山東羅欣藥業股份有限公司

Shandong Luoxin Pharmacy Stock Co., Ltd.*

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

Stock Code: 8058

ANNUAL REPORT 2011

* 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

Sun Song
Guan Yonghua
Wan Jian
Song Liang Wei

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 Mallesons
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 the Company and its subsidiaries (collectively the "Group") for the year ended 31 December 2011 (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, focusing on the speeding up of the adjustment of product structure and the production of compressed antibiotic products, expedition of market development of products for respiratory and digestive systems. The profit margins and 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 2011, turnover increased by 21.2% to RMB1,626,848,000, whereas profit attributable to shareholders increased by 11.34% to RMB426,556,000.

In the past year, our capabilities in, among others, management, market network development, technology development, 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, Shandong Yuxin Pharmacy Co., Ltd., a new member of the Company, has been granted the Drug Manufacturing Certificate (藥品生產許可證) and the construction of its infusion workshop and ancillary facilities has completed and is applying for GMP certification; the construction of pharmaceutical raw materials project of Shandong Hengxin Pharmacy Co., Ltd. is accelerated and ready for production. These projects expand the categories of new products of the Company 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. The Group has been recognised as an "Industrial Model Enterprise in the National Integrated Platform for New Pharmaceutical Research, Development and Technology (Shandong)" (國家綜合性新藥研發技術大平台 (山東) 產業化示範企業) and "Key High-Tech Enterprise under the State Torch Program" (國家火炬計劃重點高新技術企業). The Group has also been permitted to establish the "National Post-Doctoral Research Workshop" (國家博士後科研工作站). On such basis, during the year under review, the Group was permitted to establish the "Shandong Key Lyophilized Powder Injection Pharmaceutical Laboratory", the "Shandong Key Lyophilized Powder Injection Pharmaceutical Engineering Laboratory", the position of "Taishan Scholar – Pharmaceutical expert consultant" and "Enterprise Academician Workstation of Shandong Province" (山東省企業院士工作站), which introduced talents and built a stronger platform of research and development and technology improvement for the Group, which will further strengthen the research and development capacities of the Group. At present, the Company has built an extensive and seamless sales network throughout China and has established a sound marketing management system, which created sales channels for business solicitation, sale of hospital terminal products, logistics distribution, sale of third terminal products and pharmaceutical raw materials.

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.

We believe that the pharmaceutical industry will maintain rapid growth in 2012. Particularly with the acceleration of implementation of medical reform imposed by the State, the proactive introduction of new cooperative medical initiatives, further input into the pharmaceutical industry, and the improvement of public health services, together with the trends of aging population and the acceleration in urbanization, 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 consume a lot of pharmaceuticals. The room for development is extensive. The pharmaceutical industry is one of the principal supported industries in the Twelfth Five-Year Plan of the PRC central government. The central government will allocate more resources to the pharmaceutical and medical equipment industries. Looking ahead to 2012, 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
13 March 2012

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS

Mr. Liu Baoqi (劉保起), aged 50, 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 36, 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 46, 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 36, 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 43, 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 55, 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 53, 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 43, 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, until 1 May 2008. 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 48, 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 58, 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).

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

SUPERVISORS

Mr. Sun Song (孫松), aged 41, 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. Guan Yonghua (管永華), aged 49, 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 51, 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 31, 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 37, 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 76, 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 41, 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 had been serving as an independent non-executive director of Strong Petrochemical Holdings Limited since November 2008 until December 2011, 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 and accounting field, and held senior management position in several service and manufacturing companies.

MANAGEMENT DISCUSSION AND ANALYSIS

INTRODUCTION

With the government's proactive introduction of medical reforms, the further standardization and input into the pharmaceutical industry, and the improvement of public health services in 2011, the financial input into the medical and health areas has gradually increased. Together with the expansion of medical insurance coverage, the strengthening of rural health services, the enhancement of new rural cooperative medical services and the trends of aging population, the acceleration in urbanization, and the steady growth of the global pharmaceutical market, the development of pharmaceutical industry in the PRC will continue to be promising in 2012.

As a leading modern pharmaceutical enterprise in the PRC, the Group has always insisted on strategic core competencies in science and technology innovation, enhancement on its research, development and distribution, and consolidation of production. Best endeavours were used to provide reliable, high-technology and high value-added pharmaceutical products. During the year under review, the Group fully leveraged on the opportunities arising from the expansion in the market and fulfilled market demand by investing additional resources in enhancing its production capabilities, technologies and in the research and development of new products. At the same time, the Group has been keen on tapping into a broader market in order to increase its market share so as to boost its growth in both turnover and earnings to build a solid foundation for a sustainable development of the Group in the future.

BUSINESS REVIEW

For the year ended 31 December 2011, the Group has been consistent in implementing development strategies as formulated earlier and the targets of the Twelfth Five-Year Plan. A sound operation has thus been sustained in the first year of the Twelfth Five-Year Plan, supporting a balanced, healthy development in research and development, management, production, human resources, and market network. 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. In view of the current achievements, the Group will further strengthen its research and development capacities and expand its market network to further enhance its brand recognition and the Group's competitiveness so as to build up a world-class pharmaceutical brand.

Research and Development

1. Building a platform for technology research and development

   Prior to the year under review, the Group has been recognised as an "Industrial Model Enterprise in the National Integrated Platform for New Pharmaceutical Research, Development and Technology (Shandong)" (國家綜合性新藥研發技術大平台(山東)產業化示範企業) and "Key High-Tech Enterprise under the State Torch Program" (國家火炬計劃重點高新技術企業). The Group has also been permitted to establish the "National Post-Doctoral Research Workshop" (國家博士後科研工作站). On such basis, during the year under review, the Group was permitted to establish the "Shandong Key Lyophilized Powder Injection Pharmaceutical Laboratory", the "Shandong Key Lyophilized Powder Injection Pharmaceutical Engineering Laboratory", the position of "Taishan Scholar – Pharmaceutical expert consultant" and "Enterprise Academician Workstation of Shandong Province" (山東省企業院士工作站), which introduced talents and built a stronger platform of research and development and technology improvement for the Group, which will further strengthen the research and development capacities of the Group and enhance its overall competitiveness.

2. New products and patents

During the year under review, the Group received 24 patents of invention in the PRC. It is now applying for 17 patents of invention in the PRC. Eleven new drugs were approved for production and registration. As of 31 December 2011, the Group had 57 patents, of which 47 were national patents.

Production and Management

1. The Group continued to implement effective strategies on seven integral parts of its operation, namely management, culture, corporate organization, capital operation, science and technology innovation, human resources and marketing. These strategies have effectively contributed to the development of the Group and further enhanced its risk resistance capacities and overall competencies. Since 2006, 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". In 2011, the Company was named as one of the "Top Twenty Most Competitive Listed Pharmaceutical Companies in China" by China Pharmaceutical Enterprise Management Association. During the year under review, the Group was awarded the "Champion of the 2011 Best Industrial Enterprise in Pharmaceutical Research, Development and Production Line in China" (2011年中國醫藥研發產品線最佳工業企業第一名) by the Ministry of Industry and Information Technology of the PRC. These recognitions demonstrated the growth in the overall corporate strength of the Group.

2. Construction of production facilities

   (1) Pharmaceutical preparations: Shandong Yuxin Pharmacy Co., Ltd. was granted the Drug Manufacturing Certificate (藥品生產許可證) and the construction of its infusion workshop and ancillary facilities was completed, and is expected to generate revenue in 2012.

   (2) Pharmaceutical raw materials: the progress of the construction of pharmaceutical raw materials project of Shandong Hengxin Pharmacy Co., Ltd. is accelerated. The first phase of the project is scheduled to be completed and ready for operation in 2012.

Sales and Marketing

The Group continued to integrate sales resources and build up an outstanding sales team to increase the market share and competitiveness of its products. At present, the Group has built an extensive and seamless sales network throughout China and has established a sound marketing management system, which created sales channels for business solicitation, sale of hospital terminal products, logistics distribution, sale of third terminal products and pharmaceutical raw materials.

FINANCIAL REVIEW

For the year ended 31 December 2011, the Group's audited turnover was approximately RMB1,626,848,000, representing an increase of approximately 21.20% from approximately RMB1,342,254,000 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 a sales network to increase the market share of its products, which boosted an increase in turnover.

MANAGEMENT DISCUSSION AND ANALYSIS

For the year ended 31 December 2011, the audited cost of sales was approximately RMB624,217,000, representing an increase of approximately 5.45% from approximately RMB591,944,000 for the corresponding period of last year.

For the year ended 31 December 2011, the audited gross profit margin was 61.63%, representing an increase of approximately 5.73% from 55.90% for the corresponding period of last year. The increase was attributable to the Company's launch of products with high added values and upgrade of product portfolio, and improvement of production craft as a result of continuous investment on production facilities.

For the year ended 31 December 2011, the audited operating expenditure was approximately RMB530,934,000, representing an increase of approximately 69.59% from approximately RMB313,062,000 for the corresponding period of last year. The increase of operating expenditure was due to an increase in selling and distribution expenses in relation to new products launched during the year with different marketing strategies.

For the year ended 31 December 2011, the audited profit attributable to the shareholders was approximately RMB426,556,000, representing an increase of approximately 11.34% from approximately RMB383,122,000 for the corresponding period of last year. Weighted average earnings per share were RMB0.700 for the year ended 31 December 2011. The increase in the profit attributable to the shareholders was due to enhanced sales and products mix 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 2011, the Group's cash and cash equivalents amounted to approximately RMB927,358,000 (as at 31 December 2010: RMB673,847,000). As at 31 December 2011, the Group did not have any borrowings (as at 31 December 2010: nil).

PLEDGED BANK DEPOSITS/CASH AND CASH EQUIVALENTS

As at 31 December 2011, the Group's bank deposits of approximately RMB34,481,000 were pledged as security for remittance under acceptance (as at 31 December 2010: bank deposits of approximately RMB91,837,000 were pledged as security for remittance under acceptance).

MAJOR ACQUISITION AND DISPOSAL

For the year ended 31 December 2011, the Group did not have any major acquisition or disposal.

MANAGEMENT DISCUSSION AND ANALYSIS

SIGNIFICANT INVESTMENT

For the year ended 31 December 2011, the Group did not make any significant investment.

CONTINGENT LIABILITIES

As at 31 December 2011, 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.

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, as the development of the pharmaceutical industry will be one of the focuses of the State policies, the prospects of the pharmaceutical industry is optimistic. The pharmaceutical industry is one of the supported industries in the Twelfth Five-Year Plan of the PRC central government. The central government will allocate more resources to the pharmaceutical and medical equipment industries, and that a modern market system for the circulation of pharmaceutical products will be established during the Twelfth Five-Year Plan so as to enhance the concentration of the industry. The Group is confident in maintaining its sustainable and healthy development.

In addition, the "Guiding Opinions on Speeding up of the Restructuring of the Pharmaceutical Industry" (the "Opinions") jointly published by the Ministry of Industry and Information Technology, the Ministry of Health and the State Food and Drug Administration in November 2010 suggested the need 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, and will give more room for the development of competitive enterprises.

MANAGEMENT DISCUSSION AND ANALYSIS

In the future, the Group 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 the pharmaceutical industry, the Group will continue to expand its investment in research and development to enhance the standards in research and development as well as technologies, and to strengthen the capabilities of the internal research and development team. This will enable the Group to invent and develop more products of higher technology, better quality and higher added value. The Group also aims at reducing the production cost and expanding the production scale so as to achieve economies of scale, a low cost of production and differentiation of competitive edge. As the Group's new plants for Yuxin and Hengxin commence production, production capabilities will be increased to satisfy the growing market demand for pharmaceutical products. The construction of new plants will also assist the development of new categories of pharmaceutical products and expand the Group's scope in research and development on new drugs more effectively. This will facilitate a more comprehensive development in the Group's business. The Group will also accelerate the establishment of the sales team and proactively establish a broader sales network so as to enhance the market share of its products and continue to improve its core competencies.

With the implementation of the strategies stated above, the Group anticipated that "Luoxin" will be transformed into a brand representing a world-class pharmaceutical enterprise. With the rapid growth in production capacities and the launch of more high value-added products, the Group is confident in maintaining a steady growth in its business so as to bring satisfactory returns to its shareholders.

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 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') as set out 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, Mr. Sun Song, Mr. Guan Yonghua, Mr. Wang Jian and Ms. Song Liang Wei 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 Ordinance, 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 2011, 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 2011 are as follows:

	Dates of meeting			
Board Meetings	**15 March**	**13 May**	**9 August**	**1 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 2011.

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 2011, 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 2011 include:

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

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

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

During the year ended 31 December 2011, the Audit Committee has held four meetings and details of attendances of the meetings are shown below:

	Dates of meeting			
Audit Committee Meetings	**14 March**	**10 May**	**8 August**	**31 October**
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 20 November 2005 and its members during the year ended 31 December 2011 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 2011, the Remuneration Committee has held four meetings and details of the attendances of the meetings are shown below:

	Dates of meeting			
Remuneration Committee Meetings	**14 March**	**10 May**	**8 August**	**31 October**
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 2011, the Board has reviewed the engagement of auditors and their remuneration. The auditor of the Company would receive approximately HK$600,000 for audit and related service and approximately HK$179,000 for other services.

The accounts for the year were audited by HLB Hodgson Impey Cheng whose term of office will expire upon the forthcoming annual general meeting ("AGM"). In March 2012, the practice of HLB Hodgson Impey Cheng was reorganized as HLB Hodgson Impey Cheng Limited. The Audit Committee has recommended to the Board that HLB Hodgson Impey Cheng Limited be nominated for appointment as the auditors of the Company at the forthcoming AGM.

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 2011 (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 33 of this annual report.

The Directors recommend the payment of a final dividend of RMB0.2 per ordinary share, totalling RMB121,920,000. 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

Annual General Meeting

The registers of members of the Company to attend the forthcoming AGM will be closed from 14 April 2012 to 15 May 2012 (both days inclusive). All properly completed H shares transfer forms accompanied by the relevant share certificates must be lodged with the Registrar of H shares in Hong Kong, Computershare Hong Kong Investor Services Limited at Shops 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, no later than 4:30 p.m. on 13 April 2012, for registration.

Entitlement to Final Dividend

The Board has recommended the payment of a final dividend of RMB0.2 per share in respect of the year ended 31 December 2011. Subject to the approval of shareholders at the forthcoming AGM, the dividend cum-date and ex-date will be 17 May 2012 and 18 May 2012 respectively. The registers of members of the Company for entitlement of dividend will be closed from 22 May 2012 to 26 May 2012 (both days inclusive). All properly completed H shares transfer forms accompanied by the relevant share certificates must be lodged with the Registrar of H shares in Hong Kong, Computershare Hong Kong Investor Services Limited at Shops 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, no later than 4:30 p.m. on 21 May 2012, for registration.

REPORT OF THE DIRECTORS

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

Non-resident Corporate Shareholders

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 corporate shareholders whose names appear on the H share register of members on 26 May 2012. The Company will distribute the final dividend to such non-resident corporate shareholders after withholding a 10% income tax. 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 22 May 2012 to 26 May 2012, 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 21 May 2012, for registration.

Non-resident Individual Shareholders

Pursuant to the regulation promulgated by the State General Administration of Taxation of the PRC (Guo Shui Han [2011] No.348), the Company is required to withhold and pay the non-resident individual income tax for the non-resident individual H shareholders and the non-resident individual H shareholders are entitled to certain tax preferential treatments according to the double tax treaties between those countries where the non-resident individual H shareholders are residents and China and the provisions in respect of double tax treaties between the mainland China and Hong Kong or Macau. The Company would withhold and pay the individual income tax at the tax rates of 10% on behalf of the non-resident individual H shareholders who are Hong Kong residents, Macau residents or residents of those countries having double tax treaties with China for personal income tax rates in respect of dividend of 10%. For non-resident individual H shareholders who are residents of those countries having agreements with China for personal income tax rates in respect of dividend of lower than 10%, the Company would make applications on their behalf to seek entitlement of the relevant agreed preferential treatments pursuant to the Notice of the State Administration of Taxation in relation to the Administrative Measures on Preferential Treatment Entitled by Non-residents under Tax Treaties (Tentative) (Guo Shui Fa [2009] No. 124) (《國家税務總局關於印發〈非居民享受税收協議待遇管理辦法(試行)〉的通知》(國税發[2009]124號)). For non-resident individual H shareholders who are residents of those countries having double tax treaties with China for personal income tax rates in respect of dividend of higher than 10% but lower than 20%, the Company would withhold the individual income tax at the agreed-upon effective tax rate. For non-resident individual H shareholders who are residents of those countries without any double tax treaties with China or having double tax treaties with China for personal income tax in respect of dividend of 20% and other situations, the Company would withhold the individual income tax at a tax rate of 20%.

REPORT OF THE DIRECTORS

In order to determine the list of holders of H shares of the Company who are entitled to receive the final dividend, the H share register of members of the Company will be closed from 22 May 2012 to 26 May 2012, both days inclusive, during which period no transfer of the Company's H shares will be effected.

The Company will determine the country of domicile of the individual H shareholders based on the registered address as recorded in the register of members of the Company (the "Registered Address") on 26 May, 2012 and will withhold and pay the individual income tax based on the register of members of the Company as at 26 May 2012. If the country of domicile of the individual H shareholder is not the same as the Registered Address, the individual H shareholder shall notify the Company's H share registrar and provide relevant supporting documents 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 21 May 2012, for registration. If the individual H shareholders do not provide the relevant supporting documents to the share registrar of the Company's H shares within the time period stated above, the Company will determine the country of domicile of the individual H shareholders based on the recorded Registered Address on 26 May 2012.

The Company will strictly comply with the relevant PRC tax laws and regulations to withhold for payment such appropriate 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 26 May 2012.

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.

RESERVES

Movements in the reserves of the Company during the year are set out in Note 36 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 35 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 2011, amounted to RMB1,390,394,000 (2010: RMB992,767,000).

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 111 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 Group has not redeemed, purchased or sold any of its 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)

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 terms' of service of the other Directors. Mr. Chen also retred 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 commncing 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.

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 2011 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 2011, the interests and short positions of each Directors and supervisors of the Company in the shares, underlying shares and debentures of the Company, as recorded in the register required to be kept by the Company under Section 352 of Part XV of the Securities and Futures Ordinance (the "SFO"), or as otherwise notified to the Company and the Stock Exchange pursuant to Rule 5.46 of the GEM Listing Rules were as follows:

Long position of domestic shares of the Company ("Domestic Shares"), as at 31 December 2011

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 Co, Ltd ("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 2011 was 250,639,949 (representing 56.32% of total issued domestic shares and 41.12% of Company's share capital)

Save as disclosed above, as at 31 December 2011, none of the Directors or supervisors of the Company had any interests or short positions in the shares, underlying shares and debentures of the Company, which were required to be recorded in the register required to be kept by the Company under Section 352 of Part XV of the SFO, or which were required to be notified to the Company and the Stock Exchange pursuant to Rule 5.46 of the GEM Listing Rules.

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 2011, 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.

REPORT OF THE DIRECTORS

Long position of domestic shares of the Company, as at 31 December 2011

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.

Save as disclosed above, as at 31 December 2011, no other person or company (other than the Directors or supervisors of the Company) had any interest or short position in shares, underlying shares and debentures of the Company, which were required to be recorded in the register required to be kept by the Company under section 336 of Part XV of the SFO, or which were, directly or indirectly, interested in 5% or more of the Company's issued share capital.

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 2009 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	9%
– five largest suppliers combined	28%
Sales	
– the largest customer	21%
– five largest customers combined	33%

During the year ended 31 December 2011, the sales of chemical medicines to Luoxin Pharmacy Group, Linyi People Hospital, Shandong Luosheng and Shandong Mingxin amounted to approximately RMB344,252,000, RMBNil, RMB51,664,000 and RMB35,679,000 respectively. Luoxin Pharmacy Group is the largest customer of the Company for the year ended 31 December 2011.

Three of the five largest customers of the Company are Luoxin Pharmacy Group. Shandong Luosheng and Shandong Mingxin which are the related parties of the Company. For further details, please refer to note 39 to the accounts.

REPORT OF THE DIRECTORS

CONNECTED TRANSACTIONS AND CONTINUING CONNECTED TRANSACTIONS

During the year ended 31 December 2011, 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 22 December 2009 and a supplemental framework agreement dated 4 April 2011	RMB200 million	RMB550 million	RMB825 million
Sales of chemical medicines by the Company to Linyi People Hospital pursuant to a framework agreement dated 22 December 2009	RMB25 million	RMB30 million	RMB39 million
Sales of chemical medicines by the Company to Shandong Luosheng pursuant to a framework agreement dated 22 December 2009 and a supplemental framework agreement dated 4 April 2011	RMB60 million	RMB120 million	RMB180 million
Sales of chemical medicines by the Company to Shandong Mingxin pursuant to a framework agreement dated 22 December 2009 and a supplemental framework agreement dated 4 April 2011	RMB55 million	RMB110 million	RMB165 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 and supplemental framework agreements constitute continuing connected transactions of the Company, details of which are set out in the announcement issued by the Company on 5 January 2010 and 4 April 2011 and the circulars issued by the Company on 15 January 2010 and 15 April 2011.

During the year ended 31 December 2011, the sales of chemical medicines by the Company to Luoxin Pharmacy Group, Linyi People Hospital, Shandong Luosheng and Shandong Mingxin amounted to RMB344,252,000, RMBNil, RMB51,664,000 and RMB35,679,000 (2010: RMB198,073,000, RMB11,631,000, RMB57,164,000 and RMB42,430,000) 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.

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.

REPORT OF THE DIRECTORS

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 for the year were audited by HLB Hodgson Impey Cheng whose term of office will expire upon the forthcoming AGM. In March 2012, the practice of HLB Hodgson Impey Cheng was reorganized as HLB Hodgson Impey Cheng Limited. A resolution for the appointment of HLB Hodgson Impey Cheng Limited as the auditors of the Company for the subsequent year is to be proposed at the forthcoming annual general meeting.

On behalf of the Board
Liu Baoqi
Chairman

PRC, 13 March 2012

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 33 to 110, which comprise the consolidated and company statements of financial position as at 31 December 2011, 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 Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about 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 2011 and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

HLB Hodgson Impey Cheng
Chartered Accountants
Certified Public Accountants

Hong Kong, 13 March 2012

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2011

	Notes	2011 RMB'000	2010 RMB'000
Turnover	7	**1,626,848**	1,342,254
Cost of sales		**(624,217)**	(591,944)
Gross profit		**1,002,631**	750,310
Other revenue	7	**9,023**	7,705
Other income	9	**15,614**	3,303
Selling and distribution expenses		**(403,313)**	(218,663)
General and administrative expenses		**(127,621)**	(94,399)
Share of profit of an associate	17	**5,873**	2,672
Finance costs	8	**(168)**	(174)
Profit before taxation	9	**502,039**	450,754
Taxation	10	**(75,355)**	(67,360)
Profit for the year		**426,684**	383,394
Other comprehensive income for the year, net of tax			
– Share of other comprehensive income of an associate	17	**1,620**	1,889
Total comprehensive income for the year		**428,304**	385,283
Profit for the year attributable to:			
– Owners of the Company		**426,556**	383,122
– Non-controlling interests		**128**	272
		426,684	383,394
Total comprehensive income attributable to:			
– Owners of the Company		**428,176**	385,011
– Non-controlling interests		**128**	272
		428,304	385,283
Earnings per share attributable to owners of the Company (RMB)	15		
– Basic and diluted		**0.700**	0.629

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 2011

	Notes	2011 RMB'000	2010 RMB'000
Non-current assets			
Interest in an associate	17	**–**	25,051
Available-for-sale financial assets	18	**1,000**	1,000
Purchased technical know-how	19	**677**	1,202
Prepayments to acquire technical know-how	20	**11,947**	7,520
Property, plant and equipment	21	**271,207**	268,270
Construction-in-progress	22	**116,414**	52,826
Prepaid lease payments	23	**19,687**	20,101
Deferred tax assets	24	**2,680**	3,512
Goodwill	25	**165**	165
		423,777	379,647
Current assets			
Inventories	26	**148,762**	215,389
Trade and bills receivables	28	**232,813**	222,922
Other receivables, deposits and prepayments	29	**104,573**	79,101
Financial assets at fair value through profit and loss	30	**100,000**	–
Pledged bank deposits	31	**34,481**	91,837
Cash and bank balances	31	**892,877**	582,010
		1,513,506	1,191,259
Current liabilities			
Trade and bills payables	32	**142,828**	184,348
Other payables and accruals	33	**171,209**	170,182
Deposits received		**26,787**	22,343
Taxation payable		**50,329**	41,970
Dividend payable		**–**	8,757
		391,153	427,600
Net current assets		**1,122,353**	763,659
Total assets less current liabilities		**1,546,130**	1,143,306

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2011

	Notes	2011 RMB'000	2010 RMB'000
Non-current liability			
Deferred income	34	**20,380**	20,380
Net assets		**1,525,750**	1,122,926
Capital and reserves			
Share capital	35	**60,960**	60,960
Other reserves		**67,734**	67,665
Retained earnings			
– Proposed final dividend		**121,920**	30,480
– Others		**1,268,474**	962,287
Equity attributable to owners of the Company		**1,519,088**	1,121,392
Non-controlling interests		**6,662**	1,534
Total equity		**1,525,750**	1,122,926

Approved by the Board of Directors on 13 March 2012 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 2011

	Notes	2011 RMB'000	2010 RMB'000
Non-current assets			
Interests in subsidiaries	16	**118,979**	51,479
Interest in an associate	17	**–**	25,051
Available-for-sale financial assets	18	**1,000**	1,000
Purchased technical know-how	19	**677**	1,202
Prepayments to acquire technical know-how	20	**11,947**	7,520
Property, plant and equipment	21	**270,545**	268,145
Construction-in-progress	22	**14,061**	18,352
Prepaid lease payments	23	**19,687**	20,101
Deferred tax assets	24	**2,680**	3,512
		439,576	396,362
Current assets			
Inventories	26	**144,524**	213,267
Amounts due from subsidiaries	27	**184,375**	70,078
Trade and bills receivables	28	**224,495**	222,434
Other receivables, deposits and prepayments	29	**34,256**	45,951
Financial assets at fair value through profit and loss	30	**100,000**	–
Pledged bank deposits	31	**12,670**	91,837
Cash and bank balances	31	**770,483**	530,698
		1,470,803	1,174,265
Current liabilities			
Trade and bills payables	32	**118,270**	183,439
Other payables and accruals	33	**170,353**	170,119
Deposits received		**26,059**	21,923
Taxation payable		**50,329**	41,920
Dividend payable		**–**	8,757
		365,011	426,158
Net current assets		**1,105,792**	748,107
Total assets less current liabilities		**1,545,368**	1,144,469
Non-current liability			
Deferred income	34	**20,380**	20,380
Net assets		**1,524,988**	1,124,089

STATEMENT OF FINANCIAL POSITION

As at 31 December 2011

	Notes	2011 RMB'000	2010 RMB'000
Capital and reserves			
Share capital	35	**60,960**	60,960
Other reserves		**67,652**	67,652
Retained earnings			
– Proposed final dividend		**121,920**	12,192
– Others		**1,274,456**	983,285
Total equity		**1,524,988**	1,124,089

Approved by the Board of Directors on 13 March 2012 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 2011

	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 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, net of tax:								
Share of other comprehensive income of an associate	–	–	–	–	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 and 1 January 2011	**60,960**	**31,139**	**30,493**	**6,033**	**992,767**	**1,121,392**	**1,534**	**1,122,926**
Profit for the year	**–**	**–**	**–**	**–**	**426,556**	**426,556**	**128**	**426,684**
Other comprehensive income for the year, net of tax:								
Share of other comprehensive income of an associate	**–**	**–**	**–**	**–**	**1,620**	**1,620**	**–**	**1,620**
Total comprehensive income for the year	**–**	**–**	**–**	**–**	**428,176**	**428,176**	**128**	**428,304**
Addition to non-controlling interests due to capital injection to a newly incorporated subsidiary	**–**	**–**	**–**	**–**	**–**	**–**	**5,000**	**5,000**
Transfer from retained earnings to statutory surplus reserve fund	**–**	**–**	**69**	**–**	**(69)**	**–**	**–**	**–**
Dividend paid	**–**	**–**	**–**	**–**	**(30,480)**	**(30,480)**	**–**	**(30,480)**
At 31 December 2011	**60,960**	**31,139**	**30,562**	**6,033**	**1,390,394**	**1,519,088**	**6,662**	**1,525,750**
Representing:								
Proposed 2011 final dividends					**121,920**			
Others					**1,268,474**			
Retained earnings as at 31 December 2011					**1,390,394**			

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

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2011

	Notes	2011 RMB'000	2010 RMB'000
Operating activities			
Profit before taxation		502,039	450,754
Adjustments for:			
Interest income		(7,142)	(6,036)
Interest expense		168	174
Share of profit of an associate	17	(5,873)	(2,672)
Reversal of obsolete inventories written down	26	(3,664)	(393)
Reversal of impairment loss recognised in respect of trade receivables	28	(4,301)	(768)
Reversal of impairment loss recognised in respect of other receivables	29	(650)	(347)
Depreciation of property, plant and equipment	21	22,265	19,822
Loss on disposal of property, plant and equipment		11	–
Gain on disposal of property, plant and equipment		–	(299)
Write-down of obsolete inventories	26	4,104	2,867
Impairment loss recognised in respect of trade receivables	28	829	5,288
Impairment loss recognised in respect of other receivables	29	361	111
Amortisation of prepaid lease payments	23	413	378
Amortisation of purchased technical know-how	19	525	794
Operating cash flows before working capital changes		509,085	469,673
Decrease in inventories		66,187	28,741
Increase in trade and bills receivables		(6,418)	(161,254)
(Increase)/decrease in other receivables, deposits and prepayments		(25,183)	29,296
Decrease in trade and bills payables		(41,520)	(144,647)
Increase in deposits received		4,444	13,301
Increase in other payables and accruals		1,027	77,888

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2011

	Notes	2011 RMB'000	2010 RMB'000
Cash generated from operations		507,622	312,998
Interest paid		(168)	(174)
PRC income tax paid		(66,164)	(40,392)
Net cash generated from operating activities		441,290	272,432
Investing activities			
Interest received		7,142	6,036
Acquisition of financial assets at fair value through profit or loss		(100,000)	–
Increase in prepayments to acquire technical know-how		(4,427)	–
Acquisition of available-for-sale financial assets		–	(1,000)
Purchase of property, plant and equipment		(14,966)	(15,231)
Additions of construction-in-progress		(73,835)	(56,467)
Addition of prepaid lease payments		–	(29,990)
Dividend received from associate		5,400	6,300
Proceeds from disposal of interest in an associate		27,144	–
Proceeds from disposal of property, plant and equipment		–	593
Net cash used in investing activities		(153,542)	(89,759)
Financing activities			
Dividend paid		(39,237)	(10,749)
Capital injection from non-controlling interests of a subsidiary		5,000	980
Decrease in pledged bank deposits		57,356	145,357
Net cash generated from financing activities		23,119	135,588
Net increase in cash and cash equivalents		310,867	318,261
Cash and cash equivalents at the beginning of the year		582,010	263,749
Cash and cash equivalents at the end of the year		892,877	582,010
Analysis of balances of cash and cash equivalents:			
Cash and bank balances		892,877	582,010

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2011

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 the annual report.

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 13 March 2012.

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

In the current year, the Group has adopted 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 2011.

HKFRS 1 (Amendments)	Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters
HKAS 24 (As revised in 2009)	Related Party Disclosures
HKAS 32 (Amendments)	Financial Instruments: Presentation – Classification of Rights Issues
HK(IFRIC)-Int 14 (Amendments)	Prepayments of a Minimum Funding Requirement
HK(IFRIC)-Int 19	Extinguishing Financial Liabilities with Equity Instruments
HKFRSs (Amendments)	Improvements to HKFRSs issued in 2010

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

The principal effects of adopting these new HKFRSs are as follows:

HKAS 24 (As revised in 2009) clarifies and simplifies the definitions of related parties. The new definitions emphasise a symmetrical view of related party relationships and clarify the circumstances in which persons and key management personnel affect related party relationships of an entity. The revised standard also introduces an exemption from the general related party disclosure requirements for transactions with a government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity. The accounting policy for related parties has been revised to reflect the changes in the definitions of related parties under the revised standard.

Improvements to HKFRSs issued in 2010 sets out amendments to a number of HKFRSs. There are separate transitional provisions for each standard. While the adoption of some of the amendments results in changes in accounting policies, none of these amendments has had a significant financial impact on the financial position or performance of the Group. Details of the key amendments applicable to the Group are as follows:

(a) HKFRS 1 (Amendment) addresses the presentation and disclosure requirements for an entity which changes its accounting policies or its uses of the exemptions contained in this HKFRS. It also introduces the use of the revaluation basis as deemed cost and extends the use of the deemed cost exemption to entities with operations subject to rate regulation.

(b) HKFRS 3 (Amendment) clarifies that the amendments to HKFRS 7, HKAS 32 and HKAS 39 that eliminate the exemption for contingent consideration do not apply to contingent consideration that arose from business combinations whose acquisition dates precede the application of HKFRS 3 (as revised in 2008).

In addition, the amendment limits the scope of measurement choices for non-controlling interests. Only the components of non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the acquiree's net assets in the event of liquidation are measured at either fair value or at the present ownership instruments proportionate share of the acquiree's identifiable net assets. All other components of non-controlling interests are measured at their acquisition date at fair value, unless another measurement basis is required by another HKFRS.

The amendment also adds explicit guidance to clarify the accounting treatment for non-replaced and voluntarily replaced share-based payment awards.

(c) HKFRS 7 (Amendment) is intended to simplify the disclosures by reducing the volume of disclosures on collateral held and improving disclosures by requiring qualitative information to put the quantitative information in context.

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

(d) HKAS 1 (Amendment) clarifies that an analysis of each component of other comprehensive income can be presented either in the statement of changes in equity or in the notes to the financial statements. The Group elects to present the analysis of each component of other comprehensive income in the statement of changes in equity.

(e) HKAS 27 (Amendment) clarifies that the consequential amendments from HKAS 27 (as revised in 2008) made to HKAS 21, HKAS 28 and HKAS 31 shall be applied prospectively for annual periods beginning on or after 1 July 2009 or earlier if HKAS 27 is applied earlier.

(f) HKAS 34 (Amendment) requires the update of relevant information related to significant events and transactions in the most recent annual financial report. HKAS 34 now specifies events and transactions for which disclosures are required, and guidance has been added covering the application of the requirements for financial instruments.

Except for those 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 the following new and revised HKFRSs, that have been issued but are not yet effective, in these consolidated financial statements:

HKFRS 1 (Amendments)	First-time Adoption of Hong Kong Financial Reporting Standards – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters[1]
HKFRS 7 (Amendments)	Financial Instruments: Disclosures – Transfers of Financial Assets[1]
HKFRS 7 (Amendments)	Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities[4]
HKFRS 9	Financial Instruments[6]
HKFRS 10	Consolidated Financial Statements[4]
HKFRS 11	Joint Arrangements[4]
HKFRS 12	Disclosure of Interests in Other Entities[4]
HKFRS 13	Fair Value Measurement[4]
HKAS 1 (Amendments)	Presentation of Financial Statements – Presentation of Items of Other Comprehensive Income[3]
HKAS 12 (Amendments)	Deferred Tax: Recovery of Underlying Assets[2]
HKAS 19 (As revised in 2011)	Employee Benefits[4]
HKAS 27 (As revised in 2011)	Separate Financial Statements[4]
HKAS 28 (As revised in 2011)	Investments in Associates and Joint Ventures[4]
HKAS 32 (Amendments)	Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities[5]
HK(IFRIC)-Int 20	Stripping Costs in the Production Phase of a Surface Mine[4]

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

[1] effective for annual periods beginning on or after 1 July 2011

[2] effective for annual periods beginning on or after 1 January 2012

[3] effective for annual periods beginning on or after 1 July 2012

[4] effective for annual periods beginning on or after 1 January 2013

[5] effective for annual periods beginning on or after 1 January 2014

[6] effective for annual periods beginning on or after 1 January 2015

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.

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.

HKFRS 9 *Financial Instruments* (as issued in November 2009) introduces new requirements for the classification and measurement of financial assets. HKFRS 9 amended in 2010 includes the requirements for the classification and measurement of 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 addition, under HKFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognised in profit or loss.

- In relation to financial liabilities, the significant change relates to the classification and measurement of financial liabilities relates to the presentation of changes in the fair value of financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. 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 recognition 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.

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

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

The Directors anticipate that the adoption of HKFRS 9 in the future may have significant impact on amounts reported in respect of the Groups' financial assets and financial liabilities. Regarding the Group's financial assets, however, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

In June 2011, a package of five standards on consolidation, joint arrangements, associates and disclosures was issued, including HKFRS 10, HKFRS 11, HKFRS 12, HKAS 27 (as revised in 2011) and HKAS 28 (as revised in 2011).

HKFRS 10 *Consolidated Financial Statements* replaces the part of HKAS 27 *Consolidated and Separate Financial Statements* that deal with consolidated financial statements and HK (SIC) – Int 12 *Consolidation – Special Purpose Entities*. HKFRS 10 includes a new definition of control that contains three elements: power over an investee, exposure, or rights, to variable returns from its involvement with the investee, and the ability to use its power over the investee to affect the amount of the investor's returns.

HKFRS 11 replaces HKAS 31 *Interests In Joint Ventures* and HK (SIC) – Int 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. HKFRS 11 deals with how a joint arrangement of which two or more parties have joint control should be classified. Under HKFRS 11, joint arrangements are classified as joint operations or joint ventures, depending on the rights and obligations of the parties to the arrangements. In contrast, under HKAS 31, there are three types of joint arrangements: joint controlled entities, jointly controlled assets and jointly controlled operations.

In addition, joint venturers under HKFRS 11 are required to be accounted for using the equity method of accounting, whereas jointly controlled entities under HKAS 31 can be accounted for using the equity method of accounting or proportionate accounting.

HKFRS 12 is a disclosure standard and applied to those entities that have interests in subsidiaries, joint arrangements, associates and/or unconsolidated structured entities.

These five standards are effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted provided that all of these five standards are applied early at the same time.

The Directors anticipate that HKFRS 13 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 affect the amounts reported in the consolidated financial statements and result in more extensive disclosures in the consolidated financial statements.

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

The amendments to HKAS 1 retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements. However, the amendments to HKAS 1 require additional disclosures to be made in the other comprehensive income section such that items of other comprehensive income are grouped into two categories: Items that will not be reclassified subsequently to profit or loss; and Items that may be reclassified subsequently to profit or loss when specific conditions are met. Income tax on items of other comprehensive income is required to be allocated on the same basis.

The amendments to HKAS 1 are effective for annual periods beginning or after 1 July 2012.

The amendments to HKAS 12 provide an exception to the general principles in HKAS 12 that the measurement of deferred tax assets and deferred tax liabilities should reflect the tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of an asset. Specially, under the amendments, investment properties that are measured using the fair value model in accordance with HKAS 40 *Investment Property* are presumed to be recovered through sale for the purposes of measuring deferred taxes, unless the presumption is rebutted in certain circumstances.

The amendments to HKAS 12 are effective for annual periods beginning on or after 1 January 2012. The Directors anticipate that the application of the amendments to HKAS 12 in future reporting periods may result in adjustments to the amounts of deferred tax liabilities recognised in prior years regarding the Group's investment properties of which the carrying amounts are presumed to be recovered through sales. However, the Directors have not yet performed a detailed analysis of the impact of the application of the amendments and hence have not yet quantified the extent of the impact.

The amendments to HKAS 19 change the accounting for defined benefit plans and termination benefits. The most significant change relates to the accounting for changes in defined benefit obligations and plan assets. The amendments require the recognition of changes in defined benefit obligations and in the fair value of plan assets when they occur, and hence eliminate the 'corridor approach' permitted under the previous version of HKAS 19. The amendments require all actuarial gains and losses to be recognised immediately through other comprehensive income in order for the net pension asset or liability recognised in the consolidated statement of financial position to reflect the full value of the plan deficit or surplus.

The amendments to HKAS 19 are effective for annual periods beginning on or after 1 January 2013 and require retrospective application with certain exceptions. The Directors anticipate that the amendments to HKAS 19 will be adopted in the Group's consolidated financial statements for the annual period beginning 1 January 2013 and that the application of the amendments to HKAS 19 may have impact on amounts reported in respect of the Group's defined benefit plans. However, the Directors have not yet performed a detailed analysis of the impact of the application of the amendments and hence have not yet quantified the extent of the impact.

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").

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 in the annual report.

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.

Income and expenses 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. Total comprehensive income of subsidiaries 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 (effective from 1 January 2010 onwards).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of consolidation (Continued)

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.

Changes in the Group's ownership interests in existing subsidiaries

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, it derecognises the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost, it derecognises the carrying amount of any non-controlling interest in the former subsidiary at the date when control is lost and recognises the aggregate of the fair value of the consideration received and the fair value of any retained interest, with any resulting difference being recognised as a gain or loss in profit or loss attributable to the Group. When assets of the subsidiary are carried 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 Group had directly disposed of the related assets. 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 any investment in an associate or a jointly controlled entity.

Business combinations

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;

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Business combinations (Continued)

- 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 reassessment, 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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Business combinations (Continued)

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.

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 at that date.

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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

Construction-in-progress

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, unless it is clear that both elements are operating leases in which case the entire lease is classified as an operating lease. 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 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. 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.

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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impairment of tangible and intangible assets (Continued)

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, financial assets at fair value though profit and loss 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.

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.

Financial assets at fair value though profit and loss

Financial assets are classified as at fair value though profit and loss when the financial asset is either held for trading or it is designated as at fair value though profit and loss.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling 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 asset other than a financial asset held for trading may be designated as at fair value though profit and loss upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset 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 *Financial Instruments: Recognition and Measurement* permits the entire combined contract (asset or liability) to be designated as at fair value though profit and loss.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial assets (Continued)

Financial assets at fair value though profit and loss (Continued)

Financial assets at fair value though profit and 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 dividend or interest earned on the financial asset and is included in the 'other gains and losses' line item in the consolidated statement of comprehensive income. Fair value is determined in the manner described in Note 30.

Available-for-sale financial assets (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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial assets (Continued)

Impairment of financial assets (Continued)

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.

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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

Financial liabilities and equity instruments (Continued)

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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other similar allowances.

Revenue from the sale of goods is recognised when the goods are delivered and titles have passed, at which time 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.

Sales of goods that result in award credits for customers, under the Group's Maxi-Points Scheme, are accounted for as multiple element revenue transactions and the fair value of the consideration received or receivable is allocated between the goods supplied and the award credits granted. The consideration allocated to the award credits is measured by reference to the fair value of the awards for which they could be redeemed. Such consideration is not recognised as revenue at the time of the initial sale transaction – but is deferred and recognised as revenue when the award credits are redeemed and the Group's obligations have been fulfilled.

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 income 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

Borrowing costs

Borrowings costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Related party transactions

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

(a) the party is a person or a close member of that person's family and that person,

  (i) has control or joint control over, the Group;

  (ii) has significant influence over the Group; or

  (iii) is a member of the key management personnel of the Group or of a parent of the Group ; or

(b) the party is an entity where any of the following conditions applies:

  (i) the entity and the Group are members of the same group;

  (ii) one entity is an associate or joint venture of the other entity (or of a parent, subsidiary or fellow subsidiary of the other entity);

  (iii) the entity and the Group are joint ventures of the same third party;

  (iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity;

  (v) the entity is a post-employment benefit plan for the benefit of employees of either the Group or an entity related to the Group;

  (vi) the entity is controlled or jointly controlled by a person identified in (a)); and

  (vii) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

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.

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.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

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 collectibility of trade and other receivables for which provision are not made could affect the results of operations.

Fair value of financial instruments

The fair value of financial instruments that are not traded in an active market is determined by valuation techniques. The 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

	2011	2010
	RMB'000	RMB'000
The Group		
Financial assets		
Available-for-sale investments	**1,000**	1,000
Loan and receivables (including cash and cash equivalents)	**1,174,415**	902,560
Financial assets at fair value through profit and loss	**100,000**	–
Financial liabilities		
Amortised cost	**294,279**	342,617

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(Continued)

(a) *Categories of financial instruments* (Continued)

	2011 RMB'000	2010 RMB'000
The Company		
Financial assets		
Available-for-sale investments	**1,000**	1,000
Loan and receivables (including cash and cash equivalents)	**1,206,185**	920,838
Financial assets at fair value through profit and loss	**100,000**	–
Financial liabilities		
Amortised cost	**288,638**	358,484

(b) *Financial risk management objectives and policies*

The main risks arising from the Group's financial instruments are market risk (including interest rate risk, foreign currency risk and other price 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 bank balances. Floating-rate interest income is charged to the consolidated statement of comprehensive income as incurred.

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:

	2011	2010
	RMB'000	RMB'000
Assets		
HKD	**7**	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.

	2011	2010
	RMB'000	RMB'000
Impact of HKD		
Profit or loss #	**–**	(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.

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(Continued)

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

Other price risk

The Group is exposed to price risk mainly through its investment. The management manages this exposure by maintaining a portfolio of investments with different risk and return profiles. In addition, the management of the Group would monitor the price risk and will consider hedging the risk exposure should the need arise.

Sensitivity analysis on change in fair value of financial assets at fair value though profit and loss

The sensitivity analysis below have been determined based on the exposure to price risk at the end of the reporting period.

If prices had been 10% higher/lower (2010: Nil):

– post-tax profit for the year ended 31 December 2011 would increase/decrease by RMB10,000,000 (2010: Nil). This is mainly due to the changes in fair value of financial assets designated as financial assets at fair value through profit or loss investments.

Credit risk

As at 31 December 2011, the Group's and the Company's maximum exposure to credit risk which will cause a financial loss to the Group and the Company 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 and the Company have put in place policies to ensure that sales of products are made to customers with an appropriate credit history and the Group and the Company perform periodic credit evaluation of its customers. The Group's and the Company's historical experience in collection of trade and other receivables falls within the recorded allowances and the Directors are of the opinion that adequate provision for uncollectible trade and other receivables has been made in the accounts. In this regard, the Directors of the Company consider that the Group's and the Company's credit risk is significantly reduced.

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(Continued)

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

Credit risk (Continued)

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 and the Company do 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 and the Company's short, medium and long-term funding and liquidity management requirements. The Group and the Company manage liquidity risk by maintaining adequate reserves, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

The following table details the Group's and the Company'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 and the Company can be required to pay. The tables include both interest and principal cash flows.

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(Continued)

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

Liquidity risk (Continued)

	Weighted average effective interest rate	Within 1 year	Over 1 year	Total undis-counted cash flows	Total carrying amount
	%	RMB'000	RMB'000	RMB'000	RMB'000
The Group					
As at 31 December 2011					
Non-derivative financial liabilities					
Trade and bills payables	–	142,828	–	142,828	142,828
Other payables and accruals	–	147,165	–	147,165	147,165
Deposits received	–	4,286	–	4,286	4,286
		294,279	–	294,279	294,279
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

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(Continued)

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

Liquidity risk (Continued)

	Weighted average effective interest rate %	Within 1 year RMB'000	Over 1 year RMB'000	Total undis-counted cash flows RMB'000	Total carrying amount RMB'000
The Company					
As at 31 December 2011					
Non-derivative financial liabilities					
Trade and bills payables	–	118,270	–	118,270	118,270
Other payables and accruals	–	144,309	–	144,309	144,309
Dividend payable	–	–	–	–	–
Deposits received	–	26,059	–	26,059	26,059
		288,638	–	288,638	288,638
As at 31 December 2010					
Non-derivative financial liabilities					
Trade and bills payables	–	183,439	–	183,439	183,439
Other payables and accruals	–	144,367	–	144,367	144,367
Dividend payable	–	8,757	–	8,757	8,757
Deposits received	–	21,921	–	21,921	21,921
		358,484	–	358,484	358,484

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 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.

(iii) The fair values of other financial assets and financial liabilities are determined in accordance with generally accepted pricing models based on discounted cash flow analysis.

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).

	31 December 2011			
	Level 1	**Level 2**	**Level 3**	**Total**
	RMB'000	RMB'000	RMB'000	RMB'000
Financial assets				
Financial assets designated as financial assets at fair value through profit or loss	–	100,000	–	100,000

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

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 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 2011, 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 2011 and 2010 are as follows:

	As at 31 December	
	2011	2010
	RMB'000	RMB'000
Total debt	**–**	–
Total assets	**1,937,283**	1,570,906
Gearing ratio	**N/A**	N/A

6. SEGMENT INFORMATION

Information reported to the Board, being the chief operating decision maker, for the purposes of resource allocation and assessment of segment performance focuses on 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 maker who comprehensively manages the entire business. The reportable operating results report to the chief operating decision maker are the net profit of the Group and the reportable assets and liabilities report to the chief operating decision maker is the Group's assets and liabilities.

6. SEGMENT INFORMATION (Continued)

Revenue from major products

The Group's revenue from its major product is as follows:

	2011 RMB'000	2010 RMB'000
Pharmaceutical products	**1,626,848**	1,342,254

Information about major customers

Included in revenues arising from sales of pharmaceutical products of approximately RMB1,626,848,000 (2010: RMB1,342,254,000) are revenues of approximately RMB344,252,000 (2010: RMB198,073,000) 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 year ended 31 December 2011 and 2010 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 year ended 31 December 2011 and 2010.

7. TURNOVER AND OTHER REVENUE

Turnover and other revenue recognised are as follows:

	2011 RMB'000	2010 RMB'000
Turnover		
Sales of manufactured pharmaceutical products	**1,626,848**	1,342,254
Other revenue		
Interest income on bill receivables	**855**	–
Interest income on bank deposits	**6,287**	6,036
Sundry income	**1,881**	1,669
	9,023	7,705
Total revenue	**1,635,871**	1,349,959

8. FINANCE COSTS

	2011 RMB'000	2010 RMB'000
Bills payables wholly repayable within six months	168	174

9. PROFIT FROM OPERATIONS

	2011 RMB'000	2010 RMB'000
Operating profit of the Group was determined after charging/(crediting) the following:		
Raw materials and consumables used	526,651	521,089
Changes in inventories of finished goods and work-in-progress	12,441	8,357
Depreciation of property, plant and equipment (Note 21)	22,265	19,822
Amortisation of prepaid lease payments (Note 23)	413	378
Amortisation of purchased technical know-how (included in cost of sales) (Note 19)	525	794
Write-down of obsolete inventories (Note 26)	4,104	2,867
Impairment loss recognised in respect of trade receivables (Note 28)	829	5,288
Impairment loss recognised in respect of other receivables (Note 29)	361	111
Employees benefit expenses (excluding Directors' and supervisors' remuneration)	172,303	97,412
Loss on disposal of property, plant and equipment	11	–
Research and development costs	81,927	51,689
Advertising costs	5,072	14,315
Auditors' remuneration	600	480
and after crediting:		
Other income		
Waive of trade payables	1,115	–
Government subsidies	4,871	–
Penalty income	1,013	1,496
Reversal of obsolete inventories written-down (Note 26)	3,664	393
Reversal of impairment loss recognised in respect of trade receivables (Note 28)	4,301	768
Reversal of impairment loss recognised in respect of other receivables (Note 29)	650	347
Gain on disposal of property, plant and equipment	–	299
	15,614	3,303

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 (2010: Nil).

(ii) As described in the paragraph below, the Group is subject to PRC enterprise income tax at a rate of 15% (2010: 15%).

On 12 November 2009, the Company received confirmation from the Recognition Authority that the Company has been recognised as a High and New Technology Enterprise on 12 June 2009. Pursuant to the new Enterprise Income Tax Law, enterprise income tax applicable to a High and New Technology Enterprise is reduced to 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 PRC value-added tax ("VAT") at 17% (2010: 17%) of the 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:

	2011	2010
	RMB'000	RMB'000
Current taxation – Enterprise income tax	**74,523**	68,769
Deferred taxation (Note 24)	**832**	(1,409)
	75,355	67,360

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:

	2011 RMB'000	2010 RMB'000
Profit before taxation	**502,039**	450,754
Calculated at a taxation rate of 25% (2010: 25%)	**125,510**	112,689
Tax effect of utilisation of tax loss previously not recognised	**–**	(106)
Tax effect of income not taxable for tax purpose	**(13,978)**	(1,698)
Tax effect of expenses not deductible for tax purpose	**14,799**	2,956
Tax effect of tax concession	**(49,508)**	(45,813)
Tax effect of share of profit of associate	**(1,468)**	(668)
Taxation charge for the year	**75,355**	67,360

11. DIVIDENDS

A dividend in respect of 2011 of RMB0.2 per share (2010: RMB0.05 per share), amounting to a total dividend of RMB121,920,000 (2010: RMB30,480,000) is to be proposed at the annual general meeting of the Company to be held on 15 May 2012. These consolidated financial statements do not reflect this dividend payable.

	2011 RMB'000	2010 RMB'000
Proposed final dividend of RMB0.2 (2010: RMB0.05) per ordinary share	**121,920**	30,480

12. EMPLOYEE BENEFIT EXPENSES

	2011	2010
	RMB'000	RMB'000
Salaries and wages	**165,026**	40,294
Sales commission	**1,083**	50,464
Pension costs – defined contribution plans	**6,194**	6,654
	172,303	97,412

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 RMB817 (equivalent to HK$1,000) per month and thereafter contributions are voluntary.

During the year ended 31 December 2011, the Group has contributed approximately RMB9,811(2010: RMB10,170) to the MPF Scheme.

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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:

	2011 RMB'000	2010 RMB'000
Basic salaries and allowances	**1,056**	1,035
Retirement benefit costs	**51**	136
	1,107	1,171

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

	2011 RMB'000	2010 RMB'000
Executive Directors		
Liu Baoqi	**380**	456
Li Minghua	**127**	127
Liu Zhenhai	**104**	106
Han Fengsheng	**67**	67
Chen Yu	**67**	67
Non-executive Directors		
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	**67**	60
Guan Yonghua	**24**	24
Zhu Enqiang (Resigned on 30 November 2010)	**–**	22
Gao Xiaoling (Resigned on 30 November 2010)	**–**	22
Wan Jian (Appointed on 30 November 2010)	**24**	2
Song Liang Wei (Appointed on 30 November 2010)	**31**	2
	1,107	1,171

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	
	2011	2010
Nil – RMB817,600 (equivalent to Nil – HK$1,000,000)	**14**	16

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 (2010: 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 (2010: one) non-director, highest paid individual during the year are as follows:

	2011	2010
	RMB'000	RMB'000
Basic salaries and allowances	**618**	662
Retirement benefit costs	**10**	10
	628	672

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

	Number of individuals	
	2011	2010
Nil – RMB817,600 (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 (2010: Nil).

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.

	2011	2010
Profit attributable to owners of the Company (RMB'000)	426,556	383,122
Weighted average number of ordinary shares in issue ('000)	609,600	609,600
Basic and diluted earnings per share (RMB)	0.700	0.629

16. INTERESTS IN SUBSIDIARIES

The Company

	2011 RMB'000	2010 RMB'000
Cost of investments in subsidiaries, unlisted in PRC	118,979	51,479

As at 31 December 2011, 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	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

16. INTERESTS IN SUBSIDIARIES (Continued)

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	Proportion of voting power held	Principal activities
Shandong Hengxin Pharmacy Company Limited*# (山東恒欣藥業有限公司) ("Shandong Hengxin")	Incorporated	PRC	RMB50,000,000	100%	100%	Wholesale and manufacture of biochemical products and Chinese medicine
Shandong Luoxin Biological Technology Company Limited*# (山東羅欣生物工程有限公司) ("Shandong Biological")	Incorporated	PRC	RMB22,500,000	77.78%	77.78%	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 Hengxin and Shandong Biological were incorporated on 11 April 2011 and 19 December 2011 respectively

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

17. INTEREST IN AN ASSOCIATE

The Group and the Company

	2011 RMB'000	2010 RMB'000
Cost of investment in an associate, unlisted in the PRC	–	19,620
Share of post-acquisition profits and other comprehensive income, net of dividends received (Note)	–	5,431
	–	25,051

During the year ended 31 December 2011, the Company disposed of its interest in an associate, Qilu Medical Investment Management Limited, to an independent third party at a consideration of RMB27,144,000, which is same as the Company's share of net assets of the associate before disposal. Therefore, there was no gain or loss arising from the disposal.

17. INTEREST IN AN ASSOCIATE (Continued)

As at 31 December 2010, 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	Proportion 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:

	2011 RMB'000	2010 RMB'000
Total assets	–	187,647
Total liabilities	–	(62,390)
Net assets	–	125,257
Share of net assets of associate	–	25,051

	2011 RMB'000	2010 RMB'000
Revenue	29,027	21,156
Profit for the period/year	29,372	13,360
Share of profit of associate for the period/year	5,873	2,672
Share of other comprehensive income for the period/year	1,620	1,889

17. INTEREST IN AN ASSOCIATE (Continued)

Note:

During the year ended 31 December 2011, the share of profit and other comprehensive income of the associate before disposal was approximately RMB7,493,000. The Company received dividend of RMB5,400,000 from the associate during the year.

As at 31 December 2010, the amount includes (i) the accumulated share of profit and other comprehensive income of the associate of approximately RMB9,019,000 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 the associate of approximately RMB2,712,000; and (iii) net accumulated dividends received of RMB6,300,000. 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:

	2011 **RMB'000**	2010 RMB'000
Unlisted securities – Equity securities (Note)	**1,000**	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 is 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.

19. PURCHASED TECHNICAL KNOW-HOW

The Group and the Company

	RMB'000
Cost:	
At 1 January 2010	17,450
Additions	–
At 31 December 2010 and 1 January 2011	**17,450**
Additions	**–**
At 31 December 2011	**17,450**
Accumulated amortisation and impairment:	
At 1 January 2010	15,454
Charge for the year	794
At 31 December 2010 and 1 January 2011	**16,248**
Charge for the year	**525**
At 31 December 2011	**16,773**
Net book value:	
At 31 December 2011	**677**
At 31 December 2010	1,202

20. PREPAYMENTS TO ACQUIRE TECHNICAL KNOW-HOW

The Group and the Company

As at 31 December 2011 and 2010, 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.

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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 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 and 1 January 2011	**178,935**	**141,476**	**13,749**	**10,884**	**345,044**
Additions	**2,534**	**2,712**	**4,150**	**5,570**	**14,966**
Disposals	**(12)**	**–**	**–**	**–**	**(12)**
Transfer from construction-in-progress (Note 22)	**250**	**9,997**	**–**	**–**	**10,247**
At 31 December 2011	**181,707**	**154,185**	**17,899**	**16,454**	**370,245**
Accumulated depreciation and impairment:					
At 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 and 1 January 2011	**14,383**	**49,200**	**6,159**	**7,032**	**76,774**
Charge for the year	**4,599**	**13,767**	**2,387**	**1,512**	**22,265**
Written back on disposals	**(1)**	**–**	**–**	**–**	**(1)**
At 31 December 2011	**18,981**	**62,967**	**8,546**	**8,544**	**99,038**
Net book value:					
At 31 December 2011	**162,726**	**91,218**	**9,353**	**7,910**	**271,207**
At 31 December 2010	164,552	92,276	7,590	3,852	268,270

21. PROPERTY, PLANT AND EQUIPMENT (Continued)

As at 31 December 2011 and 2010, all buildings of the Group are located in the PRC.

Depreciation expense of RMB15,354,000 (2010: RMB12,339,000) have been expensed in cost of sales and RMB6,911,000 (2010: RMB7,483,000) have been included in administrative expenses for the year.

The Company

	Buildings	Plant and machinery	Motor vehicles	Office equipment	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Cost:					
At 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 And 1 January 2011	**178,935**	**141,476**	**13,692**	**10,803**	**344,906**
Additions	**2,534**	**2,712**	**3,524**	**5,551**	**14,321**
Disposals	**(12)**	**–**	**–**	**–**	**(12)**
Transfer from construction-in-progress (Note 22)	**250**	**9,997**	**–**	**–**	**10,247**
At 31 December 2011	**181,707**	**154,185**	**17,216**	**16,354**	**369,462**
Accumulated depreciation and impairment:					
At 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 and 1 January 2011	**14,383**	**49,200**	**6,159**	**7,019**	**76,761**
Charge for the year	**4,599**	**13,767**	**2,307**	**1,484**	**22,157**
Written back on disposals	**(1)**	**–**	**–**	**–**	**(1)**
At 31 December 2011	**18,981**	**62,967**	**8,466**	**8,503**	**98,917**
Net book value:					
At 31 December 2011	**162,726**	**91,218**	**8,750**	**7,851**	**270,545**
At 31 December 2010	164,552	92,276	7,533	3,784	268,145

22. CONSTRUCTION-IN-PROGRESS

The Group

	RMB'000
At 1 January 2010	9,293
Additions	56,467
Transfer to property, plant and equipment (Note 21)	(12,934)
At 31 December 2010 and 1 January 2011	**52,826**
Additions	**73,835**
Transfer to property, plant and equipment (Note 21)	**(10,247)**
At 31 December 2011	**116,414**

Analysis of construction-in-progress as follows:

	2011	2010
	RMB'000	RMB'000
Construction cost of buildings	**63,994**	28,683
Cost of plant and machinery	**52,420**	24,143
	116,414	52,826

22. CONSTRUCTION-IN-PROGRESS (Continued)

The Company

	RMB'000
At 1 January 2010	9,293
Additions	21,993
Transfer to property, plant and equipment (Note 21)	(12,934)
At 31 December 2010 and 1 January 2011	**18,352**
Additions	**5,956**
Transfer to property, plant and equipment (Note 21)	**(10,247)**
At 31 December 2011	**14,061**

Analysis of construction-in-progress as follows:

	2011	2010
	RMB'000	RMB'000
Construction cost of buildings	**3,938**	1,676
Cost of plant and machinery	**10,123**	16,676
	14,061	18,352

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 2010	11,174
Additions of prepaid lease payments	9,717
Amortisation of prepaid lease payments	(378)
At 31 December 2010 and 1 January 2011	20,513
Amortisation of prepaid lease payments	(413)
At 31 December 2011	**20,100**

Analysed for reporting purposes as:

	2011	2010
	RMB'000	RMB'000
Current assets (included in other receivables, deposits and prepayments)	**413**	412
Non-current assets	**19,687**	20,101
	20,100	20,513

	2011	2010
	RMB'000	RMB'000
Long-term lease	**9,420**	9,613
Medium-term lease	**10,680**	10,900
	20,100	20,513

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% (2010: 25%).

The movements in the deferred tax assets are as follows:

	2011 **RMB'000**	2010 RMB'000
At the beginning of the year	**3,512**	2,103
Deferred taxation credited to the consolidated statement of comprehensive income (Note 10)	**(832)**	1,409
At the end of the year	**2,680**	3,512

	Provisions RMB'000	**Amortisation charge on purchased technical know-how** RMB'000	**Total** RMB'000
At 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 and 1 January 2011	**2,940**	**572**	**3,512**
Credited/(charged) to the consolidated statement of comprehensive income	**(720)**	**(112)**	**(832)**
At 31 December 2011	**2,220**	**460**	**2,680**

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

There is no unprovided deferred taxation during the year.

25. GOODWILL

The Group

	2011 RMB'000	2010 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

	2011 RMB'000	2010 RMB'000
Raw materials	**43,138**	94,676
Work-in-progress	**39,395**	58,205
Finished goods	**70,582**	66,421
	153,115	219,302
Less: Write down of obsolete inventories	**(4,353)**	(3,913)
	148,762	215,389

The cost of inventories recognised as expense and included in cost of sales amounted to approximately RMB547,879,000 (2010: RMB530,472,000).

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26. INVENTORIES (Continued)

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

	2011 RMB'000	2010 RMB'000
Balance at the beginning of the year	**3,913**	1,439
Write-down of obsolete inventories during the year	**4,104**	2,867
Reversal of obsolete inventories written-down	**(3,664)**	(393)
Balance at the end of the year	**4,353**	3,913

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 RMB4,353,000 (2010: RMB3,913,000) be made in respect of the net realisable value of the inventories.

The Company

	2011 RMB'000	2010 RMB'000
Raw materials	**43,138**	94,676
Work-in-progress	**39,395**	58,205
Finished goods	**66,344**	64,299
	148,877	217,180
Less: Write down of obsolete inventories	**(4,353)**	(3,913)
	144,524	213,267

The cost of inventories recognised as expense and included in cost of sales amounted to approximately RMB543,499,000 (2010: RMB530,472,000).

26. INVENTORIES (Continued)

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

	2011 RMB'000	2010 RMB'000
Balance at the beginning of the year	3,913	1,439
Write-down of obsolete inventories during the year	4,104	2,867
Reversal of obsolete inventories written-down	(3,664)	(393)
Balance at the end of the year	4,353	3,913

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 2011 and have considered a write-down of obsolete inventories of approximately RMB4,353,000 (2010: RMB3,913,000) 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	2011 RMB'000	2010 RMB'000
Sichuan Luoxin	15,922	15,922	5,614
Shandong Hengxin	98,954	98,954	–
Shandong Yuxin	69,499	69,499	64,464
	184,375	184,375	70,078

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

28. TRADE AND BILLS RECEIVABLES

The Group

	2011 **RMB'000**	2010 RMB'000
Trade receivables	**147,950**	207,530
Bills receivables	**88,590**	22,591
	236,540	230,121
Less: Provision for impairment loss recognised in respect of trade receivables	**(3,727)**	(7,199)
	232,813	222,922

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

	2011 **RMB'000**	2010 RMB'000
1 to 90 days	**136,180**	189,120
91 to 180 days	**94,386**	32,032
181 to 365 days	**2,247**	1,770
	232,813	222,922

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 2011 and 2010 were denominated in RMB.

As at 31 December 2011, various amounts of approximately RMB47,074,000 and RMB13,214,000 were receivable from a shareholder 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 2010, various amounts of approximately RMB67,924,000, RMB13,608,000 and RMB35,660,000 were 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.

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 RMB2,247,000 (2010: RMB1,770,000) 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:

	2011 **RMB'000**	2010 RMB'000
181 to 365 days	**2,247**	1,770

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

	2011 **RMB'000**	2010 RMB'000
Balance at the beginning of the year	**7,199**	2,679
Impairment loss recognised during the year	**829**	5,288
Reversal of impairment loss recognised in respect of trade receivables	**(4,301)**	(768)
Balance at the end of the year	**3,727**	7,199

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.

28. TRADE AND BILLS RECEIVABLES (Continued)

The Company

	2011 RMB'000	2010 RMB'000
Trade receivables	141,375	207,530
Bills receivables	86,847	22,103
	228,222	229,633
Less: Provision for impairment loss recognised in respect of trade receivables	(3,727)	(7,199)
	224,495	222,434

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

	2011 RMB'000	2010 RMB'000
1 to 90 days	128,084	188,632
91 to 180 days	94,305	32,032
181 to 365 days	2,106	1,770
	224,495	222,434

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 2011 and 2010 are denominated in RMB.

As at 31 December 2011, various amounts of approximately RMB47,074,000 and RMB13,214,000 were receivable from a shareholder and two fellow subsidiaries of a shareholder respectively. The amounts due are unsecured, interest-free and receivable within 180 days.

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

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 RMB2,106,000 (2010: RMB1,770,000) 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:

	2011 RMB'000	2010 RMB'000
181 to 365 days	**2,106**	1,770

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

	2011 RMB'000	2010 RMB'000
Balance at the beginning of the year	**7,199**	2,679
Impairment loss recognised during the year	**829**	5,288
Reversal of impairment loss recognised in respect of trade receivables	**(4,301)**	(768)
Balance at the end of the year	**3,727**	7,199

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.

29. OTHER RECEIVABLES, DEPOSITS AND PREPAYMENTS

The Group

	2011 RMB'000	2010 RMB'000
Other receivables and deposits	**15,043**	6,879
Prepayments (Note)	**90,329**	73,310
	105,372	80,189
Less: Provision for impairment loss recognised in respect of other receivables	**(799)**	(1,088)
	104,573	79,101

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 RMB12,109,000 (2010: RMB15,785,000), RMB9,764,000 (2010: RMB22,702,000) and RMB68,569,000 (2010: RMB29,990,000) respectively.

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

	2011 RMB'000	2010 RMB'000
Balance at the beginning of the year	**1,088**	1,324
Impairment loss recognised during the year	**361**	111
Reversal of impairment loss recognised in respect of other receivables	**(650)**	(347)
Balance at the end of the year	**799**	1,088

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 RMB799,000 (2010: RMB1,088,000) 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.

29. OTHER RECEIVABLES, DEPOSITS AND PREPAYMENTS (Continued)

The Company

	2011 RMB'000	2010 RMB'000
Other receivables and deposits	**14,961**	6,879
Prepayments (Note)	**20,094**	40,160
	35,055	47,039
Less: Provision for impairment loss recognised in respect of other receivables	**(799)**	(1,088)
	34,256	45,951

Note:

Prepayments mainly comprised of prepayment of value-added tax, and acquisition of raw materials, packing materials and consumable of approximately RMB12,109,000 (2010: RMB15,182,000) and RMB7,572,000 (2010: RMB22,702,000) respectively.

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

	2011 RMB'000	2010 RMB'000
Balance at the beginning of the year	**1,088**	1,324
Impairment loss recognised during the year	**361**	111
Reversal of impairment loss recognised in respect of other receivables	**(650)**	(347)
Balance at the end of the year	**799**	1,088

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 RMB799,000 (2010: RMB1,088,000) 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.

30. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

As at 31 December 2011, the financial assets at fair value through profit or loss represent a participation note linked to certain bonds, beneficial rights of trusts and currencies tools in the PRC.

The above investment was classified as fair value through profit or loss on initial recognition and current asset as set as the maturity is less than one year of the reporting date.

The participation note will mature in August 2012. The host contract of this investment is a debt instrument and the embedded derivative is an option tied to changes in the underlying value of certain bonds, beneficial rights of trusts and currencies tools. As the contract contains an embedded derivative, the Directors of the Company have designated the investment as financial assets at fair value through profit or loss.

The participation note is not publicly traded and in the absence of readily available information to determine the fair value of this investment, the Group has adopted the indicative market value provided by the issuer as its best estimate of the fair value of this investment.

31. PLEDGED BANK DEPOSITS/CASH AND BANK BALANCES

The Group and the Company

As at 31 December 2011, bank deposits of approximately RMB34,481,000 (2010: RMB91,837,000) are pledged as collateral for bills payables.

The annual effective interest rate on pledged bank deposits is 3.3% (2010: 2.2%).

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.

32. TRADE AND BILLS PAYABLES

The Group

	2011	2010
	RMB'000	RMB'000
Trade payables	**108,347**	97,511
Bills payables	**34,481**	86,837
	142,828	184,348

32. TRADE AND BILLS PAYABLES (Continued)

The Group (Continued)

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

	2011 RMB'000	2010 RMB'000
1 to 90 days	**79,624**	74,311
91 to 180 days	**36,615**	92,742
181 to 365 days	**5,546**	2,332
Over 365 days	**21,043**	14,963
	142,828	184,348

Trade and bills payables as at 31 December 2011 and 2010 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 Group has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

The Company

	2011 RMB'000	2010 RMB'000
Trade payables	**105,600**	96,602
Bills payables	**12,670**	86,837
	118,270	183,439

32. TRADE AND BILLS PAYABLES (Continued)

The Company (Continued)

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

	2011	2010
	RMB'000	RMB'000
1 to 90 days	**68,856**	73,402
91 to 180 days	**22,825**	92,742
181 to 365 days	**5,546**	2,332
Over 365 days	**21,043**	14,963
	118,270	183,439

Trade and bills payables as at 31 December 2011 and 2010 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 has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

33. OTHER PAYABLES AND ACCRUALS

The Group

	2011	2010
	RMB'000	RMB'000
Accruals	**86,468**	84,437
Other payables	**60,697**	59,993
Received in advance (Note)	**24,044**	25,752
	171,209	170,182

Note:

As at 31 December 2011, amounts of approximately RMBNil (2010: RMB21,629,000) and RMBNil (2010: RMB110,000) are received in advance from a shareholder and a related company respectively (Note 39).

33. OTHER PAYABLES AND ACCRUALS (Continued)

The Company

	2011 RMB'000	2010 RMB'000
Accruals	86,468	84,437
Other payables	59,841	59,930
Received in advance (Note)	24,044	25,752
	170,353	170,119

Note:

As at 31 December 2011, amounts of approximately RMBNil (2010: RMB21,629,000) and RMBNil (2010: RMB110,000) are received in advance from a shareholder and a related company respectively.

34. 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 2011 and 2010, the Company has not commenced the construction of the new manufacturing plant.

35. SHARE CAPITAL

	Number of shares '000	Nominal value Domestic shares RMB'000	H shares RMB'000	Total RMB'000
Registered, issued and fully paid:				
At 31 December 2010 (nominal value of RMB0.10 each)	609,600	44,504	16,456	60,960
At 31 December 2011 (nominal value of RMB0.10 each)	**609,600**	**44,504**	**16,456**	**60,960**

36. 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	Statutory surplus reserve fund	Statutory public welfare fund	Retained earnings	Total
	RMB'000	RMB'000 (Note (i))	RMB'000 (Note (ii))	RMB'000	RMB'000
At 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 and 1 January 2011	**31,139**	**30,480**	**6,033**	**995,477**	**1,063,129**
Profit attributable to owners of the Company	**-**	**-**	**-**	**431,379**	**431,379**
Other comprehensive income for the year	**-**	**-**	**-**	**-**	**-**
Total comprehensive income for the year	**-**	**-**	**-**	**431,379**	**431,379**
Dividend paid	**-**	**-**	**-**	**(30,480)**	**(30,480)**
At 31 December 2011	**31,139**	**30,480**	**6,033**	**1,396,376**	**1,464,028**
Representing:					
Proposed 2011 final dividends				**121,920**	
Others				**1,274,456**	
Retained earnings as at 31 December 2011				**1,396,376**	

36. 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 2011, appropriation of RMB69,000 (2010: RMB13,000) was made by a subsidiary of the Company.

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 2011 and 2010.

37. BANKING FACILITIES

The Group had aggregate banking facilities of approximately RMB34,481,000 (2010: RMB86,837,000) which were fully utilised as at 31 December 2011.

As at 31 December 2011, RMB34,481,000 (2010: RMB86,837,000) of the banking facilities were secured by pledged bank deposits of approximately RMB34,481,000 (2010: RMB91,837,000).

38. COMMITMENTS

The Group had the following significant capital commitments:

	2011	2010
	RMB'000	RMB'000
Contracted but not provided for:		
– Purchase of technical know-how	**4,376**	3,130
– Purchase of property, plant and equipment	**103,759**	50,905

39. RELATED PARTY TRANSACTIONS

Key management compensation for the year ended 31 December 2011 and 2010 was disclosed in Note 14(i).

Apart from those as disclosed under Notes 28 and 33 and elsewhere in the consolidated financial statements, the Group had the following material transactions with related parties during the year:

	2011	2010
	RMB'000	RMB'000
Sales of finished goods to Luoxin Pharmacy Group Company Limited ("Luoxin Pharmacy Group") (note (i))	**344,252**	198,073
Sales of finished goods to The Linyi City People's Hospital ("Linyi People Hospital") (note (ii))	**–**	11,631
Sales of finished goods to Shandong Luosheng Pharmacy Co., Ltd. ("Shandong Luosheng") (note (iv))	**51,664**	57,164
Sales of finished goods to Shandong Mingxin Pharmacy Co., Ltd. ("Shandong Mingxin") (note (v))	**35,679**	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 2011, amount of approximately RMB47,074,000 (2010:RMB67,924,000) 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. As at 31 December 2011, amount of approximately RMBNil (2010: RMB13,608,000) due from Linyi People Hospital is included in trade and bills receivables, the terms of the outstanding balance is set out in Note 28.

39. RELATED PARTY TRANSACTIONS (Continued)

Notes: (Continued)

(iii) 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. As at 31 December 2011, amount of approximately RMB2,336,000 (2010: RMB16,204,000) due from Shandong Luosheng is included in trade and bills receivables, the terms of the outstanding balance is set out in Note 28.

(iv) 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. As at 31 December 2011, amount of approximately RMB10,878,000 (2010: RMB19,456,000) 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 2011.

41. APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements were approved and authorised for issue by the Board of Directors on 13 March 2012.

FIVE YEARS FINANCIAL SUMMARY

	For the year ended 31 December				
	2011	2010	2009	2008	2007
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Results					
Turnover	**1,626,848**	1,342,254	907,453	667,792	509,092
Cost of sales	**(624,217)**	(591,944)	(479,736)	(351,196)	(260,628)
Gross profit	**1,002,631**	750,310	427,717	316,596	248,464
Other revenue	**9,023**	7,705	3,767	2,613	3,323
Other income	**15,614**	3,303	2,501	2,894	2,368
Selling and distribution expenses	**(403,313)**	(218,663)	(79,668)	(48,869)	(33,585)
General and administrative expenses	**(127,621)**	(94,399)	(42,874)	(29,438)	(33,057)
Share of profit of an associate	**5,873**	2,672	4,063	3,107	–
Finance costs	**(168)**	(174)	(240)	(1,250)	(4,554)
Profit before taxation	**502,039**	450,754	315,266	245,653	182,959
Taxation	**(75,355)**	(67,360)	(46,716)	(62,498)	(61,016)
Profit for the year	**426,684**	383,394	268,550	183,155	121,943
Profit attributable to:					
Owners of the Company	**426,556**	383,122	268,550	183,155	121,943
Non-controlling interests	**128**	272	–	–	–
	426,684	383,394	268,550	183,155	121,943
Dividends	**121,920**	12,192	12,192	12,192	12,192
Earnings per share attributable to owners of the Company (RMB)	**0.700**	0.629	0.441	0.300	0.200

FIVE YEARS FINANCIAL SUMMARY

	As at 31 December				
	2011	2010	2009	2008	2007
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Assets & Liabilities					
Total assets	**1,937,283**	1,570,906	1,220,473	680,919	470,569
Total liabilities	**(411,533)**	(447,980)	(471,618)	(189,507)	(149,317)
	1,525,750	1,122,926	748,855	491,412	321,252
Equity attributable to owners of the Company	**1,519,088**	1,121,392	748,573	492,215	321,252
Non-controlling interests	**6,662**	1,534	282	–	–
	1,525,750	1,122,926	748,855	492,215	321,252