and details of the attendances of the meetings are shown below:

	Dates of meeting			
Renumeration Committee Meetings	**22 March**	**10 May**	**9 August**	**8 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 of the Company is disseminated to the shareholders and interested parties in the following manner:

* delivery of the quarterly, interim and annual results and reports to all shareholders and interest parties;

* publication of announcements on the quarterly, interim and annual results on the Stock Exchange websites, and issue of other announcements and shareholders' circulars in accordance with the continuing disclosure obligation under the GEM Listing Rules;

CORPORATE GOVERNANCE REPORT

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

http://shandongluoxin.quamir.com

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 is necessary for shareholders to assess the financial performance and other matters of the Company.

During the year ended 31 December 2010, 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 approximately HK$208,000 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 three 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's resources and compliance with financial reporting and disclosure requirements. The Audit Committee will also give advice on internal control issues and take an active role in communicating 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 2010 (the "year").

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activity of the Company and the Group is the manufacture and sale of pharmaceutical products.

RESULTS AND DIVIDENDS

The results of the Group for the year are set out in the consolidated statement of comprehensive income on page 31 of this annual report.

The Directors recommend the payment of a final dividend of RMB0.05 per ordinary share, totalling RMB30,480,000. 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 2 May 2011 to 1 June 2011 (both days inclusive). All properly completed H Shares transfer forms accompanied by the relevant share certificates must be lodged with the Register 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 29 April 2011, for registration.

RESERVES

Movements in the reserves of the Company during the year are set out in Note 35 to the accounts.

PROPERTY, PLANT AND EQUIPMENT

Details of the movements in property, plant and equipment of the Group and the Company are set out in Note 21 to the accounts.

SHARE CAPITAL

Details of the movements in share capital of the Company are set out in Note 34 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 2010, amounted to RMB992,767,000 (2009: RMB619,961,000).

REPORT OF THE DIRECTORS

FIVE YEARS FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 107 of this report.

COMPARISON BETWEEN BUSINESS OBJECTIVE AND ACTUAL BUSINESS PROGRESS

The business objectives stated in the prospectus which remain still outstanding and not yet fulfilled are the commencement of promotional activities and production of Rhodiola for Injection.

The promotional activities of Rhodiola for Injection, including press release and other target customer oriented promotional activities, has not yet officially commenced as the Company has not obtained the production approval. But the patent in respect of Rhodiola for Injection has been obtained by the Company on 10 May 2006 which was widely reported.

The production of Rhodiola for Injection has not yet commenced either and the Company is in the process of obtaining the production approval from PRC Government.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

The Company has not redeemed any of its listed securities nor 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.

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)
Chen, Yu (陳雨)

REPORT OF THE DIRECTORS

Non-executive directors
Liu, Yuxin (劉玉欣)
Yin, Chuangui (尹傳貴)

Independent non-executive directors
Fu, Hongzheng (付宏征)
Foo, Victor Tin Chung (傅天忠)
Li Hongjian (李宏建)

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' service was expired and was re-elected as follows:

Mr. Liu, Baoqi (劉保起), Mr. Liu, Zhenhai (劉振海), Ms. Li, Minghua (李明華) and Mr. Han Fengsheng (韓風生), being executive Directors, retired and were re-elected on 24 November 2010 with a term of three years commencing from 30 November 2010.

Mr. Chen Yu (陳雨), an executive Director, was appointed on 28 April 2009. Mr. Chen entered into a service agreement with the Company for a term of three years commencing from 28 April 2009, subject to the retirement and re-election requirements of the Articles of Association. However, to align with the three years' term of service of the other Directors, Mr. Chen also retired and offered himself for re-election and re-appointment at the shareholders meeting held on 24 November 2010. Mr. Chen was re-elected on 24 November 2010 with a term of three years commencing from 30 November 2010.

Mr. Liu, Yuxin (劉玉欣) and Mr. Yin, Chuangui (尹傳貴), being non-executive Directors, retired and were re-elected on 24 November 2010 with a term of three years commencing from 30 November 2010.

Mr. Fu, Hongzheng (付宏征), Mr. Foo, Victor Tin Chung (傅天忠) and Ms. Li Hongjian (李宏建), being independent non-executive Directors retired and were re-elected on 24 November 2010 with a term of three years commencing from 30 November 2010.

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 30 November 2010 for a term of three years.

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

DIRECTORS AND SUPERVISORS' INTEREST 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 2010, the interests and short positions of each of the 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 ("Domestic Shares"), as at 31 December 2010

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	250,639,949	56.32%	41.12%
Mr. Liu Zhenhai (劉振海)	Beneficial Owner	35,000,000	7.86%	5.74%

Note

1. These 250,639,949 Domestic Shares are registered in the name of Luoxin Pharmacy Group. Liu Baoqi (劉保起) ("Mr. Liu") is interested in 51.72% of the registered share capital of Luoxin Pharmacy Group. Mr. Liu is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Luoxin Pharmacy Group. For the purpose of the SFO, Mr. Liu is deemed to be interested in the entire 250,639,949 Domestic Shares held by Luoxin Pharmacy Group. The total number of Domestic Shares deemed to be interested by Mr. Liu as at 31 December 2010 was 250,639,949 (representing 56.32% of total issued Domestic Shares and 41.12% of Company's share capital).

REPORT OF THE DIRECTORS

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND/OR SHORT POSITION IN THE SHARES, UNDERLYING SHARES OF THE COMPANY

In respect of 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 2010, 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 supervisors of the Company.

Long position of domestic shares of the Company, as at 31 December 2010

Name	Capacity/ Nature of Interest	Number of domestic shares	% of total issued domestic shares	% of Company's Share Capital
Luoxin Pharmacy Group	Beneficial Owner	250,639,949	56.32%	41.12%
Zuo Hongmei (左洪梅)	Family interest *(note 1)*	250,639,949	56.32%	41.12%
Cao Tingting (曹婷婷)	Family interest *(notes 2, 4)*	35,000,000	7.86%	5.74%
Liu Zhendong (劉振東)	Beneficial Owner *(note 4)*	35,000,000	7.86%	5.74%
Chen Weiwei (陳偉偉)	Family interest *(notes 3, 4)*	35,000,000	7.86%	5.74%

Notes:

1. These 250,639,949 Domestic Shares are registered in the name of Luoxin Pharmacy Group. Luoxin Pharmacy Group is owned as to approximately 51.72% by Mr. Liu. As Mr. Liu is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Luoxin Pharmacy Group, for the purpose of the SFO, Mr. Liu is deemed to be interested in the entire 250,639,949 Domestic Shares held by Luoxin Pharmacy Group. Zuo Hongmei (左洪梅), as the wife of Mr. Liu, is taken to be interested in the entire 250,639,949 Domestic Shares held by Mr. Liu.

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

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

4. Each of Cao Tingting, Mr. ZD Liu, Chen Weiwei, are not considered to be a substantial shareholder for the purpose of the GEM Listing Rules as each of them is interested in less than 10% of the total registered share capital of the Company.

REPORT OF THE DIRECTORS

CONTRACTS OF SIGNIFICANCE

During the year, the Company did not enter into any significant contract. However, the framework agreements of continuing connected transaction, entered into between the Company and (i) Luoxin Pharmacy Group, the controlling shareholder of the Company; (ii) Linyi People Hospital, the promoter of the Company; (iii) Shandong Luosheng Pharmacy Co., Ltd. ("Shandong Luosheng") and (iv) Shandong Mingxin Pharmacy Co., Ltd. ("Shandong Mingxin"), both being the fellow subsidiaries of the Company, in 2010 which remained effective during the year. Please refer to the section on Connected Transactions and Continuing Connected Transactions for details.

MANAGEMENT CONTRACTS

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

MAJOR SUPPLIERS AND CUSTOMERS

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

Purchases	
– the largest supplier	7.14%
– five largest suppliers combined	26.91%
Sales	
– the largest customer	14.91%
– five largest customers combined	27.04%

During the year ended 31 December 2010, the sales of chemical medicines to Luoxin Pharmacy Group, Linyi People Hospital, Shandong Luosheng and Shandong Mingxin amounted to approximately RMB198,073,000, RMB11,631,000, RMB57,164,000 and RMB42,430,000 respectively. Luoxin Pharmacy Group is the largest customer of the Company for the year ended 31 December 2010.

REPORT OF THE DIRECTORS

CONNECTED TRANSACTIONS AND CONTINUING CONNECTED TRANSACTIONS

During the year ended 31 December 2010, the Company had the following non-exempt continuing connected transactions, details of which are set out below:

	Annual Cap for the financial years ending 31 December		
Nature of transaction	**2010**	**2011**	**2012**
Sales of chemical medicines from the Company to Luoxin Pharmacy Group pursuant to a framework agreement dated 1 January 2010	RMB200 million	RMB300 million	RMB400 million
Sales of chemical medicines by the Company to Linyi People Hospital pursuant to a framework agreement dated 1 January 2010	RMB25 million	RMB30 million	RMB39 million
Sales of chemical medicines by the Company to Shandong Luosheng pursuant to a framework agreement dated 1 January 2010	RMB60 million	RMB80 million	RMB100 million
Sales of chemical medicines by the Company to Shandong Mingxin pursuant to a framework agreement dated 1 January 2010	RMB55 million	RMB75 million	RMB90 million

Luoxin Pharmacy Group is the single largest and a substantial shareholder of the Company, holding approximately 41.12% of the issued share capital of the Company. Linyi People Hospital is one of the promoters of the Company. Shandong Luosheng and Shandong Mingxin are fellow subsidiaries of the Company of which Luoxin Pharmacy Group is holding more than 51% of both companies. They are therefore connected persons of the Company pursuant to Rule 20.11 of the GEM Listing Rules. The sale of the chemical medicines from the Company to Luoxin Pharmacy Group, Linyi People Hospital, Shandong Luosheng and Shandong Minxin 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 5 January 2010 and 14 January 2010 respectively.

REPORT OF THE DIRECTORS

During the year ended 31 December 2010, the sales of chemical medicines by the Company to Luoxin Pharmacy Group, Linyi People Hospital, Shandong Luosheng and Shandong Mingxin amounted to RMB198,073,000, RMB11,631,000, RMB57,164,000 and RMB42,430,000 (2009: 119,688,000, 15,671,000, Nil, Nil) respectively which did not exceed the annual cap for the relevant transactions. Further details are set out in Note 39 to the consolidated financial statements. The Company received confirmation from auditors that these transactions are complied with the matters stated in Rule 20.38 of the GEM Listing Rules. 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 the business of the Company;

B. on terms of arm's length transactions to the Company; 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.

SUFFICIENCY OF PUBLIC FLOAT

Based on information that is publicly available to the Company and within the knowledge of the Directors, at least 25% of the Company's total issued share capital was held by the public as at the date of this report.

COMPETING BUSINESS

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

Luoxin Pharmacy Group

Luoxin Pharmacy Group is the controlling shareholder of the Company which holds 41.12% of the Company's issued share capital. The chairman of the Company Mr. Liu Baoqi is also an executive director and chairman of Luoxin Pharmacy Group and a controlling shareholder holding 51.72% of the registered capital of Luoxin Pharmacy Group.

REPORT OF THE DIRECTORS

Before a non-competition undertaking in favour of the Company was signed by Luoxin Pharmacy Group on 7 November 2002, Luoxin Pharmacy Group was engaged in the sales of chemical medicines, Chinese medicines, medical equipment, health and beauty products. Since the execution of the non-competition undertaking, Luoxin Pharmacy Group has ceased its chemical medicine business. In June 2005, Luoxin Pharmacy Group 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 hospitals below county-level. The Company had received from Luoxin Pharmacy Group an annual confirmation in respect of the compliance of these undertakings.

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

Linyi Municipal Pharmacy is a State-owned enterprise established in the PRC, holding approximately 1.42% of the registered share capital of the Company. Linyi Municipal Pharmacy is principally engaged in the sale of Chinese and chemical medicines, medical equipment and health products in Linyi City and nearby districts. To the best knowledge of the Directors, Linyi Municipal Pharmacy is not and will 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.

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 the medicine products sold by Linyi Municipal Pharmacy which have the same or similar curative effects as 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 interests in a business which competes or is likely to compete, either directly or indirectly, with the business of the Company.

AUDITORS

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

On behalf of the Board
Liu Baoqi
Chairman

PRC, 15 March 2011

INDEPENDENT AUDITORS' REPORT

HLB 國衛會計師事務所
Hodgson Impey Cheng

Chartered Accountants
Certified Public Accountants

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

TO THE SHAREHOLDERS OF SHANDONG LUOXIN PHARMACY STOCK CO., LTD.

(Incorporated in the People's Republic of China with limited liability)

We have audited the consolidated financial statements of Shandong Luoxin Pharmacy Stock Co., Ltd. (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 31 to 106, which comprise the consolidated and company statements of financial position as at 31 December 2010, and the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

The Directors of the Company are responsible for the preparation of consolidated financial statements that give a true and fair view 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, and for such internal control as the Directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. We conducted our audit in accordance with Hong Kong Standard 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 consolidated financial statements are free from material misstatement.

INDEPENDENT AUDITORS' REPORT

AUDITORS' RESPONSIBILITY (Continued)

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view 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 consolidated financial statements.

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 consolidated financial statements give a true and fair view of the state of affairs of the Group as at 31 December 2010 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, 15 March 2011

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2010

	Notes	2010 RMB'000	2009 RMB'000
Turnover	7	**1,342,254**	907,453
Cost of sales		**(591,944)**	(479,736)
Gross profit		**750,310**	427,717
Other revenue	7	**7,705**	3,767
Other income	9	**3,303**	2,501
Selling and distribution expenses		**(218,663)**	(79,668)
General and administrative expenses		**(94,399)**	(42,874)
Share of profit of an associate	17	**2,672**	4,063
Finance costs	8	**(174)**	(240)
Profit before taxation	9	**450,754**	315,266
Taxation	10	**(67,360)**	(46,716)
Profit for the year		**383,394**	268,550
Other comprehensive income for the year, net of tax			
– Share of other comprehensive income of an associate	17	**1,889**	–
Total comprehensive income for the year		**385,283**	268,550
Profit for the year attributable to:			
– Owners of the Company		**383,122**	268,550
– Non-controlling interests		**272**	–
		383,394	268,550
Total comprehensive income attributable to:			
– Owners of the Company		**385,011**	268,550
– Non-controlling interests		**272**	–
		385,283	268,550
Earnings per share attributable to owners of the Company (RMB)			
– Basic and diluted	15	**0.629**	0.441

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

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

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2010

	Notes	2010 RMB'000	2009 RMB'000
Non-current assets			
Interest in an associate	17	25,051	26,790
Available-for-sale financial assets	18	1,000	–
Purchased technical know-how	19	1,202	1,996
Prepayments to acquire technical know-how	20	7,520	7,520
Property, plant and equipment	21	268,270	260,221
Construction-in-progress	22	52,826	9,293
Prepaid lease payments	23	20,101	10,901
Deferred tax assets	24	3,512	2,103
Goodwill	25	165	165
		379,647	318,989
Current assets			
Inventories	26	215,389	246,604
Trade and bills receivables	28	222,922	66,188
Other receivables, deposits and prepayments	29	79,101	87,749
Pledged bank deposits	30	91,837	237,194
Cash and bank balances	30	582,010	263,749
		1,191,259	901,484
Current liabilities			
Trade and bills payables	31	184,348	328,995
Other payables and accruals	32	170,182	92,294
Deposits received		22,343	9,042
Taxation payable		41,970	13,593
Dividend payable		8,757	7,314
		427,600	451,238
Net current assets		763,659	450,246
Total assets less current liabilities		1,143,306	769,235

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2010

	Notes	2010 RMB'000	2009 RMB'000
Non-current liability			
Deferred income	33	20,380	20,380
Net assets		1,122,926	748,855
Capital and reserves			
Share capital	34	60,960	60,960
Other reserves		67,665	67,652
Retained earnings			
– Proposed final dividend		30,480	12,192
– Others		962,287	607,769
Equity attributable to owners of the Company		1,121,392	748,573
Non-controlling interests		1,534	282
Total equity		1,122,926	748,855

Approved by the Board of Directors on 15 March 2011 and signed on its behalf by:

Liu Baoqi
Director

Liu Zhenhai
Director

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

STATEMENT OF FINANCIAL POSITION

As at 31 December 2010

	Notes	2010 RMB'000	2009 RMB'000
Non-current assets			
Interests in subsidiaries	16	51,479	459
Interest in an associate	17	25,051	26,790
Available-for-sale financial assets	18	1,000	–
Purchased technical know-how	19	1,202	1,996
Prepayments to acquire technical know-how	20	7,520	7,520
Property, plant and equipment	21	268,145	260,216
Construction-in-progress	22	18,352	9,293
Prepaid lease payments	23	20,101	10,901
Deferred tax assets	24	3,512	2,103
		396,362	319,278
Current assets			
Inventories	26	213,267	246,604
Amounts due from subsidiaries	27	70,078	–
Trade and bills receivables	28	222,434	66,188
Other receivables, deposits and prepayments	29	45,951	87,209
Pledged bank deposits	30	91,837	237,194
Cash and bank balances	30	530,698	263,718
		1,174,265	900,913
Current liabilities			
Trade and bills payables	31	183,439	328,995
Other payables and accruals	32	170,119	92,294
Deposits received		21,923	9,042
Taxation payable		41,920	13,593
Dividend payable		8,757	7,314
		426,158	451,238
Net current assets		748,107	449,675
Total assets less current liabilities		1,144,469	768,953
Non-current liability			
Deferred income	33	20,380	20,380
Net assets		1,124,089	748,573

STATEMENT OF FINANCIAL POSITION

As at 31 December 2010

	Notes	2010 RMB'000	2009 RMB'000
Capital and reserves			
Share capital	34	**60,960**	60,960
Other reserves		**67,652**	67,652
Retained earnings			
– Proposed final dividend		**30,480**	12,192
– Others		**964,997**	607,769
Total equity		**1,124,089**	748,573

Approved by the Board of Directors on 15 March 2011 and signed on its behalf by:

Liu Baoqi
Director

Liu Zhenhai
Director

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2010

	Share capital RMB'000	Share premium RMB'000	Statutory surplus reserve fund RMB'000	Statutory public welfare fund RMB'000	Retained earnings RMB'000	Attributable to owners of the Company RMB'000	Non-controlling interests RMB'000	Total RMB'000
At 1 January 2009	60,960	31,139	30,480	6,033	363,603	492,215	–	492,215
Total comprehensive income for the year	–	–	–	–	268,550	268,550	–	268,550
Dividend paid	–	–	–	–	(12,192)	(12,192)	–	(12,192)
Non-controlling interests arising on the acquisition of a subsidiary	–	–	–	–	–	–	282	282
At 31 December 2009 and 1 January 2010	60,960	31,139	30,480	6,033	619,961	748,573	282	748,855
Profit for the year	–	–	–	–	383,122	383,122	272	383,394
Other comprehensive income for the year	–	–	–	–	1,889	1,889	–	1,889
Total comprehensive income for the year	–	–	–	–	385,011	385,011	272	385,283
Addition to non-controlling interests due to additional capital injection to a subsidiary	–	–	–	–	–	–	980	980
Transfer from retained earnings to statutory surplus reserve fund	–	–	13	–	(13)	–	–	–
Dividend paid	–	–	–	–	(12,192)	(12,192)	–	(12,192)
At 31 December 2010	**60,960**	**31,139**	**30,493**	**6,033**	**992,767**	**1,121,392**	**1,534**	**1,122,926**
Representing:								
Proposed 2010 final dividends					**30,480**			
Others					**962,287**			
Retained earnings as at 31 December 2010					**992,767**			

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

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2010

	Notes	2010 RMB'000	2009 RMB'000
Operating activities			
Profit before taxation		450,754	315,266
Adjustments for:			
Interest income	7	(6,036)	(2,191)
Interest expense	8	174	240
Share of profit of an associate	17	(2,672)	(4,063)
Reversal of obsolete inventories written down	26	(393)	(878)
Reversal of impairment loss recognised in respect of trade receivables	28	(768)	(266)
Reversal of impairment loss recognised in respect of other receivables	29	(347)	(217)
Depreciation of property, plant and equipment	21	19,822	17,203
Gain on disposal of property, plant and equipment		(299)	(167)
Write-down of obsolete inventories	26	2,867	1,377
Impairment loss recognised in respect of prepayments to acquire technical know-how	20	–	2,430
Impairment loss recognised in respect of trade receivables	28	5,288	1,861
Impairment loss recognised in respect of other receivables	29	111	541
Amortisation of prepaid lease payments	23	378	274
Amortisation of purchased technical know-how	19	794	844
Operating cash flows before working capital changes		469,673	332,254
Decrease/(increase) in inventories		28,741	(115,825)
(Increase)/decrease in trade and bills receivables		(161,254)	419
Decrease/(increase) in other receivables, deposits and prepayments		29,296	(50,020)
(Decrease)/increase in trade and bills payables		(144,647)	263,140
Increase in deposits received		13,301	848
Increase in other payables and accruals		77,888	8,684

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2010

	Notes	2010 RMB'000	2009 RMB'000
Cash generated from operations		312,998	439,500
Interest paid		(174)	(240)
PRC income tax paid		(40,392)	(40,975)
Net cash generated from operating activities		272,432	398,285
Investing activities			
Interest received		6,036	2,191
Acquisition of a subsidiary	36	–	(428)
Acquisition of available-for-sale financial assets		(1,000)	–
Purchase of property, plant and equipment	21	(15,231)	(13,018)
Additions of construction-in-progress	22	(56,467)	(27,971)
Addition of prepaid lease payments		(29,990)	–
Dividend received from associate		6,300	–
Proceeds from disposal of property, plant and equipment		593	1,304
Net cash used in investing activities		(89,759)	(37,922)
Financing activities			
Dividend paid		(10,749)	(4,878)
Capital injection from non-controlling interests of a subsidiary		980	–
Decrease/(increase) in pledged bank deposits		145,357	(222,354)
Net cash generated from/(used in) financing activities		135,588	(227,232)
Net increase in cash and cash equivalents		318,261	133,131
Cash and cash equivalents at the beginning of the year		263,749	130,618
Cash and cash equivalents at the end of the year		582,010	263,749
Analysis of balances of cash and cash equivalents:			
Cash and bank balances		582,010	263,749

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

1. GENERAL INFORMATION

The Company was established as a collectively-owned enterprise under the name of Shandong Luoxin Factory in the People's Republic of China (the "PRC") on 14 December 1995 and was converted into a joint stock co-operative enterprise on 12 July 1997. On 19 November 2001, Shandong Luoxin Factory underwent a corporate reorganisation and was transformed into a joint stock limited liability company by way of promotion with a registered capital of Renminbi ("RMB") 46,000,000. Subsequent to the above reorganisation, the name of the Company was changed to Shandong Luoxin Pharmacy Stock Co., Ltd. The H shares of the Company have been listed on the 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 principal activities of the subsidiaries are described in Note 16.

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

These consolidated financial statements were approved for issue by the Board on 15 March 2011.

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

In the current year, the Group has applied all of the new and revised standards, amendments and interpretations ("new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") that are relevant to its operations and effective for annual periods beginning on or after 1 January 2010.

HKFRSs (Amendments)	Amendments to HKFRS 5 as part of Improvements to HKFRSs issued in 2008
HKFRSs (Amendments)	Improvements to HKFRSs issued in 2009
HKAS 27 (as revised in 2008)	Consolidated and Separate Financial Statements
HKAS 28 (as revised in 2008)	Investments in Associates
HKAS 39 (Amendment)	Eligible Hedged Items
HKFRS 2 (Amendment)	Group Cash-settled Share-based Payment Transactions
HKFRS 3 (as revised in 2008)	Business Combinations
HKFRS 5 (Amendments as part of Improvements to HKFRSs issued in 2008)	Non-current Assets Held for Sale and Discontinued Operations – Plan to Sell the Controlling Interest in a Subsidiary

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

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

HK(IFRIC) – Int 17	Distributions of Non-cash Assets to Owners
HK – Int 5	Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause

The impact of the application of the above new HKFRSs is discussed below.

HKFRS 3 (as revised in 2008) Business Combinations

HKFRS 3 (as revised in 2008) has been applied in the current year prospectively to business combinations of which the acquisition date is on or after 1 January 2010 in accordance with the relevant transitional provisions. Its application has affected the accounting for business combinations in the current year.

The impact of the application of HKFRS 3 (as revised in 2008) is as follows:

- HKFRS 3 (as revised in 2008) allows a choice on a transaction-by-transaction basis for the measurement of non-controlling interests at the date of acquisition (previously referred to as "minority" interests) either at fair value or at the non-controlling interests' share of recognised identifiable net assets of the acquiree. In the current year, in accounting for the acquisition of subsidiaries, the Group has elected to measure the non-controlling interests at fair value at the date of acquisition. Consequently, the goodwill recognised in respect of that acquisition reflects the impact of the difference between the fair value of the non-controlling interests and their share of recognised identifiable net assets of the acquiree.

- HKFRS 3 (as revised in 2008) changes the recognition and subsequent accounting requirements for contingent consideration. Previously contingent consideration was recognised at the acquisition date only if payment of the contingent consideration was probable and it could be measured reliably; any subsequent adjustments to the contingent consideration were always made against the cost of the acquisition. Under the revised standard, contingent consideration is measured at fair value at the acquisition date; subsequent adjustments to the consideration are recognised against the cost of acquisition only to the extent that they arise from new information obtained within the measurement period (a maximum of 12 months from the acquisition date) about the fair value at the acquisition date. All other subsequent adjustments to contingent consideration classified as an asset or a liability are recognised in profit or loss.

- HKFRS 3 (as revised in 2008) requires the recognition of a settlement gain or loss when the business combination in effect settles a pre-existing relationship between the Group and the acquiree.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

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

HKFRS 3 (as revised in 2008) Business Combinations (Continued)

- HKFRS 3 (as revised in 2008) requires acquisition-related costs to be accounted for separately from the business combination, generally leading to those costs being recognised as an expense in profit or loss as incurred, whereas previously they were accounted for as part of the cost of the acquisition.

HKAS 27 (as revised in 2008) Consolidated and Separate Financial Statements

The application of HKAS 27 (as revised in 2008) has resulted in changes in the Group's accounting policies for the Group's changes in ownership interests in subsidiaries of the Group.

Specifically, the revised standard has affected the Group's accounting policies regarding changes in the Group's ownership interests in its subsidiaries that do not result in loss of control. In prior years, in the absence of specific requirements in HKFRSs, increases in interests in existing subsidiaries were treated in the same manner as the acquisition of subsidiaries, with goodwill or a bargain purchase gain being recognised, when appropriate; for decreases in interests in existing subsidiaries that did not involve a loss of control, the difference between the consideration received and the adjustment to the non-controlling interests was recognised in profit or loss. Under HKAS 27 (as revised in 2008), all such increases or decreases are dealt with in equity, with no impact on goodwill or profit or loss.

When control of a subsidiary is lost as a result of a transaction, event or other circumstance, the revised standard requires the Group to derecognise all assets, liabilities and non-controlling interests at their carrying amounts and to recognise the fair value of the consideration received. Any retained interest in the former subsidiary is recognised at its fair value at the date control is lost. The resulting difference is recognised as a gain or loss in profit or loss.

These changes have been applied prospectively from 1 January 2010 in accordance with the relevant transitional provisions.

In addition, under HKAS 27 (as revised in 2008), the definition of non-controlling interest has been changed. Specifically, under the revised standard, non-controlling interest is defined as the equity in a subsidiary not attributable, directly or indirectly, to a parent.

HKAS 28 (as revised in 2008) Investments in Associates

The principle adopted under HKAS 27 (as revised in 2008) that a loss of control is recognised as a disposal and re-acquisition of any retained interest at fair value is extended by consequential amendments to HKAS 28. Therefore, when significant influence over an associate is lost, the investor measures any investment retained in the former associate at fair value, with any consequential gain or loss recognised in profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

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

HK – Int 5 Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause

HK – Int 5 Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause ("HK Int 5") clarifies that term loans that include a clause that gives the lender the unconditional right to call the loans at any time ("repayment on demand clause") should be classified by the borrower as current liabilities. The Group has applied HK Int 5 for the first time in the current year. HK Int 5 requires retrospective application.

In order to comply with the requirements set out in HK Int 5, the Group has changed its accounting policy on classification of term loans with a repayment on demand clause. In the past, the classification of such term loans were determined based on the agreed scheduled repayment dates set out in the loan agreements. Under HK Int 5, term loans with a repayment on demand clause are classified as current liabilities.

Such term loans have been presented in the earliest time band in the maturity analysis for financial liabilities that reflects the remaining contractual maturities.

Except for those as disclosed above, the Directors anticipate that the application of these new HKFRSs has no material impact on the results and the financial position of the Group.

The Group has not applied in advance the following new and revised HKFRSs that have been issued but are not yet effective.

HKFRSs (Amendments)	Improvements to HKFRSs issued in 2010 except for the amendments to HKFRS 3(as revised in 2008), HKFRS 7, HKAS 1 and HKAS 28[2]
HKFRS 7 (Amendments)	Disclosures – Transfers of Financial Assets[5]
HKFRS 1 (Amendments)	Limited Exemption from Comparative HKFRS 7 – Disclosures for First-time Adopters[3]
HKFRS 9	Financial Instruments[7]
HKAS 12 (Amendments)	Deferred Tax: Recovery of Underlying Assets[6]
HKAS 24 (as revised in 2009)	Related Party Disclosures[4]
HKAS 32 (Amendments)	Classification of Rights Issues[1]
HK(IFRIC) – Int 14 (Amendments)	Prepayments of a Minimum Funding Requirement[4]
HK(IFRIC) – Int 19	Extinguishing Financial Liabilities with Equity Instruments[3]

1 Effective for annual periods beginning on or after 1 February 2010
2 Effective for annual periods beginning on or after 1 July 2010 or 1 January 2011, as appropriate.
3 Effective for annual periods beginning on or after 1 July 2010
4 Effective for annual periods beginning on or after 1 January 2011
5 Effective for annual periods beginning on or after 1 July 2011
6 Effective for annual periods beginning on or after 1 January 2012
7 Effective for annual periods beginning on or after 1 January 2013

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

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

HKFRS 9 Financial Instruments (as issued in November 2009) introduces new requirements for the classification and measurement of financial assets. HKFRS 9 Financial Instruments (as revised in November 2010) adds requirements for financial liabilities and for derecognition.

- Under HKFRS 9, all recognised financial assets that are within the scope of HKAS 39 Financial Instruments: Recognition and Measurement are subsequently measured at either amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods.

- In relation to financial liabilities, the significant change relates to financial liabilities that are designated as at fair value through profit or loss. Specifically, under HKFRS 9, for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the presentation of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Previously, under HKAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit or loss was presented in profit or loss.

HKFRS 9 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.

The Directors anticipate that HKFRS 9 that will be adopted in the Group's consolidated financial statements for the annual period beginning 1 January 2013 and that the application of the new standard may have a significant impact on amounts reported in respect of the Groups' financial assets. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

The amendments to HKFRS 7 titled Disclosures – Transfers of Financial Assets increase the disclosure requirements for transactions involving transfers of financial assets. These amendments are intended to provide greater transparency around risk exposures when a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. The amendments also require disclosures where transfers of financial assets are not evenly distributed throughout the period.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

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

The Directors do not anticipate that these amendments to HKFRS 7 will have a significant effect on the Group's disclosures regarding transfers of trade receivables previously effected. However, if the Group enters into other types of transfers of financial assets in the future, disclosures regarding those transfers may be affected.

HKAS 24 Related Party Disclosures (as revised in 2009) modifies the definition of a related party and simplifies disclosures for government-related entities.

The disclosure exemptions introduced in HKAS 24 (as revised in 2009) do not affect the Group because the Group is not a government-related entity. However, disclosures regarding related party transactions and balances in these consolidated financial statements may be affected when the revised version of the standard is applied in future accounting periods because some counterparties that did not previously meet the definition of a related party may come within the scope of the standard.

The amendments to HKAS 32 titled Classification of Rights Issues address the classification of certain rights issues denominated in a foreign currency as either an equity instrument or as a financial liability. To date, the Group has not entered into any arrangements that would fall within the scope of the amendments. However, if the Group does enter into any rights issues within the scope of the amendments in future accounting periods, the amendments to HKAS 32 will have an impact on the classification of those rights issues.

HK(IFRIC) – Int 19 provides guidance regarding the accounting for the extinguishment of a financial liability by the issue of equity instruments. To date, the Group has not entered into transactions of this nature. However, if the Group does enter into any such transactions in the future, HK(IFRIC) – Int 19 will affect the required accounting. In particular, under HK(IFRIC) – Int 19, equity instruments issued under such arrangements will be measured at their fair value, and any difference between the carrying amount of the financial liability extinguished and the fair value of equity instruments issued will be recognised in profit or loss.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated 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, the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of The Rules Governing the Listing of Securities on GEM of the Stock Exchange (the "GEM Listing Rules").

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The preparation of consolidated financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions 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 judgements 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.

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

Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis except for certain financial assets and financial liabilities, which are measured at fair values, as explained in the accounting policies set out below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities (including special purpose entities) controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated in full on consolidation.

Non-controlling interests in subsidiaries are presented separately from the Group's equity therein.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of consolidation (Continued)

Allocation of total comprehensive income to non-controlling interests

Total comprehensive income and expense of a subsidiary is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. Prior to 1 January 2010, losses applicable to the non-controlling interests in excess of the non-controlling interests in the subsidiary's equity were allocated against the interests of the Group except to the extent that the non-controlling interests had a binding obligation and were able to make an additional investment to cover the losses.

Changes in the Group's ownership interests in existing subsidiaries

Changes in the Group's ownership interests in existing subsidiaries on or after 1 January 2010

Changes in the Group's ownership interests in subsidiaries that do not result in the Group losing control over the subsidiaries are accounted for as equity transactions. The carrying amounts of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to owners of the Company.

When the Group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), and liabilities of the subsidiary and any non-controlling interests. Where certain assets of the subsidiary are measured at revalued amounts or fair values and the related cumulative gain or loss has been recognised in other comprehensive income and accumulated in equity, the amounts previously recognised in other comprehensive income and accumulated in equity are accounted for as if the Company had directly disposed of the related assets (i.e. reclassified to profit or loss or transferred directly to retained earnings). The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under HKAS 39 *Financial Instruments: Recognition and Measurement* or, when applicable, the cost on initial recognition of an investment in an associate or a jointly controlled entity.

Changes in the Group's ownership interests in existing subsidiaries prior to 1 January 2010

Increases in interests in existing subsidiaries were treated in the same manner as the acquisition of subsidiaries, with goodwill or a bargain purchase gain being recognised where appropriate. For decreases in interests in subsidiaries, regardless of whether the disposals would result in the Group losing control over the subsidiaries, the difference between the consideration received and the adjustment to the non-controlling interests was recognised in profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Business combinations

Business combinations that took place on or after 1 January 2010

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are generally recognised in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and liabilities or assets related to employee benefit arrangements are recognised and measured in accordance with HKAS 12 *Income Taxes* and HKAS 19 *Employee Benefits* respectively;

- liabilities or equity instruments related to share-based payment transactions of the acquiree or the replacement of an acquiree's share-based payment transactions with share-based payment transactions of the Group are measured in accordance with HKFRS 2 *Share-based Payment* at the acquisition date; and

- assets (or disposal groups) that are classified as held for sale in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* are measured in accordance with that standard.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after assessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interests are measured at their fair value or another measurement basis required by another standard.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Business combinations (Continued)

Where the consideration the Group transfers in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and considered as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with the corresponding adjustments being made against goodwill or gain on bargain purchase. Measurement period adjustments are adjustments that arise from additional information obtained during the measurement period about facts and circumstances that existed as of the acquisition date. Measurement period does not exceed one year from the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with HKAS 39, or HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, as appropriate, with the corresponding gain or loss being recognised in profit or loss.

When a business combination is achieved in stages, the Group's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date (i.e. the date when the Group obtains control), and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other comprehensive income are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

Changes in the value of the previously held equity interest recognised in other comprehensive income and accumulated in equity before the acquisition date are reclassified to profit or loss when the Group obtains control over the acquiree.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised as of that date.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Business combinations (Continued)

Business combinations that took place prior to 1 January 2010

Acquisition of businesses was accounted for using the purchase method. The cost of the acquisition was measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that met the relevant conditions for recognition were generally recognised at their fair value at the acquisition date.

Goodwill arising on acquisition was recognised as an asset and initially measured at cost, being the excess of the cost of the acquisition over the Group's interest in the recognised amounts of the identifiable assets, liabilities and contingent liabilities recognised. If, after assessment, the Group's interest in the recognised amounts of the acquiree's identifiable assets, liabilities and contingent liabilities exceeded the cost of the acquisition, the excess was recognised immediately in profit or loss.

The minority interest in the acquiree was initially measured at the minority interest's proportionate share of the recognised amounts of the assets, liabilities and contingent liabilities of the acquiree.

Contingent consideration was recognised, if and only if, the contingent consideration was probable and could be measured reliably. Subsequent adjustments to contingent consideration were recognised against the cost of the acquisition.

Business combinations achieved in stages were accounted for as separate steps. Goodwill was determined at each step. Any additional acquisition did not affect the previously recognised goodwill.

Goodwill

Goodwill arising on an acquisition of a business is carried at cost less accumulated impairment losses, if any, and is presented separately in the consolidated statement of financial position.

For the purposes of impairment testing, goodwill is allocated to each of the Group's cash-generating units (or groups of cash-generating units) that is expected to benefit from the synergies of the combination.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit, and then to the other assets of the unit on a pro rata basis based on the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in profit or loss in the consolidated statement of comprehensive income. An impairment loss recognised for goodwill is not reversed in subsequent periods.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Goodwill (Continued)

On disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Investment in an associate

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of an associate are incorporated in these consolidated financial statements using the equity method of accounting, except when the investment is classified as held for sale, in which case it is accounted for in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Under the equity method, investment in an associate is initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of the profit or loss and other comprehensive income of the associate. When the Group's share of losses of an associate exceeds the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. Additional losses are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of an associate recognised at the date of acquisition is recognised as goodwill, which is included with the carrying amount of the investment.

Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

The requirements of HKAS 39 are applied to determine whether it is necessary to recognise any impairment loss with respect to the Group's investment in an associate. When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with HKAS 36 *Impairment of Assets* as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Any impairment loss recognised forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognised in accordance with HKAS 36 to the extent that the recoverable amount of the investment subsequently increases.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment in an associate (Continued)

From 1 January 2010 onwards, upon disposal of an associate that results in the Group losing significant influence over that associate, any retained investment is measured at fair value at that date and the fair value is regarded as its fair value on initial recognition as a financial asset in accordance with HKAS 39. The difference between the previous carrying amount of the associate attributable to the retained interest and its fair value is included in the determination of the gain or loss on disposal of the associate. In addition, the Group accounts for all amounts previously recognised in other comprehensive income in relation to that associate on the same basis as would be required if that associate had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income by that associate would be reclassified to profit or loss on the disposal of the related assets or liabilities, the Group reclassifies the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses significant influence over that associate.

When a group entity transacts with its associate, profits and losses resulting from the transactions with the associate are recognised in the Group's consolidated financial statements only to the extent of interests in the associate that are not related to the Group.

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 Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in profit or loss 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 the end of each reporting period.

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.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

Leasehold land

When a lease includes both land and building elements, the Group assesses the classification of each element as a finance or an operating lease separately based on the assessment as to whether substantially all the risks and rewards incidental to ownership of each element have been transferred to the Group. Specifically, the minimum lease payments (including any lump-sum upfront payments) are allocated between the land and the building elements in proportion to the relative fair values of the leasehold interests in the land element and building element of the lease at the inception of the lease. When the lease payments cannot be allocated reliably between the land and building elements, the entire lease is generally classified as a finance lease and accounted for as property, plant and equipment.

To the extent the allocation of the lease payments can be made reliably, interest in leasehold land that is accounted for as an operating lease is presented as "prepaid lease payments" in the consolidated statement of financial position and is amortised over the lease term on a straight-line basis.

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 Group and amortised on a straight-line basis over its estimated economic life of a period of five years since the commencement of related production. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Impairment of tangible and intangible assets

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impairment of tangible and intangible assets (Continued)

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. 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 for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or a cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or the cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or a cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Financial instruments

Financial assets and financial liabilities are recognised when a group entity becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Financial assets

The Group's financial assets are classified into loans and receivables and available-for-sale financial assets ("AFS financial assets"). The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial assets (Continued)

Effective interest method

The effective interest method is a method of calculating the amortised cost of a debt instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Income is recognised on an effective interest basis for debt instruments other than financial assets classified as at fair value through profit or loss, of which interest income is included in net gains and losses.

AFS financial assets

AFS financial assets are non-derivatives that are either designated as available-for-sale or are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

AFS financial assets are measured at fair value at the end of the reporting period. Changes in fair value are recognised in other comprehensive income and accumulated under the heading of investments revaluation reserve. Where the financial asset is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

AFS equity investments that do not have a quoted market price in the active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity investments are measured at cost less any identified impairment losses at the end of the reporting period.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables (including trade and bills receivables, other receivables, pledged bank deposits, cash and bank balances) are measured at amortised cost using the effective interest method, less any impairment.

Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets, other than those at fair value through profit or loss, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial assets (Continued)

Impairment of financial assets (Continued)

For AFS equity investments, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- breach of contract, such as default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation; or
- the disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial asset, such as trade receivables, assets that are assessed not to be impaired individually are assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period of 180 days, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, the amount of the impairment loss recognised is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss in the period.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial assets (Continued)

Impairment of financial assets (Continued)

For financial assets measured at amortised cost, 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 through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

In respect of AFS equity securities, impairment losses previously recognised in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognised in other comprehensive income and accumulated under the heading of investments revaluation reserve. In respect of AFS debt securities, impairment losses are subsequently reversed through profit or loss if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

Financial liabilities and equity instruments

Debt and equity instruments issued by a group entity are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

The Group's financial liabilities are generally classified into financial liabilities at fair value through profit or loss and other financial liabilities.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recognised at the proceeds received, net of direct issue costs.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Interest expense is recognised on an effective interest basis other than financial liabilities classified as at fair value through profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial liabilities and equity instruments (Continued)

Financial liabilities at fair value through profit or loss

Financial liabilities are classified as at fair value through profit or loss when the financial liability is either held for trading or it is designated as at fair value through profit or loss on initial recognition.

A financial liability is classified as held for trading if:

- it has been acquired principally for the purpose of repurchasing it in the near term; or
- on initial recognition it is part of a portfolio of identified financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

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 Group'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.

Financial liabilities at fair value through profit or loss are stated at fair value, with any gains or losses arising on remeasurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability.

Other financial liabilities

Other financial liabilities (including trade and bills payables and other payables and accruals) are subsequently measured at amortised cost using the effective interest method.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial liabilities and equity instruments (Continued)

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recognised at the proceeds received, net of direct issue costs.

Repurchase of the Company's own equity instruments is recognised and deducted directly in equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Company's own equity instruments.

Derecognition

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

On derecognition of a financial asset other than in its entirety (e.g. when the Group retains an option to repurchase part of a transferred asset or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the Group retains control), the Group allocates the previous carrying amount of the financial asset between the part it continues to recognise under continuing involvement, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognised and the sum of the consideration received for the part no longer recognised and any cumulative gain or loss allocated to it that had been recognised in other comprehensive income is recognised in profit or loss. A cumulative gain or loss that had been recognised in other comprehensive income is allocated between the part that continues to be recognised and the part that is no longer recognised on the basis of the relative fair values of those parts.

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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.

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.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Current or deferred tax for the year is recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax is also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods sold and services provided in the course of the ordinary activities, net of discounts and sales related taxes.

Revenue from the sale of goods is recognised when all the following conditions are satisfied:

- the Group has transferred to the buyer the significant risks and rewards of ownership of the goods;
- the Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the Group; and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Specifically, revenue from the sale of goods is recognised when goods are delivered and legal title is passed.

Interest income from a financial asset is recognised when it is probable that the economic benefits will flow to the Group and the amount of revenue can be measured reliably. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

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 end of the reporting period. Employee entitlements to sick leave and maternity leave are not recognised until the time of leave.

Pension obligations

Payments to defined contribution retirement plans are charged as an expense when employees have rendered service entitling them to the contributions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 profit or loss over the period of the borrowings using the effective interest method.

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

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 profit or loss on a straight-line basis over the expected useful lives of the related assets.

Foreign and presentation currency

Functional and presentation currency

Items included in the accounts of the Group are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The accounts are presented in RMB, which is the Group'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 consolidated statement of comprehensive income.

Dividend distribution

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Related party transactions

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

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

(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 Group 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 Group, or of any entity that is a related party of the Group.

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

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In the application of the Group's accounting policies, which are described in Note 3, management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and underlying assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

Estimated impairment of purchased technical know-how

The Group assesses annually whether purchased technical know-how has suffered any impairment, in accordance with the accounting policy stated in Note 3. The recoverable amounts 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 Group 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 Group 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 Group estimates the useful lives of property, plant and equipment 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 Group also performs annual reviews on whether the assumptions made on useful lives continue to be valid.

Provision for obsolete inventories

The management of the Group reviews an aging analysis at the end of each reporting period, 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 Group carries out an inventory review on a product-by-product basis at the end of each reporting period and makes provision for obsolete items.

Trade and other receivables

The debt profile of trade and other debtors is reviewed on a regular basis to ensure that the trade and other 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 Group may experience delays in collection. Where recoverability of trade and other debtor balances are called into doubts, specific provisions for trade and other receivables are made based on credit status of the debtors, the aged analysis of the 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 consolidated statement of comprehensive income. Changes in the collectability of trade and other receivables for which provision are not made could affect the results of operations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

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 Group uses its judgement to select a variety of methods and make assumptions that are primarily based on market conditions existing at the end of each reporting period.

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(a) Categories of financial instruments

	As at 31 December	
	2010	2009
	RMB'000	RMB'000
Financial assets		
Available-for-sale investments	**1,000**	–
Loan and receivables (including cash and cash equivalents)	**902,560**	570,124
Financial liabilities		
Amortised cost	**342,617**	416,352

(b) Financial risk management objectives and policies

The main risks arising from the Group's financial instruments are market risk (including interest rate risk and foreign currency risk), credit risk and liquidity risk. The Board of Directors review and agree policies for managing each of these risks and they are summarised below.

There has been no change to the types of the Group's exposure in respect of financial instruments or the manner in which it manages and measures the risks.

Market risk

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

Interest rate risk management

The Group considers that there is no significant cash flow interest rate risk and fair value interest rate risk as the Group does not have variable rate and fixed rate borrowings. The Group did not enter into interest rate swap to hedge against its exposures to changes in fair values of the borrowings.

The Group's exposure to market risk for changes in interest rates relates primarily to the cash and bank balances. Floating-rate interest income is charged to the consolidated statement of comprehensive income as incurred.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(Continued)

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

Market risk (Continued)

Foreign currency risk management

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

The carrying amounts of the Group's foreign currency denominated monetary assets at the end of the reporting period are as follows:

	As at 31 December	
	2010	2009
	RMB'000	RMB'000
Assets		
HKD	**739**	739

Sensitivity analysis on foreign currency

The following table details the Group's sensitivity to a 5% increase and decrease in RMB against the relevant foreign currency. 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	
	2010	2009
	RMB'000	RMB'000
Impact of HKD		
Profit or loss #	**(37)**	(37)

This is mainly attributable to the exposure outstanding on cash and bank balances denominated in HKD not subject to cash flow hedge at the end of the reporting period.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(Continued)

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

Credit risk

As at 31 December 2010, the Group's maximum exposure to credit risk which will cause a financial loss to the Group due to failure to discharge an obligation by the counterparties is arising from the carrying amount of the respective recognised financial assets as stated in the consolidated statement of financial position.

The Group has put in place policies to ensure that sales of products are made to customers with an appropriate credit history and the Group performs periodic credit evaluation of its customers. The Group's historical experience in collection of trade and other receivables falls within the recorded allowances and the Directors are of the opinion that adequate provision for uncollectible trade and other receivables has been made in the accounts. In this regard, the Directors of the Company consider that the Group's credit risk is significantly reduced.

The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

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

Liquidity risk

Ultimate responsibility for liquidity risk management rests with the Board of Directors, which has built an appropriate liquidity risk management framework to meet the Group's short, medium and long-term funding and liquidity management requirements. The Group manages liquidity risk by maintaining adequate reserves, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(Continued)

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

Liquidity risk (Continued)

The following table details the Group's remaining contractual maturity for its financial liabilities based on the agreed repayment terms. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The tables include both interest and principal cash flows.

	Weighted average effective interest rate %	Within 1 year RMB'000	Over 1 year RMB'000	Total undis-counted cash flows RMB'000	Total carrying amount RMB'000
As at 31 December 2010					
Non-derivative financial liabilities					
Trade and bills payables	–	184,348	–	184,348	184,348
Other payables and accruals	–	144,430	–	144,430	144,430
Dividend payable	–	8,757	–	8,757	8,757
Deposits received	–	5,082	–	5,082	5,082
		342,617	–	342,617	342,617
As at 31 December 2009					
Non-derivative financial liabilities					
Trade and bills payables	–	328,995	–	328,995	328,995
Other payables and accruals	–	74,867	–	74,867	74,867
Dividend payable	–	7,314	–	7,314	7,314
Deposits received	–	5,176	–	5,176	5,176
		416,352	–	416,352	416,352

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(Continued)

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

Fair value of financial instruments

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

(i) the fair value of financial assets and financial liabilities with standard terms and conditions and traded in active markets are determined with reference to quoted market bid prices and ask prices respectively.

(ii) the fair value of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models (e.g. discounted cash flow analysis using observable and/or unobservable inputs).

(iii) The fair values of derivative instruments are calculated using quoted prices. Where such prices are not available, a discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives.

The Group's financial instruments that are measured subsequent to initial recognition at fair value are grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;

- Level 2 fair value measurements are those derived from inputs other than quote prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

No analysis is disclosed since the Group has no financial instruments that are measured subsequent to initial recognition at fair value at the end of the reporting period.

There were no transfers between Levels 1 and 2 in the both years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(Continued)

(c) Capital risk management

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

Gearing ratio

The Directors of the Company 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 2010, the Group'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 2010 and 2009 are as follows:

	As at 31 December	
	2010	2009
	RMB'000	RMB'000
Total debt	**–**	–
Total assets	**1,570,906**	1,220,473
Gearing ratio	**N/A**	N/A

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

6. SEGMENT INFORMATION

Information reported to the Board, being the chief operating decision makers, for the purposes of resources allocation and assessment of segment performance of different types of goods delivered.

The Group currently operates in one business segment in the manufacturing and selling of pharmaceutical products in the PRC. A single management team reports to the chief operating decision makers who comprehensively manage the entire business. The reportable operating results report to the chief operating decision makers are the net profit of the Group and the reportable assets and liabilities report to the chief operating decision makers are the Group's assets and liabilities.

Revenue from major products

The Group's revenue from its major products are as follows:

	2010	2009
	RMB'000	RMB'000
Pharmaceutical products	**1,342,254**	907,453

Information about major customers

Included in revenues arising from sales of pharmaceutical products of approximately RMB1,342,254,000 (2009: RMB907,453,000) are revenues of approximately RMB198,073,000 (2009: RMB119,688,000) which arose from sales to the Group's largest customer.

Geographical information

The Group only operates in the PRC. The Group's revenue for each of the years ended 31 December 2010 and 2009 is derived from external customers located in the PRC. The non-current assets of the Group are all located in the PRC in each of the years ended 31 December 2010 and 2009.

7. TURNOVER AND OTHER REVENUE

Turnover and other revenue recognised are as follows:

	2010	2009
	RMB'000	RMB'000
Turnover		
Sales of manufactured pharmaceutical products	**1,342,254**	907,453
Other revenue		
Interest income on bank deposits	**6,036**	2,191
Sundry income	**1,669**	1,576
	7,705	3,767

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

8. FINANCE COSTS

	2010 RMB'000	2009 RMB'000
Bills payables wholly repayable within six months	174	240

9. PROFIT FROM OPERATIONS

	2010 RMB'000	2009 RMB'000
Operating profit of the Group was determined after charging/(crediting) the followings:		
Raw materials and consumables used	521,089	476,278
Changes in inventories of finished goods and work-in-progress	8,357	(50,270)
Depreciation of property, plant and equipment (Note 21)	19,822	17,203
Amortisation of prepaid lease payments (Note 23)	378	274
Amortisation of purchased technical know-how (included in cost of sales) (Note 19)	794	844
Write-down of obsolete inventories (Note 26)	2,867	1,377
Impairment loss recognised in respect of prepayments to acquire technical know-how (Note 20)	–	2,430
Impairment loss recognised in respect of trade receivables (Note 28)	5,288	1,861
Impairment loss recognised in respect of other receivables (Note 29)	111	541
Employee benefit expenses (excluding Directors' and supervisors' remuneration)	97,412	85,301
Research and development costs	51,689	14,902
Advertising costs	14,315	2,678
Auditors' remuneration	480	480
and after crediting:		
Other income		
Penalty income	1,496	973
Reversal of obsolete inventories written-down (Note 26)	393	878
Reversal of impairment loss recognised in respect of trade receivables (Note 28)	768	266
Reversal of impairment loss recognised in respect of other receivables (Note 29)	347	217
Gain on disposal of property, plant and equipment	299	167
	3,303	2,501

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

10. TAXATION

(i) No provision for Hong Kong profits tax has been made as the Group did not carry on any business in Hong Kong during the year (2009: Nil).

(ii) As described in the paragraph below, the Group is subject to the PRC enterprise income tax at a rate of 15% (2009: 15%).

On 12 November 2009, the Company received confirmation from the Recognition Authority that the Company has been recognised as the High and New Technology Enterprise on 12 June 2009. Pursuant to the new Enterprise Income Tax Law, the enterprise income tax applicable to the High and New Technology Enterprise is reduced to be levied at 15%. The Company has since been enjoying the tax concession rate of 15% for three years effective from 1 January 2009.

(iii) The PRC value-added tax

The Group is subject to the PRC value-added tax ("VAT") at 17% (2009: 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 consolidated statement of comprehensive income represents:

	2010	2009
	RMB'000	RMB'000
Current taxation – Enterprise income tax	**68,769**	47,137
Deferred taxation (Note 24)	**(1,409)**	(421)
	67,360	46,716

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

10. TAXATION (Continued)

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

	2010 RMB'000	2009 RMB'000
Profit before taxation	450,754	315,266
Calculated at a taxation rate of 25% (2009: 25%)	112,689	78,817
Tax effect of utilisation of tax loss previously not recognised	(106)	–
Tax effect of income not taxable for tax purpose	(1,698)	(388)
Tax effect of expenses not deductible for tax purpose	2,956	830
Tax effect of tax concession	(45,813)	(31,527)
Tax effect of share of profit of associate	(668)	(1,016)
Taxation charge for the year	67,360	46,716

11. DIVIDENDS

A dividend in respect of 2010 of RMB0.05 per share, amounting to a total dividend of RMB30,480,000 (2009: RMB12,192,000) is to be proposed at the annual general meeting of the Company on 1 June 2011. These consolidated financial statements do not reflect this dividend payable.

	2010 RMB'000	2009 RMB'000
Proposed final dividend of RMB0.05 (2009: RMB0.02) per ordinary share	30,480	12,192

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

12. EMPLOYEE BENEFIT EXPENSES

	2010	2009
	RMB'000	RMB'000
Salaries and wages	**40,294**	42,742
Sales commission	**50,464**	37,122
Pension costs – defined contribution plans	**6,654**	5,437
	97,412	85,301

13. PENSION AND RETIREMENT BENEFIT COSTS

The Group 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 30% on the employees' salary or the monthly average salaries set out by the PRC local government.

Commencing 2003, the Group 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 Scheme based on 5% of the Hong Kong employees' relevant income as defined under the Mandatory Provident Fund Schemes Ordinance. Both the Group's and the employees' contributions are subject to a cap of RMB848 (equivalent to HK$1,000) per month and thereafter contributions are voluntary.

During the year ended 31 December 2010, the Group has contributed approximately RMB10,170 (2009: RMB10,580) to the MPF Scheme.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

14. 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:

	2010 RMB'000	2009 RMB'000
Basic salaries and allowances	**1,035**	991
Retirement benefit costs	**136**	166
	1,171	1,157

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

	2010 RMB'000	2009 RMB'000
Executive Directors		
Liu Baoqi	**456**	456
Li Minghua	**127**	127
Liu Zhenhai	**106**	106
Han Fengsheng	**67**	67
Chen Yu (Appointed on 28 April 2009)	**67**	45
Non-executive Directors		
Zhou Wuxian (Resigned on 28 April 2009)	**–**	8
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**	24
Supervisors		
Sun Song	**60**	60
Guan Yonghua	**24**	24
Zhu Enqiang (Resigned on 30 November 2010)	**22**	24
Gao Xiaoling (Resigned on 30 November 2010)	**22**	24
Wang Jian (Appointed on 30 November 2010)	**2**	–
Song Liangwei (Appointed on 30 November 2010)	**2**	–
	1,171	1,157

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

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

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

The number of Directors and supervisors whose emoluments fell within the following band is as follows:

	Number of individuals	
	2010	2009
Nil – RMB847,500 (equivalent to Nil – HK$1,000,000)	**16**	15

None of the Directors have waived any emoluments during the year.

(ii) The five individuals whose emoluments were the highest in the Group for the year include four (2009: 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 (2009: one) non-director, highest paid individual during the year are as follows:

	2010 RMB'000	2009 RMB'000
Basic salaries and allowances	**662**	660
Retirement benefit costs	**10**	12
	672	672

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

	Number of individuals	
	2010	2009
Nil – RMB847,500 (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 (2009: Nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

15. EARNINGS PER SHARE

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

	2010	2009
Profit attributable to owners of the Company (RMB'000)	**383,122**	268,550
Weighted average number of ordinary shares in issue ('000)	**609,600**	609,600
Basic and diluted earnings per share (RMB)	**0.629**	0.441

16. INTERESTS IN SUBSIDIARIES

The Company

	2010 RMB'000	2009 RMB'000
Cost of investments in subsidiaries, unlisted in PRC	**51,479**	459

As at 31 December 2010, the Company had interests in the following subsidiaries:

Name of the entity	**Form of business structure**	**Place of incorporation and operation**	**Paid up registered capital**	**Proportion of registered capital held by the Company (directly)**	**Proportion of voting power held**	**Principal activities**
Sichuan Luoxin Pharmacy Company Limited* (四川羅欣醫葯有限公司) ("Sichuan Luoxin")	Incorporated	PRC	RMB3,000,000	51%	51%	Wholesale of biochemical products and Chinese medicine
Shandong Yuxin Pharmacy Company Limited*# (山東裕欣藥業有限公司) ("Shandong Yuxin")	Incorporated	PRC	RMB50,000,000	100%	100%	Wholesale and manufacture of biochemical products and Chinese medicine

The subsidiaries had no debt securities outstanding at the end of the reporting period or at any time during the year.

Shandong Yuxin was incorporated on 30 December 2010.

* The English name represents the translated name of the subsidiary as no English name has been registered.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

17. INTEREST IN AN ASSOCIATE

The Group and the Company

	2010 RMB'000	2009 RMB'000
Cost of investment in an associate, unlisted in PRC	19,620	19,620
Share of post-acquisition profits and other comprehensive income, net of dividend received (Note)	5,431	7,170
	25,051	26,790

As at 31 December 2010 and 2009, the Group had interest in the following associate:

Name of the entity	Form of business structure	Place of incorporation and principal operation	Proportion of registered capital held by the Group	Promotion of voting power held	Principal activities
Qilu Medical Investment Management Limited	Incorporated	PRC	20%	20%	Management and consultation of medical related business

The summarised financial information in respect of the associate is set out below:

	2010 RMB'000	2009 RMB'000
Total assets	187,647	179,229
Total liabilities	(62,390)	(45,279)
Net assets	125,257	133,950
Share of net assets of associate	25,051	26,790

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

17. INTEREST IN AN ASSOCIATE (Continued)

	2010 RMB'000	2009 RMB'000
Revenue	**21,156**	16,290
Profit for the year	**13,360**	20,318
Share of profit of associate for the year	**2,672**	4,063
Share of other comprehensive income for the year	**1,889**	–

Note:

The amount includes (i) the accumulated share of profit and other comprehensive income of associate of approximately RMB9,019,000 (2009: RMB4,458,000) for the year ended 31 December 2010; (ii) excess of the share of the net fair value of the associate's identifiable assets, liabilities and contingent liabilities over the cost of the investment in associate of approximately RMB2,712,000; and (iii) net of accumulated dividends received of RMB6,300,000 (2009: Nil). The Company received dividend of RMB6,300,000 from the associate during the year ended 31 December 2010. The Group has reassessed the fair value of the associate's identifiable net assets and considered the values of net assets are measured reliably.

18. AVAILABLE-FOR-SALE FINANCIAL ASSETS

The Group and the Company

Available-for-sale investments comprise:

	2010 RMB'000	2009 RMB'000
Unlisted securities – Equity securities *(Note)*	**1,000**	–

Note:

The Group holds 10% of the capital of 山東羅欣陽光包裝制品有限公司, a company involved in the production and selling of plastic and packaging materials. The Directors of the Company are of the opinion that the Group is not able to exercise significant influence over 山東羅欣陽光包裝制品有限公司 as the 80% of the capital is controlled by one shareholder, who also manages the daily operations of the entity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

19. PURCHASED TECHNICAL KNOW-HOW

The Group and the Company

	RMB'000
Cost:	
At 1 January 2009	17,300
Additions	150
At 31 December 2009 and 1 January 2010	17,450
Additions	–
At 31 December 2010	17,450
Accumulated amortisation and impairment:	
At 1 January 2009	14,610
Charge for the year	844
At 31 December 2009 and 1 January 2010	15,454
Charge for the year	794
At 31 December 2010	16,248
Net book value:	
At 31 December 2010	**1,202**
At 31 December 2009	1,996

20. PREPAYMENTS TO ACQUIRE TECHNICAL KNOW-HOW

The Group and the Company

As at 31 December 2010 and 2009, the amounts are prepayments to third parties to acquire technical know-how. During the year ended 31 December 2009, amount of RMB2,430,000 was impaired. The Directors of the Company have considered that the amount of the prepayment to acquire technical know-how of RMB2,430,000 was not recoverable as the research and development process was not successful and would not bring any future economic benefit to the Group and the Company. The Directors of the Company are of the opinion that no further impairment was recognised because the remaining research and development process was considered to be successful and would bring future economic benefit to the Group and the Company.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

21. PROPERTY, PLANT AND EQUIPMENT

The Group

	Buildings RMB'000	**Plant and machinery** RMB'000	**Motor vehicles** RMB'000	**Office equipment** RMB'000	**Total** RMB'000
Cost:					
At 1 January 2009	163,191	114,058	8,806	7,830	293,885
Additions	4,156	4,505	2,312	2,045	13,018
Transfer from construction-in-progress (Note 22)	8,607	10,071	–	–	18,678
Acquisition through business combination	–	–	–	5	5
Disposals	(4,083)	(2,286)	(1,539)	(27)	(7,935)
At 31 December 2009 and 1 January 2010	171,871	126,348	9,579	9,853	317,651
Additions	4,816	4,585	4,733	1,097	15,231
Disposals	–	(143)	(563)	(66)	(772)
Transfer from construction-in-progress (Note 22)	2,248	10,686	–	–	12,934
At 31 December 2010	178,935	141,476	13,749	10,884	345,044
Accumulated depreciation and impairment:					
At 1 January 2009	6,191	27,095	4,643	5,058	42,987
Charge for the year	3,988	10,945	1,386	884	17,203
Written back on disposals	(185)	(1,375)	(1,176)	(24)	(2,760)
At 31 December 2009 and 1 January 2010	9,994	36,665	4,853	5,918	57,430
Charge for the year	4,389	12,613	1,659	1,161	19,822
Written back on disposals	–	(78)	(353)	(47)	(478)
At 31 December 2010	14,383	49,200	6,159	7,032	76,774
Net book value:					
At 31 December 2010	**164,552**	**92,276**	**7,590**	**3,852**	**268,270**
At 31 December 2009	161,877	89,683	4,726	3,935	260,221

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

21. PROPERTY, PLANT AND EQUIPMENT (Continued)

As at 31 December 2010 and 2009, all buildings of the Group are located in the PRC.

Depreciation expense of RMB12,339,000 (2009: RMB12,306,000) have been expensed in cost of sales and RMB7,483,000 (2009: RMB4,897,000) have been included in administrative expenses for the year.

The Company

	Buildings RMB'000	**Plant and machinery** RMB'000	**Motor vehicles** RMB'000	**Office equipment** RMB'000	**Total** RMB'000
Cost:					
At 1 January 2009	163,191	114,058	8,806	7,830	293,885
Additions	4,156	4,505	2,312	2,045	13,018
Transfer from construction-in-progress (Note 22)	8,607	10,071	–	–	18,678
Disposals	(4,083)	(2,286)	(1,539)	(27)	(7,935)
At 31 December 2009 and 1 January 2010	171,871	126,348	9,579	9,848	317,646
Additions	4,816	4,585	4,676	1,021	15,098
Disposals	–	(143)	(563)	(66)	(772)
Transfer from construction-in-progress (Note 22)	2,248	10,686	–	–	12,934
At 31 December 2010	178,935	141,476	13,692	10,803	344,906
Accumulated depreciation and impairment:					
At 1 January 2009	6,191	27,095	4,643	5,058	42,987
Charge for the year	3,988	10,945	1,386	884	17,203
Written back on disposals	(185)	(1,375)	(1,176)	(24)	(2,760)
At 31 December 2009 and 1 January 2010	9,994	36,665	4,853	5,918	57,430
Charge for the year	4,389	12,613	1,659	1,148	19,809
Written back on disposals	–	(78)	(353)	(47)	(478)
At 31 December 2010	14,383	49,200	6,159	7,019	76,761
Net book value:					
At 31 December 2010	**164,552**	**92,276**	**7,533**	**3,784**	**268,145**
At 31 December 2009	161,877	89,683	4,726	3,930	260,216

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

22. CONSTRUCTION-IN-PROGRESS

The Group

	RMB'000
At 1 January 2009	–
Additions	27,971
Transfer to property, plant and equipment (Note 21)	(18,678)
At 31 December 2009 and 1 January 2010	9,293
Additions	56,467
Transfer to property, plant and equipment (Note 21)	(12,934)
At 31 December 2010	**52,826**

Analysis of construction-in-progress as follows:

	2010	2009
	RMB'000	RMB'000
Construction cost of buildings	**28,683**	2,241
Cost of plant and machinery	**24,143**	7,052
	52,826	9,293

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

22. CONSTRUCTION-IN-PROGRESS (Continued)

The Company

	RMB'000
At 1 January 2009	–
Additions	27,971
Transfer to property, plant and equipment (Note 21)	(18,678)
At 31 December 2009 and 1 January 2010	9,293
Additions	21,993
Transfer to property, plant and equipment (Note 21)	(12,934)
At 31 December 2010	**18,352**

Analysis of construction-in-progress as follows:

	2010 RMB'000	2009 RMB'000
Construction cost of buildings	**1,676**	2,241
Cost of plant and machinery	**16,676**	7,052
	18,352	9,293

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

23. PREPAID LEASE PAYMENTS

The Group and the Company

Prepaid lease payments represent 50-year to 70-year land use rights in the PRC expiring from November 2050 to September 2079. This payment is recognised as an expense over the leasehold period.

	RMB'000
At 1 January 2009	11,448
Amortisation of prepaid lease payments	(274)
At 31 December 2009 and 1 January 2010	11,174
Additions of prepaid lease payments	9,717
Amortisation of prepaid lease payments	(378)
At 31 December 2010	**20,513**

Analysed for reporting purposes as:

	2010 RMB'000	2009 RMB'000
Current assets (included in other receivables, deposits and prepayments)	**412**	273
Non-current assets	**20,101**	10,901
	20,513	11,174

	2010 RMB'000	2009 RMB'000
Long-term lease	**9,613**	–
Medium-term lease	**10,900**	11,174
	20,513	11,174

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

24. DEFERRED TAX ASSETS

The Group and the Company

Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 25% (2009: 25%).

The movements in the deferred tax assets are as follows:

	2010	2009
	RMB'000	RMB'000
At the beginning of the year	**2,103**	1,682
Deferred taxation credited to the consolidated statement of comprehensive income (Note 10)	**1,409**	421
At the end of the year	**3,512**	2,103

	Provisions	**Amortisation charge on purchased technical know-how**	**Total**
	RMB'000	RMB'000	RMB'000
At 1 January 2009	756	926	1,682
Credited/(charged) to the consolidated statement of comprehensive income	605	(184)	421
At 31 December 2009 and 1 January 2010	1,361	742	2,103
Credited/(charged) to the consolidated statement of comprehensive income	1,579	(170)	1,409
At 31 December 2010	**2,940**	**572**	**3,512**

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

There is no unprovided deferred taxation during the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

25. GOODWILL

The Group

	2010 RMB'000	2009 RMB'000
The carrying amount of goodwill was allocated to cash-generating unit as follows:		
Manufacturing and selling of pharmaceutical products	**165**	165

At the end of the reporting period, the Group assessed the recoverable amount of goodwill, and determined that goodwill associated with the Group's manufacturing and selling of pharmaceutical products activity was not impaired. The recoverable amount was assessed by reference to the cash-generating unit's value in use.

The recoverable amount of this cash-generating unit is determined based on a value in use calculation which uses cash flow projections based on financial budgets approved by the Directors covering a five-year period, and a discount rate of 12%.

Cash flow projections during the budget period are based on the same expected gross margins and raw material price inflation throughout the budget period. The Directors believe that any reasonably possible change in the key assumptions on which the recoverable amount is based would not cause the carrying amount of the unit to exceed the aggregate recoverable amount of the cash-generating unit.

26. INVENTORIES

The Group

	2010 RMB'000	2009 RMB'000
Raw materials	**94,676**	117,183
Work-in-progress	**58,205**	61,138
Finished goods	**66,421**	69,722
	219,302	248,043
Less: Write-down of obsolete inventories	**(3,913)**	(1,439)
	215,389	246,604

The cost of inventories recognised as expense and included in cost of sales amounted to approximately RMB529,446,000 (2009: RMB426,008,000).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

26. INVENTORIES (Continued)

Movements in the write-down of obsolete inventories are as follows:

	2010 RMB'000	2009 RMB'000
Balance at the beginning of the year	**1,439**	940
Write-down of obsolete inventories during the year	**2,867**	1,377
Reversal of obsolete inventories written-down	**(393)**	(878)
Balance at the end of the year	**3,913**	1,439

The reversal of obsolete inventories written-down arose from sales of obsolete inventories recognised during the year.

The Directors of the Company have assessed the net realisable values and conditions of the Group's inventories as at 31 December 2010 and have considered a write-down of obsolete inventories of approximately RMB3,913,000 (2009: RMB1,439,000) be made in respect of the net realisable value of the inventories.

The Company

	2010 RMB'000	2009 RMB'000
Raw materials	**94,676**	117,183
Work-in-progress	**58,205**	61,138
Finished goods	**64,299**	69,722
	217,180	248,043
Less: Write-down of obsolete inventories	**(3,913)**	(1,439)
	213,267	246,604

The cost of inventories recognised as expense and included in cost of sales amounted to approximately RMB529,446,000 (2009: RMB426,008,000).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

26. INVENTORIES (Continued)

Movements in the write-down of obsolete inventories are as follows:

	2010 RMB'000	2009 RMB'000
Balance at the beginning of the year	**1,439**	940
Write-down of obsolete inventories during the year	**2,867**	1,377
Reversal of obsolete inventories written-down	**(393)**	(878)
Balance at the end of the year	**3,913**	1,439

The reversal of obsolete inventories written-down arose from sales of obsolete inventories recognised during the year.

The Directors of the Company have assessed the net realisable values and conditions of the Company's inventories as at 31 December 2010 and have considered a write-down of obsolete inventories of approximately RMB3,913,000 (2009: RMB1,439,000) be made in respect of the net realisable value of the inventories.

27. AMOUNTS DUE FROM SUBSIDIARIES

The Company

	Highest balances during the year RMB'000	2010 RMB'000	2009 RMB'000
Sichuan Luoxin	5,614	**5,614**	–
Shandong Yuxin	64,464	**64,464**	–
		70,078	–

The amounts due are unsecured, interest-free and recoverable on demand.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

28. TRADE AND BILLS RECEIVABLES

The Group

	2010 RMB'000	2009 RMB'000
Trade receivables	207,530	50,235
Bills receivables	22,591	18,632
	230,121	68,867
Less: Provision for impairment loss recognised in respect of trade receivables	(7,199)	(2,679)
	222,922	66,188

The following is an analysis of trade and bills receivables by age, presented based on the invoice date, net of provision for impairment loss:

	2010 RMB'000	2009 RMB'000
1 to 90 days	189,120	32,343
91 to 180 days	32,032	28,359
181 to 365 days	1,770	5,486
	222,922	66,188

Customers are generally granted with credit term of 180 days. Bills receivables are all due to mature within 180 days. Trade and bills receivables as at 31 December 2010 and 2009 are denominated in RMB.

As at 31 December 2010, amount of approximately RMB67,924,000, RMB13,608,000 and RMB35,660,000 is receivable from a shareholder, a promoter and two fellow subsidiaries of a shareholder respectively (Note 39). The amounts due are unsecured, interest-free and receivable within 180 days.

As at 31 December 2009, amount of approximately RMB6,977,000 and RMB673,000 is receivable from a shareholder and promoter respectively (Note 39). The amounts due are unsecured, interest-free and receivable within 180 days.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

28. TRADE AND BILLS RECEIVABLES (Continued)

(a) Included in the Group's trade and bills receivables balance are debtors with a carrying amount of approximately RMB1,770,000 (2009: RMB5,486,000) which are past due at the reporting date for which the Group has not provided for impairment loss. The Group has recognised provision for impairment loss of 100% against all receivables over 365 days because historical experience has been that receivables that are past due beyond 365 days are not recoverable. The Group 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:

	2010 RMB'000	2009 RMB'000
181 to 365 days	1,770	5,486

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

	2010 RMB'000	2009 RMB'000
Balance at the beginning of the year	2,679	1,084
Impairment loss recognised during the year	5,288	1,861
Reversal of impairment loss recognised in respect of trade receivables	(768)	(266)
Balance at the end of the year	7,199	2,679

In determining the recoverability of trade receivables, the Group 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 of the Company have considered provision for impairment is values be made in respect of trade receivables to their recoverable values and believed that there is no further credit provision required in excess of the provision for impairment loss recognised in respect of trade receivables.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

28. TRADE AND BILLS RECEIVABLES (Continued)

The Company

	2010 RMB'000	2009 RMB'000
Trade receivables	207,530	50,235
Bills receivables	22,103	18,632
	229,633	68,867
Less: Provision for impairment loss recognised in respect of trade receivables	(7,199)	(2,679)
	222,434	66,188

The following is an analysis of trade and bills receivables by age, presented based on the invoice date, net of provision for impairment loss:

	2010 RMB'000	2009 RMB'000
1 to 90 days	188,632	32,343
91 to 180 days	32,032	28,359
181 to 365 days	1,770	5,486
	222,434	66,188

Customers are generally granted with credit term of 180 days. Bills receivables are all due to mature within 180 days. Trade and bills receivables as at 31 December 2010 and 2009 are denominated in RMB.

As at 31 December 2010, amount of approximately RMB67,924,000, RMB13,608,000 and RMB35,660,000 is receivable from a shareholder, a promoter and two fellow subsidiaries of a shareholder respectively (Note 39). The amounts due are unsecured, interest-free and receivable within 180 days.

As at 31 December 2009, amount of approximately RMB6,977,000 and RMB673,000 is receivable from a shareholder and a promoter respectively (Note 39). The amounts due are unsecured, interest-free and receivable within 180 days.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

28. TRADE AND BILLS RECEIVABLES (Continued)

(a) Included in the Company's trade and bills receivables balance are debtors with a carrying amount of approximately RMB1,770,000 (2009: RMB5,486,000) which are past due at the reporting date for which the Company has not provided for impairment loss. The Company has recognised provision for impairment loss of 100% against all receivables over 365 days because historical experience has been that receivables that are past due beyond 365 days are not recoverable. 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:

	2010 RMB'000	2009 RMB'000
181 to 365 days	**1,770**	5,486

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

	2010 RMB'000	2009 RMB'000
Balance at the beginning of the year	**2,679**	1,084
Impairment loss recognised during the year	**5,288**	1,861
Reversal of impairment loss recognised in respect of trade receivables	**(768)**	(266)
Balance at the end of the year	**7,199**	2,679

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

29. OTHER RECEIVABLES, DEPOSITS AND PREPAYMENTS

The Group

	2010 RMB'000	2009 RMB'000
Other receivables and deposits	6,879	4,887
Prepayments (Note)	73,310	84,186
	80,189	89,073
Less: Provision for impairment loss recognised in respect of other receivables	(1,088)	(1,324)
	79,101	87,749

Note:

Prepayments mainly comprised of prepayment of value-added tax, acquisition of raw materials, packing materials and consumables, and acquisition of prepaid lease payments of approximately RMB15,785,000 (2009: RMB16,012,000), RMB22,702,000 (2009: RMB52,367,000) and RMB29,990,000 (2009: RMB10,023,000) respectively.

Movements in the provision for impairment loss recognised in respect of other receivables are as follows:

	2010 RMB'000	2009 RMB'000
Balance at the beginning of the year	1,324	1,000
Impairment loss recognised during the year	111	541
Reversal of impairment loss recognised in respect of other receivables	(347)	(217)
Balance at the end of the year	1,088	1,324

The reversal of impairment loss recognised due to the recovery of other receivables during the year.

In determining the recoverability of other receivables, the Group considers any change in the credit quality of the other receivables. Included in the provision for impairment loss recognised in respect of other receivables are individually impaired other receivables with a balance of approximately RMB1,088,000 (2009: RMB1,324,000) which have been in financial difficulty. The impairment recognised represents the difference between the carrying amount of these other receivables and the present value of the expected recoverable amounts. The Group does not hold any collateral over these balances.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

29. OTHER RECEIVABLES, DEPOSITS AND PREPAYMENTS (Continued)

The Company

	2010 RMB'000	2009 RMB'000
Other receivables and deposits	6,879	4,347
Prepayments (Note)	40,160	84,186
	47,039	88,533
Less: Provision for impairment loss recognised in respect of other receivables	(1,088)	(1,324)
	45,951	87,209

Note:

Prepayments mainly comprised of prepayment of value-added tax, acquisition of raw materials, packing materials and consumables, and acquisition of prepaid lease payments of approximately RMB15,182,000 (2009: RMB16,012,000), RMB22,702,000 (2009: RMB52,367,000) and Nil (2009: RMB10,023,000) respectively.

Movements in the provision for impairment loss recognised in respect of other receivables are as follows:

	2010 RMB'000	2009 RMB'000
Balance at the beginning of the year	1,324	1,000
Impairment loss recognised during the year	111	541
Reversal of impairment loss recognised in respect of other receivables	(347)	(217)
Balance at the end of the year	1,088	1,324

The reversal of impairment loss recognised due to the recovery of other receivables during the year.

In determining the recoverability of other receivables, the Company considers any change in the credit quality of the other receivables. Included in the provision for impairment loss recognised in respect of other receivables are individually impaired other receivables with a balance of approximately RMB1,088,000 (2009: RMB1,324,000) which have been in financial difficulty. The impairment recognised represents the difference between the carrying amount of these other receivables and the present value of the expected recoverable amounts. The Company does not hold any collateral over these balances.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

30. PLEDGED BANK DEPOSITS/CASH AND BANK BALANCES

The Group and the Company

As at 31 December 2010, bank deposits of approximately RMB91,837,000 (2009: RMB237,194,000) are pledged as collateral for bills payables.

The annual effective interest rate on pledged bank deposits is 2.2% (2009: 1.98%).

Cash and cash equivalents of the Group and the Company are denominated in RMB and HKD and bank deposits are placed with banks in the PRC and in Hong Kong. The remittance of funds out of the PRC is subject to the exchange control restrictions imposed by the PRC government.

31. TRADE AND BILLS PAYABLES

The Group

	2010	2009
	RMB'000	RMB'000
Trade payables	**97,511**	92,013
Bills payables	**86,837**	236,982
	184,348	328,995

The following is an analysis of trade and bills payables by age based on the invoice date:

	2010	2009
	RMB'000	RMB'000
1 to 90 days	**74,311**	69,664
91 to 180 days	**92,742**	243,286
181 to 365 days	**2,332**	8,624
Over 365 days	**14,963**	7,421
	184,348	328,995

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

31. TRADE AND BILLS PAYABLES (Continued)

The average credit period on trade and bills payables is 90 days. Bills payables are all due to mature within 180 days. The Group financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

The Company

	2010 RMB'000	2009 RMB'000
Trade payables	96,602	92,013
Bills payables	86,837	236,982
	183,439	328,995

The following is an analysis of trade and bills payables by age based on the invoice date:

	2010 RMB'000	2009 RMB'000
1 to 90 days	73,402	69,664
91 to 180 days	92,742	243,286
181 to 365 days	2,332	8,624
Over 365 days	14,963	7,421
	183,439	328,995

Trade and bills payables as at 31 December 2010 and 2009 are denominated in RMB.

The average credit period on trade and bills payables is 90 days. Bills payables are all due to mature within 180 days. The Company financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

32. OTHER PAYABLES AND ACCRUALS

The Group

	2010 RMB'000	2009 RMB'000
Accruals	84,437	16,373
Other payables	59,993	44,901
Received in advance	25,752	31,020
	170,182	92,294

The Company

	2010 RMB'000	2009 RMB'000
Accruals	84,437	16,373
Other payables	59,930	44,901
Received in advance	25,752	31,020
	170,119	92,294

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

33. DEFERRED INCOME

The Group and the Company

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 a new manufacturing plant to produce Chinese medicines. As at 31 December 2010 and 2009, the Company has not commenced the construction of the new manufacturing plant.

34. SHARE CAPITAL

		Nominal value		
	Number of shares	**Domestic shares**	**H shares**	**Total**
	'000	RMB'000	RMB'000	RMB'000
Registered, issued and fully paid:				
At 31 December 2009 (nominal value of RMB0.10 each)	609,600	44,504	16,456	60,960
At 31 December 2010 (nominal value of RMB0.10 each)	**609,600**	**44,504**	**16,456**	**60,960**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

35. RESERVES

The Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity to the consolidated financial statements.

The Company

The movements of reserves of the Company are as follows:

	Share premium RMB'000	**Statutory surplus reserve fund** RMB'000 (Note (i))	**Statutory public welfare fund** RMB'000 (Note (ii))	**Retained earnings** RMB'000	**Total** RMB'000
At 1 January 2009	31,139	30,480	6,033	363,603	431,255
Profit attributable to owners of the Company	–	–	–	268,550	268,550
Dividend paid	–	–	–	(12,192)	(12,192)
At 31 December 2009 and 1 January 2010	31,139	30,480	6,033	619,961	687,613
Profit attributable to owners of the Company	–	–	–	385,819	385,819
Other comprehensive income for the year	–	–	–	1,889	1,889
Total comprehensive income for the year	–	–	–	387,708	387,708
Dividend paid	–	–	–	(12,192)	(12,192)
At 31 December 2010	**31,139**	**30,480**	**6,033**	**995,477**	**1,063,129**

Representing:	
Proposed 2010 final dividends	**30,480**
Others	**964,997**
Retained earnings as at 31 December 2010	**995,477**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

35. RESERVES (Continued)

Notes:

(i) Pursuant to the PRC regulations and the Articles of Association of the Group's entities in the PRC, the entities in the PRC are 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 entity's registered capital. The transfer to this reserve must be made before distribution of dividends to shareholders. During the year ended 31 December 2010, appropriation of RMB13,000 was made by a subsidiary of the Company. During the year ended 31 December 2009, no appropriation has been made because either the statutory surplus reserve fund has reached 50% of the Company's registered capital or the subsidiaries of the Group record net losses for the year.

The statutory surplus reserve fund shall only be used to make good previous years' losses, to expand the entity's production operations, or to increase the capital of the entity. Upon approval by a resolution passed at a shareholders' general meeting, the entity 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 Articles of Association of the Group's entities in the PRC, the contribution to statutory public welfare fund by the entities 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 2010 and 2009.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

36. BUSINESS COMBINATION

For the year ended 31 December 2009

On 30 December 2009, the Company acquired 51% of the paid up capital of Sichuan Luoxin. The consideration for the acquisition was RMB459,000 which represented the cash paid as at the date of acquisition. The amount of goodwill arising as a result of the acquisition was approximately RMB165,000.

The net assets acquired in the transaction are as follows:

	The carrying amount of the acquiree's net assets before combination and at fair values
	RMB'000
Net assets acquired:	
Property, plant and equipment	5
Other receivables	540
Cash and cash equivalents	31
100% equity interest of Sichuan Luoxin	576
Non-controlling interests	(282)
51% equity interest of Sichuan Luoxin	294
Goodwill	165
	459

	RMB'000
Total consideration satisfied by:	
Cash consideration	459
Net cash outflow arising on acquisition:	
Cash consideration	(459)
Cash and cash equivalents acquired	31
	(428)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

36. BUSINESS COMBINATION (Continued)

Notes:

(i) Goodwill arose in the business combination because the cost of the combination effectively included amounts in relation to the benefit of synergies, revenue growth and future market development of Sichuan Luoxin. These benefits are not recognised separately from goodwill as the future economic benefits arising from them cannot be reliably measured.

(ii) Sichuan Luoxin did not contribute any to the Group's turnover and profit for the period from the date of acquisition to the end of the reporting period.

If the acquisition had been completed on 1 January 2009, total Group revenue for the year would have been approximately RMB907,453,000, and profit for the year attributable to owners of the Company would have been approximately RMB268,550,000. The pro forma information is for illustrative purpose only and is not necessarily an indication of revenue and results of the Group that actually would have been achieved had the acquisition been completed on 1 January 2009, nor is it intended to be a projection of future results.

37. BANKING FACILITIES

The Group had aggregate banking facilities of approximately RMB86,837,000 (2009: RMB236,982,000) which were fully utilised as at 31 December 2010.

As at 31 December 2010, RMB86,837,000 (2009: RMB236,982,000) of the banking facilities were secured by pledged bank deposits of approximately RMB91,837,000 (2009: RMB237,194,000).

38. COMMITMENTS

The Group had the following significant capital commitments:

	2010	2009
	RMB'000	RMB'000
Contracted but not provided for:		
– Purchase of technical know-how	**3,130**	3,130
– Purchase of property, plant and equipment	**50,905**	10,019

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

39. RELATED PARTY TRANSACTIONS

Key management compensation for the year ended 31 December 2010 and 2009 was disclosed in Note 14(i).

Apart from those as disclosed under Note 28 and elsewhere in the consolidated financial statements, the Group had the following material transactions with related parties during the year:

	2010 RMB'000	2009 RMB'000
Sales of finished goods to Luoxin Pharmacy Group Company Limited ("Luoxin Pharmacy Group") (note (i))	**198,073**	119,688
Sales of finished goods to The Linyi City People's Hospital ("Linyi People Hospital") (note (ii))	**11,631**	15,671
Sales of finished goods to The Pingyi County People's Hospital ("Pingyi People Hospital") (note (iii))	**–**	98
Sales of finished goods to Shandong Luosheng Pharmacy Co., Ltd. ("Shandong Luosheng") (note (iv))	**57,164**	–
Sales of finished goods to Shandong Mingxin Pharmacy Co., Ltd. ("Shandong Mingxin") (note (v))	**42,430**	–

Notes:

(i) Luoxin Pharmacy Group is the shareholder and promoter of the Company. Mr. Liu Baoqi is the Director for both Luoxin Pharmacy Group and the Company. As at 31 December 2010, amount of approximately RMB67,924,000 (2009:RMB6,977,000) due from Luoxin Pharmacy Group is included in trade and bills receivables, the terms of the outstanding balance is set out in Note 28.

(ii) Linyi People Hospital is the promoter of the Company. Mr. Yin Chuangui, a non-executive Director of the Company, is also the director of Linyi People Hospital during the year ended 31 December 2010. As at 31 December 2010, amount of approximately RMB13,608,000 (2009: RMB673,000) due from Linyi People Hospital is included in trade and bills receivables, the terms of the outstanding balance is set out in Note 28.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2010

39. RELATED PARTY TRANSACTIONS (Continued)

Notes: (Continued)

(iii) Pingyi People Hospital is the promoter of the Company. Mr. Liu Yuxin, a non-executive Director of the Company, is also the director of Pingyi People Hospital during the year ended 31 December 2010.

(iv) Shandong Luosheng is the fellow subsidiary of which Luoxin Pharmacy Group is holding 51% of the equity interests of Shandong Luosheng. Mr. Liu Baoqi and Mr. Liu Zhenhai are also the directors of Shandong Luosheng during the year ended 31 December 2010. As at 31 December 2010, amount of approximately RMB16,204,000 (2009: Nil) due from Shandong Luosheng is included in trade and bills receivables, the terms of the outstanding balance is set out in Note 28.

(v) Shandong Mingxin is the fellow subsidiary of which Luoxin Pharmacy Group is holding 51% of the equity interests of Shandong Mingxin. Mr. Liu Baoqi and Mr. Liu Zhenhai are also the directors of Shandong Mingxin during the year ended 31 December 2010. As at 31 December 2010, amount of approximately RMB19,456,000 (2009: Nil) due from Shandong Mingxin is included in trade and bills receivables, the terms of the outstanding balance is set out in Note 28.

The above transactions constitute connected transactions under GEM Listing Rules. Please also refer to "Connected Transactions and Continuing Connected Transactions" under "Report of the Directors".

40. CONTINGENT LIABILITIES

The Group and the Company had no material contingent liabilities as at 31 December 2010.

41. APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements were approved and authorised for issue by the Board of Directors on 15 March 2011.

FIVE YEARS FINANCIAL SUMMARY

	For the year ended 31 December				
	2010	2009	2008	2007	2006
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Results					
Turnover	**1,342,254**	907,453	667,792	509,092	317,868
Cost of sales	**(591,944)**	(479,736)	(351,196)	(260,628)	(175,905)
Gross profit	**750,310**	427,717	316,596	248,464	141,963
Other revenue	**7,705**	3,767	2,613	3,323	2,565
Other income	**3,303**	2,501	2,894	2,368	2,961
Selling and distribution expenses	**(218,663)**	(79,668)	(48,869)	(33,585)	(23,637)
General and administrative expenses	**(94,399)**	(42,874)	(29,438)	(33,057)	(24,955)
Share of profit of an associate	**2,672**	4,063	3,107	–	–
Finance costs	**(174)**	(240)	(1,250)	(4,554)	(7,679)
Profit before taxation	**450,754**	315,266	245,653	182,959	91,218
Taxation	**(67,360)**	(46,716)	(62,498)	(61,016)	(31,049)
Profit for the year	**383,394**	268,550	183,155	121,943	60,169
Profit attributable to:					
Owners of the Company	**383,122**	268,550	183,155	121,943	60,169
Non-controlling interests	**272**	–	–	–	–
	383,394	268,550	183,155	121,943	60,169
Dividends	**30,480**	12,192	12,192	12,192	12,192
Earnings per share attributable to owners of the Company (RMB)	**0.629**	0.441	0.300	0.200	0.099

FIVE YEARS FINANCIAL SUMMARY

	As at 31 December				
	2010	2009	2008	2007	2006
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Assets & Liabilities					
Total assets	**1,570,906**	1,220,473	681,722	470,569	398,923
Total liabilities	**(447,980)**	(471,618)	(189,507)	(149,317)	(187,422)
	1,122,926	748,855	492,215	321,252	211,501
Equity attributable to owners of the Company	**1,121,392**	748,573	492,215	321,252	211,501
Non-controlling interests	**1,534**	282	-	-	-
	1,122,926	748,855	492,215	321,252	211,501