山東羅欣藥業集團股份有限公司

Shandong Luoxin Pharmaceutical Group Stock Co., Ltd.*

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

Stock Code: 8058

Annual Report 2016

* For identification purposes only

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CORPORATE INFORMATION

DIRECTORS

Executive Directors

Liu Baoqi
Li Minghua
Han Fengsheng
Chen Yu
Liu Zhenteng

Non-executive Directors

Yin Chuangui (retired on 30 June 2016)
Liu Zhenhai

Independent Non-executive Directors

Foo Tin Chung, Victor
Fu Hongzheng
Prof. Chen Yun Zhen (retired on 30 June 2016)
Prof. Du Guanhua
Huang Huiwen (appointed on 1 July 2016)

SUPERVISORS

Sun Song (resigned on 30 June 2016)
Wang Jian
Song Liang Wei
Liu Zhenfei
Song Lili (appointed on 1 July 2016)

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,
Linyi High and New Technology
Industrial Development Zone,
Shandong Province, PRC

MEMBERS OF THE AUDIT COMMITTEE

Foo Tin Chung, Victor *(chairman of the audit committee)*
Fu Hongzheng
Prof. Chen Yun Zhen (retired on 30 June 2016)
Prof. Du Guanhua
Huang Huiwen (appointed on 1 July 2016)

LEGAL ADVISER TO THE COMPANY

Howse Williams Bowers
27/F, Alexandra House
18 Chater Road, Hong Kong

AUDITORS

HLB Hodgson Impey Cheng Limited
Certified Public Accountants
31/F, Gloucester Tower
The Landmark
11 Pedder St., Central
Hong Kong

H-SHARE SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
Shops 1712–1716, 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

Room 1110, 11/F, Tower B
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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 Group for the year ended 31 December 2016 (hereafter referred to as the "Year") for your review.

With an aim to maximising shareholders' value, our Company is devoted to enhancing the capabilities in research and development ("R&D"), increasing production capacity and consolidating sales network development, focusing on speeding up product structure adjustment and production of compressed antibiotic products, expediting of market development of products for respiratory and digestive systems, and accelerating sales network development to increase the market share of our products and the core competitiveness of the Company. 2016 was a stressful year. Due to the sustained decrease in tender prices, drug proportion, medical insurance premium control, and the introduction of policies like quality consistency evaluation for generic drugs, the development of pharmaceutical enterprises is under glaring pressure. While in short-to-mid-term, the changing market environment and our R&D efforts may put pressure on the results of the Company, nevertheless, it shall be beneficial to the core competitiveness of the Group in the long run. Through dedication and concerted efforts of our management and employees, the Company achieved steady growth and healthy development. For the year ended 31 December 2016, our turnover increased by 14.02% to approximately RMB4,117,573, whereas profit attributable to our shareholders decreased by 23.07% to approximately RMB379,198,000.

In the past year, under the influence of factors such as the slowdown in the domestic economy, sustained decrease in tender prices and medical insurance premium control, the industry has been growing at a slower pace and witnessed further fragmentation. The Group upheld its underlying development strategies and endeavoured to achieve the targets of the 13th Five-Year Plan. It managed to maintain stable and healthy development in R&D, management, production, human resources and market network, thus laying a solid foundation for the future development of the Group. To cope with our business development and the increasing market demand, Shandong Yuxin Pharmaceutical Co., Ltd.* (山東裕欣藥業有限公司) ("Yuxin"), a new member of the Group, has obtained the Drug Manufacturing Certificate (藥品生產許可證) and the Sanitation License of Disinfectant Manufacturers (消毒產品生產企業衛生許可證). Installation of the automated storage system was completed and put into operation. Further assistance is received from the completion and commission of its infusion workshop, spray workshop, inhalator powder workshop and ancillary facilities. We have also completed the construction of the new lyophilized powder injection workshop, which has obtained new GMP certificate and commenced full production. Constructions of phase I of the pharmaceutical raw materials project under Shandong Luoxin Pharmaceutical Group Hengxin Pharmaceutical Co., Ltd.* (山東羅欣藥業集團恒欣藥業有限公司) ("Hengxin"), including workshop of raw materials of cephalosporins sterile (with lyophilization); workshop of non-cephalosporins sterile; workshop of raw materials of synthetic drugs and oral raw materials; workshop of raw materials of anti-tumor drugs; workshop of solvent recovery and deep water treatment projects were all completed with the GMP certifications and have been put into use. Phase II of the pharmaceutical raw materials project is currently under construction, with two workshops of pharmaceutical raw material of cephalosporins sterile will be completed soon, two workshops of raw materials of non-sterile synthetics have entered the purification and pipeline installation phases and will be put into operations after obtaining GMP certifications. Newly-built research buildings and office buildings have commenced operations. In addition, several pharmaceutical preparations of the Group have passed the GMP certifications, included lyophilized powder injection, powder injection, tablets, hard capsules, low-volume injections, granules, dry suspension agent, large-volume injections and bulk pharmaceuticals (including sterile bulk medicines). Furthermore, solid injections (i.e. tablets, capsules and granules) are getting prepared to apply for the European Union GMP certifications. These projects expand the categories of new products of the Company and rapidly increase the integrated production capability of the Group. In June 2014, the Company established a wholly-owned subsidiary named Luoxin Biological Technology (Shanghai) Co., Ltd.* (羅欣生物科技(上海)有限公司) ("Shanghai R&D Centre")

CHAIRMAN'S STATEMENT

in Shanghai Zhangjiang Hi-tech Park, which is responsible for R&D of the Group's high-tech solution and high-tech talents training, which formed a trio-partnership with our headquarter and further strengthened the development of new drugs. As at 31 December 2016, the Shanghai R&D Centre has a team of approximately 165 staff members. Their key members, who are well-known domestic and international experts with R&D experience in medicines in internationally prominent pharmaceutical enterprises, have formed a R&D team that covers all phases of R&D on new drugs and will continue to expand its scale along with further enrichment of the product lines of the Company. During the Year, the Group actively implemented the quality consistency evaluation for generic drugs in a comprehensive manner. The first category for evaluation is the oral drugs category in National Essential Drugs List, which is required to be completed by the end of 2018 according to the national quality consistency evaluation policy. Currently, we have completed the registration of the reference listed drugs for this category. The Group's quality consistency evaluation for other categories of drugs is also commencing by stages. In addition, the Shanghai R&D Centre has commenced various R&D projects on new drugs and established cooperation relationships with renowned foreign pharmaceutical enterprises and leading domestic R&D institutions. It will lead the domestic and global R&D of two potential innovative drugs. A number of the Company's new products were derived from successful R&D results, which were subsequently commercialised. Many products of the Group received invention patents and Scientific and Technological Progress Awards granted by the State. The technology centre of the Company was recognised as a "State-Accredited Enterprise Technology Centre" by National Development and Reform Commission, Ministry of Science and Technology, Ministry of Finance, General Administration of Customs and State Administration of Taxation. Currently, the Company has obtained or been awarded approvals to establish several scientific research platforms which include a state-accredited enterprise technology centre, a state-province joint engineering laboratory, the "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), the "National Post-Doctoral Research Workshop*" (國家博士後科研工作站), the "Key High-Tech Enterprise under the State Torch Programme*" (國家火炬計劃重點高新技術企業), the "National Technological Innovation Demonstration Enterprise*" (國家技術創新示範企業), the "Pilot Enterprise on the Implementation of Management System for the Integration of Informatisation and Industrialisation*" (兩化融合管理體系貫標試點企業), the "Model Engineering Technology Research Centre of Shandong Province*" (山東省級示範工程技術研究中心), the "Shandong Key Lyophilized Powder Injection Pharmaceutical Laboratory*" (山東省凍乾粉針劑藥物重點實驗室), the "Shandong Lyophilized Powder Injection Pharmaceutical Engineering Laboratory*" (山東省凍乾粉針劑藥物工程實驗室), the "Taishan Scholar — Pharmaceutical Expert Consultant*" (泰山學者 — 藥學特聘專家), and the "Enterprise Academician Workstation of Shandong Province*" (山東省企業院士工作站). Together, they formed a strong platform for talent accumulation, R&D and technology advancement, and further strengthened the R&D capabilities and overall competitiveness of the Group. Currently, the Company has an extensive and seamless sales network throughout the PRC and a sound marketing management system. It has also formed an over-the-counter ("OTC") sales network and a hospital terminal sales network. With the gradual implementation of classification treatment, the primary medical terminal market is in continuous growth. The Group boosts the development of the primary market and continues exploring the third terminal markets, such as primary medical institutions, in order to expand its market share in the primary market. Currently, the Group's sales team in the third terminal market has been growing steadily with increasing market coverage area.

CHAIRMAN'S STATEMENT

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

2017 will continue to be a stressful year. Due to the sustained decrease in tender prices, drug proportion, medical insurance premium control, the introduction of policies such as quality consistency evaluation for generic drugs, reform on registration category for chemical drugs and reform on assessment and approval for pharmaceutical products, the development of pharmaceutical enterprises is under glaring pressure. Nevertheless, with the acceleration of medical reform implemented by the PRC government, proactive introduction of new cooperative medical initiatives, further input into the pharmaceutical industry, improvement in public health services as well as the population aging trend, the full implementation of two-child policy, the urbanisation development, we expect the overall market expenditure on medical and pharmaceutical treatment will increase dramatically, which will create huge market potential. Meanwhile, it is obvious that relevant policies are aimed at improving the quality of pharmaceutical products and encouraging R&D which in turn will create new demands and opportunities for pharmaceutical enterprises. In the long run, the measures favour the overall development of innovative enterprises which will expand the room for the development of competitive enterprises. The pharmaceutical industry has been included into the list of supported industries in the 13th Five-Year Plan of the PRC government. The PRC government will allocate more resources to pharmaceutical and medical equipment industries. Looking forward to 2017, the Company is prepared to embark on a new voyage where it will face certain new challenges as well as development opportunities. We strongly believe that the Company will be able to accelerate its development in a steady and healthy manner. The rapid development and advancement of the Company always depends on sustained efforts of its management and employees, as well as incessant support from all shareholders, customers, suppliers and business partners of the Company. 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 giving tremendous support for the advancement of our Company.

Liu Baoqi
Chairman

7 March 2017

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS

Mr. Liu Baoqi (劉保起), aged 55, is an executive Director, the chairman of the Board and the compliance officer 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 Luoxin Pharmaceutical Group Co., Ltd.* (formerly known as "Linyi Luozhuang Pharmacy Company") ("Luoxin Pharmaceutical Group") 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 Shandong Province and the Linyi City People's Congress of the PRC. Mr. Liu is currently the chairman of the board of directors of Shandong Luoxin Holdings Co., Ltd.* (山東羅欣控股有限公司) ("Luoxin Holdings"), Luoxin Pharmaceutical Group, Shandong Luosheng Pharmacy Company Limited* (山東羅盛醫藥有限公司), Shandong Mingxin Pharmacy Company Limited* (山東明欣醫藥有限公司), and the Second Hospital of Fei County* (費縣第二醫院). Mr. Liu is interested in 51.73% of the registered share capital of Luoxin Holdings. Mr. Liu is the uncle of Mr. Liu Zhenhai, and the father of Mr. Liu Zhenteng and Mr. Liu Zhenfei.

Ms. Li Minghua (李明華), aged 51, is an executive Director, the general manager and the chief executive officer of the Company. She is responsible for assisting the chairman of the Board in the overall business development and operation of the Company. She graduated from Shenyang Pharmacy University* (瀋陽藥科大學) with a bachelor's degree in pharmacy. Ms. Li is a senior professional engineer in medicine in the PRC certified by Hei Long Jiang Human Resource Department (黑龍江人事廳) and a registered practising pharmacist. Before joining the Company in 2001, Ms. Li had over 15 years of experience working in several pharmaceutical enterprises in the PRC. Ms. Li was granted the Qi Lu Female Inventor Award (齊魯巾幗發明家) in 2010. She was accredited as Outstanding Engineer of Shandong Province (山東省優秀工程師) in 2011 and was granted the Adultescent Professional with Outstanding Contribution of Shandong Province (山東省有突出貢獻的中青年專家). She is a delegate of the Fei County People's Congress of the PRC. Ms. Li is currently a director of Yuxin and the Second Hospital of Fei County* (費縣第二醫院).

Mr. Han Fengsheng (韓風生), aged 41, is an executive Director and the secretary of the Board. Mr. Han graduated from Dalian University* (大連大學) majoring in computer science. Before joining the Company in November 2001, Mr. Han had over 5 years of experience working in the information technology department of Luoxin Pharmaceutical Group. Mr. Han is a member of the National Committee of the Chinese People's Political Consultative Conference of Luo Zhuang District of the PRC (中國羅莊區政協委員會).

Mr. Chen Yu (陳雨), aged 48, is an executive Director and the vice general manager of the Company who is responsible for production management. 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 the Liaoning Province Human Resources Bureau of the PRC (中國遼寧省人力資源局). Mr. Chen has over 20 years of experience in medicine manufacturing industry in the PRC.

Mr. Liu Zhenteng (劉振騰), aged 31, is an executive Director. Mr. Liu Zhenteng obtained a bachelor's degree in accountancy from Macquarie University and a master's degree in business administration ("MBA") from the University of New South Wales, Australia. After his graduation from Macquarie University, Mr. Liu worked as an analyst with a securities company for a year in Hong Kong, and after obtaining his MBA, he worked as a researcher in a private equity company for another year in Shanghai, the PRC. Mr. Liu is responsible for finance, human resources and strategy planning of the Company. Mr. Liu is currently a director of Luoxin Holdings, Shanghai R&D Centre and Luoxin Hong Kong Holdings Limited. Mr. Liu Zhenteng is the son of Mr. Liu Baoqi, the chairman of the Board.

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

NON-EXECUTIVE DIRECTORS

Mr. Liu Zhenhai (劉振海), aged 41, is a non-executive Director. He has about 15 years of experience in the medical and pharmaceutical industry in the PRC. Mr. Liu is also a delegate of the Linyi City Luo Zhuang District People's Congress of the PRC. Mr. Liu Zhenhai is the nephew of Mr. Liu Baoqi.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Foo Tin Chung Victor (傅天忠), aged 48, was appointed as an independent non-executive Director in April 2005 and has carried on this role after the Company's listing on GEM since December 2005. Mr. Foo obtained a bachelor of commerce in accounting and information system from the University of New South Wales in Australia in April 1994 and a MBA from the Australian Graduate School of Management in July 2007. He has been a member of the Australia Society of Certified Practising Accountants since January 1998 and an associate member of the Hong Kong Institute of Certified Public Accountants since July 1999. Mr. Foo has been the company secretary of China Grand Pharmaceutical and Healthcare Holdings Limited (stock code: 512) since 2011, and the company secretary of Huisheng International Holdings Limited (stock code: 1340) since 2013. Mr. Foo was an executive director of Jinheng Automotive Safety Technology Holdings Limited (stock code: 872) but resigned in September 2014. Mr. Foo was a non-executive director of Sino Haijing Holdings Limited (stock code: 1106) from April 2015 to July 2016. Mr. Foo was a non-executive director of Ngai Shun Holdings Limited (stock code: 1246) from March 2015 to July 2015. Shares of all these companies are listed on the Stock Exchange.

Mr. Fu Hongzheng (付宏征), aged 53, was appointed as an independent non-executive Director in June 2001 and has carried on this role after the Company's listing on GEM since December 2005. Mr. Fu graduated from Pharmacy School of Yanbian University* (延邊大學藥學院) in 1985 with a bachelors' degree and obtained his master's degree from Shenyang Medical University* (瀋陽醫科大學) in 1991. Mr. Fu has been an independent non-executive director of Beijing Saikai Pharmaceutical Co., Ltd* (北京賽開藥業股份有限公司) since 2015.

Prof. Du Guanhua (杜冠華), aged 60, was appointed as an independent non-executive Director on 1 July 2013. Prof. Du is a professor, tutor to PhD candidates, pharmacology researcher and deputy director of Chinese Academy of Medical Sciences* (中國醫學科學院) and Union Medical College* (中國協和醫科大學). Prof. Du is also a supervisor of the National Centre of Drug Screening* (國家藥物篩選中心) and the president of the Chinese Pharmacological Society* (中國藥理學會). Prof. Du obtained bachelor of pharmacy from Shandong University* (山東大學), and master of medicine from Tongji Medical College* (同濟醫學院) and PhD from Union Medical College* (中國協和醫科大學). Prof. Du has been an independent non-executive director of Hebei Changshan Shengdai Pharmaceutical Co., Ltd* (河北常山生代藥業股份有限公司), Shandong Xinhua Pharmaceutical Co., Ltd* (山東新華製藥有限公司), and Shanxi Zhendong Pharmaceutical Co., Ltd* (山西振東製藥股份有限公司) since 2014, March 2015 and October 2015, respectively.

Ms. Huang Huiwen (黃慧文), aged 43, was appointed as an independent non-executive Director on 1 July 2016. Ms. Huang has been working with Linyi City People's Hospital* (臨沂市人民醫院) since 2000 and currently is a director of the economics and management department and the head of the finance department of Linyi City People's Hospital* (臨沂市人民醫院). Ms. Huang obtained a bachelor's degree from Shandong University of Finance* (山東財政學院) in 1995.

PROFILES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

SUPERVISORS

Mr. Wang Jian (王健), aged 56, was appointed as a supervisor of the Company on 30 November 2010. Mr. Wang obtained 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 Guangzhou Bidi Pharmacy Co., Ltd* (廣州彼迪藥業有限公司) prior to 1999 and has been individually researching on new medicine since 1999. Mr. Wang currently holds 9,360,136 domestic shares of the Company ("Domestic Shares"), representing approximately 2.10% of all Domestic Shares or approximately 1.54% of all issued share capital of the Company.

Ms. Song Liang Wei (宋良偉), aged 36, was appointed as a supervisor of the Company on 30 November 2010. Ms. Song is the manager of the new medicine research and development technical centre of the Company. Ms. Song obtained a diploma in professional pharmacy from Shandong University* (山東大學). Before joining the Company, Ms. Song worked at Linyi City People's Hospital* (臨沂市人民醫院).

Mr. Liu Zhenfei (劉振飛), aged 29, joined Luoxin Pharmaceutical Group, a previous controlling shareholder of the Company, as a sales executive in 2011 and was appointed as a supervisor of the Company on 1 July 2013. Mr. Liu Zhenfei obtained a bachelor's degree in business administration from Macquarie University, Australia. Mr. Liu Zhenfei is the son of Mr. Liu Baoqi, the chairman of the Board.

Ms. Song Lili (宋麗麗), aged 33, was nominated by the staff congress of the Company and was appointed as a supervisor of the Company on 1 July 2016. Ms. Song Lili is the manager of the human resources department of the Company. Ms. Song Lili obtained a bachelor's degree in applied chemistry from Linyi University* (臨沂大學), and a master's degree in pharmaceutical engineering from Shandong University* (山東大學).

SENIOR MANAGEMENT

Mr. Lau Hon Kee (劉漢基), FCPA, CPA (Aust.), aged 46, is the financial controller and the company secretary of the Company. Mr. Lau is responsible for accounting, financial reporting and corporate governance of the Company. Mr. Lau obtained a bachelor's degree in commerce from Australian National University and a master's degree in professional accounting from Hong Kong Polytechnic University. 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 had over 10 years of experience in finance and accounting field, and held senior management positions in several service and manufacturing companies. He is currently an independent non-executive director of Dafeng Port Heshun Technology Company Limited (a company listed on the Stock Exchange with stock code: 8310) since May 2016, and Astrum Financial Holdings Limited (a company listed on the Stock Exchange with stock code: 8333) since June 2016. He is also a joint company secretary of Zhejiang Tengy Environmental Technology Co., Ltd (a company listed on the Stock Exchange with stock code: 1527).

MANAGEMENT DISCUSSION AND ANALYSIS

INTRODUCTION

Since the end of 2015, a series of policies regarding the pharmaceutical industry have been introduced, including the issuance of new classification measure of drug registration relating to technology and research, implementation of quality consistency evaluation for generic drugs, shortage of resources at clinical bases as a result of upgraded clinical standards, as well as decreasing drug prices under the relevant bidding system in the market. Such policies have posed new and enormous challenges to the pharmaceutical industry in the short run. The Company believes that in such a tumultuous and challenging environment, companies have to seize the opportunities and strengthen efforts to establish sustainable core capabilities, so as to solve the crisis arising from such challenges from the root.

In terms of market, for those provinces completed this round of tendering, tender prices of the pharmaceutical products were in a significant downward trend. In particular, the national pricing policy was negotiated by reference to the minimum tender price, which caused significant adverse effects on the pharmaceutical enterprises during product pricing. In addition, following the pilot scheme of cancellation of markup of drug price in provincial and municipal public hospitals, hospitals in different areas will make second price negotiation on bulk purchase basis when purchasing pharmaceutical products after the award of tender. This move could further reduce the purchasing price on these pharmaceutical products, thus further pressurising pharmaceutical enterprises to reduce the price of their products. Moreover, with the gradual implementation of control on proportion of drugs and medical expenditure of medical insurance, the growth in sales of products of the pharmaceutical enterprises is subject to greater pressure.

In terms of R&D, on one hand, as a result of upgraded standards for research work at clinical base and contract research organisation for clinical trials, the rate of clinical-related work have increased, which has increased the costs for clinical trials of the pharmaceutical enterprises. At the same time, the full implementation of consistent evaluation of generic drugs and more stringent time constraints have resulted in a shortage of clinical resources, thus further increased the costs of clinical-related work. On the other hand, a series of policies encouraging the R&D of new drugs have been introduced. Pharmaceutical enterprises have to balance their input for both existing generic drugs and R&D of innovative drugs.

As a leading modern pharmaceutical enterprise in the PRC, the Group has always been committed to providing safe, reliable and high-tech pharmaceutical products and focused on the strategies of strengthening science and technology innovation, production optimisation as well as strengthening marketing and distribution systems. During the year ended 31 December 2016, in the face of numerous newly-implemented industry policies, the Group endeavoured to adjust its operating strategies in order to adapt to changes in the industry and market demands by investing additional resources in enhancing its production capabilities, building R&D teams and deploying product pipelines. However, the growth of the Group's sales results is facing greater pressure due to the industrial policies and the market environment.

The Group will continue its work on the establishment of an outstanding sales team mainly targeting at the third terminal markets, such as primary medical institutions, and the OTC sales network and a hospital terminal sales network, thereby constantly boosting market share and competitiveness of its products and laying a solid foundation for sustainable development of the Group in the future.

MANAGEMENT DISCUSSION AND ANALYSIS

In respect of R&D activities, the Group will mainly concentrate on the following objectives:

- Quality consistency evaluation for generic drugs: The Group will commence numerous consistency evaluation works in the coming years due to the large number of approvals obtained for generic drugs of the Group.

- Clinical development of generic drugs: Currently, the Group has obtained many generic drugs clinical trial approvals and intends to allocate more capital to the clinical development of such drugs.

- R&D of innovative drugs: The Group intends to further allocate capital to the Shanghai R&D Centre for the R&D of high-tech products through independent R&D, cooperation with institutions and R&D organisations and introduction from foreign projects etc., so as to expand the product portfolio of the Group.

The management of the Group believes that in short-to-mid-term, such R&D efforts may put pressure on the results of the Company. Nevertheless, it shall be beneficial to the core competitiveness of the Group in the long run.

BUSINESS REVIEW

During the year ended 31 December 2016, under the influence of factors such as the slowdown in the domestic economy, sustained decrease in tender prices and medical insurance premium control, the industry has been growing at a slower pace and witnessed further fragmentation. The Group upheld its underlying development strategies and endeavoured to achieve the targets of the 13th Five-Year Plan. It managed to maintain stable and healthy development in R&D, management, production, human resources and market network, thus laying a solid foundation for the future sustainable development of the Group.

Research and Development

1. *Building Platform for Technology Research and Development*

   R&D and innovation are the core drivers of the long-term development of the Group. As early as in 1996, the Group established an R&D base for generic drugs in Shandong Province, the PRC. In June 2014, the Group established the Shanghai R&D Centre in Shanghai Zhangjiang Hi-Tech Park, to reinforce its core competitive edge by leveraging the various advantages acquired from Shanghai Zhangjiang Hi-Tech Park. The Group will conduct R&D for high-tech projects and provide training to high-tech talents in the Shanghai R&D Centre. As at 31 December 2016, the Shanghai R&D Centre had a team of approximately 165 staff members. Their key members, who are well-known domestic and international experts with R&D experience in medicines in internationally prominent pharmaceutical enterprises, have formed a R&D team that covers all phases of R&D on new drugs and will continue to expand its scale along with further enrichment of the product lines of the Company.

   During the year ended 31 December 2016, the Group actively implemented the quality consistency evaluation for generic drugs in a comprehensive manner based on the national quality consistency evaluation policy. The first category for evaluation is the oral drugs category in National Essential Drugs List, which is required to be completed by the end of 2018 according to the national quality consistency evaluation policy. Currently, we have completed the registration of the reference listed drugs for this category while related R&D and applications are undergoing in a timely and orderly manner. The Group's quality consistency evaluation for other categories of drugs is also commencing by stages.

MANAGEMENT DISCUSSION AND ANALYSIS

Furthermore, the Shanghai R&D Centre focuses on the R&D on innovative drugs. It has developed products by advanced technologies adopted through self-development, cooperation with institutions, R&D organisations and introduction from overseas projects. The Group's product lines will, therefore, be greatly enriched. As at 31 December 2016, the Shanghai R&D Centre has commenced various self-developed and co-developed R&D projects on new drugs and established cooperation relationships with renowned foreign pharmaceutical enterprises and leading domestic R&D institutions.

Currently, the Group has been leading the domestic and global R&D of two potential innovative drugs, including:

Item LXI-15028 (CJ-12420)

For pharmaceutical product LXI-15028 jointly developed with CJ HealthCare in Korea, we made the application for clinical trial approvals to the Shandong Food and Drug Administration* (山東省食品藥品監督管理局) ("SDFDA") in December 2016. The application has also been submitted to the Technical Evaluation Center of the China Food and Drug Administration* (中國國家食品藥品監督管理總局) ("CFDA") and is currently pending technical evaluation by the Technical Evaluation Center. The Company has been granted an exclusive right to develop, manufacture and commercialise the proposed pharmaceutical product LXI-15028 in the PRC, where the Company will be responsible for the development, manufacture, and commercial activities within the territory and bear the associated expenses.

LXI-15028 is a potassium-competitive acid blocker (P-CAB) in phase III development for the treatment of reflux esophagitis and other acid-related gastrointestinal diseases. LXI-15028 competitively inhibits the binding of potassium ions to H+, K+-ATPase in the final step of gastric acid secretion in gastric parietal cells, which has the potential to provide a strong and sustained acid secretion inhibitory effect.

The Company is one of the leaders in acid inhibition treatment market in the PRC. LXI-15028 will complement the Company's current growing business in this therapeutic area. Currently, the Company is accelerating the development process of LXI-15028 according to the schedule, with the clinical development stage scheduled to commence in 2017, in order to address the unmet needs of patients with acid-related diseases.

Item LXI-15029 (SCC-31)

For pharmaceutical product LXI-15029 (SCC-31) jointly developed with Shanghai Institute of Materia Medica, Chinese Academy of Sciences* (中科院上海藥物所) ("SIMM") and Fudan University (復旦大學), we have obtained clinical trial approvals (Authorisation No. 2016L07931, 2016L07932, 2016L07933) from the CFDA. The Company and the project partners expect to submit the clinical research application to the relevant foreign drug administrative authorities in 2017. The Company has the exclusive right to the R&D, manufacture and commercialise the drug in the PRC, Hong Kong and Macau. The Company also co-owns the right of the product with the project partners in markets beyond the PRC, Hong Kong and Macau, and will work together to expedite the R&D of this pharmaceutical product.

MANAGEMENT DISCUSSION AND ANALYSIS

The pharmaceutical product is a new competitive ATP mTOR kinase inhibitor that acts as potent and highly selective dual inhibitors of mTORC1 and mTORC2. PI3K-AKT-mTOR is an essential signal transduction pathway inside the cells and plays a crucial role in controlling the process of tumor formation, growth and resistance to the drug. Given that about 50% of human tumors occur by abnormal activation of mTOR and the central position of mTOR in the tumor signal network, the mTOR inhibitor should be a new generation drug targeting at broad-spectrum cancer and frequency with inhibiting effects on tumors with various molecular mechanisms. Compared with simple mTORC1 inhibitor, mTOR inhibitor, with its prospect of broadening cancer spectrum and enhancing the effectiveness of cancer treatment, the Company expects to see enormous development going forward, especially in the fields of solid tumors such as breast cancer, lung cancer, and gastric cancer.

Since 2014, in addition to the Group's existing generic drugs, the Group has strengthened its efforts in R&D of innovative drugs with a view to expanding the innovative drug product line step by step. The R&D of innovative drugs focuses on oncology, digestive, respiratory and cardiovascular metabolism treatments. The cooperation with SIMM and Fudan University on the pharmaceutical product marks a major step in executing R&D strategy of innovative drugs. The organic combination of generic drugs with innovative patent drugs forms a quality product portfolio, enabling the Group to lay a solid foundation for its future development.

Currently, the Company has obtained or been awarded approvals to establish several scientific research platforms which include a state-accredited enterprise technology centre, a state-province joint engineering laboratory, the "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), the "National Post-Doctoral Research Workshop*" (國家博士後科研工作站), the "Key High-Tech Enterprise under the State Torch Programme*" (國家火炬計劃重點高新技術企業), the "National Technological Innovation Demonstration Enterprise*" (國家技術創新示範企業), the "Pilot Enterprise on the Implementation of Management System for the Integration of Informatisation and Industrialisation*" (兩化融合管理體系貫標試點企業), the "Model Engineering Technology Research Centre of Shandong Province*" (山東省級示範工程技術研究中心), the "Shandong Key Lyophilized Powder Injection Pharmaceutical Laboratory*" (山東省凍乾粉針劑藥物重點實驗室), the "Shandong Lyophilized Powder Injection Pharmaceutical Engineering Laboratory*" (山東省凍乾粉針劑藥物工程實驗室), the "Taishan Scholar — Pharmaceutical Expert Consultant*" (泰山學者 — 藥學特聘專家), and the "Enterprise Academician Workstation of Shandong Province*" (山東省企業院士工作站). Together, they formed a strong platform for talent accumulation, R&D and technology advancement, and further strengthened the R&D capabilities and overall competitiveness of the Group.

2. *New Products*

For the year ended 31 December 2016, the Company obtained nine pharmaceutical production approvals. As at 31 December 2016, the Group had obtained a total of 313 pharmaceutical production approvals and six antiseptic germicide production approvals.

(1) The Group's levofloxacin hydrochloride tablets (鹽酸左氧氟沙星片) with specifications of 0.25g and 0.75g were granted production approval by the CFDA on 22 March 2016. The product is mainly used for the prevention and treatment of bacterial infection caused by proven or highly suspected sensitive bacteria.

(2) The Group's cefoxitin sodium for injection (注射用頭孢西丁鈉) with specification of 0.5g was granted production approval by the CFDA on 4 May 2016. The product is mainly used for the treatment of respiratory infections, infections of the urinary and reproductive systems, sepsis as well as local infections of bones, joints, skins and soft tissues.

MANAGEMENT DISCUSSION AND ANALYSIS

(3) The Group's cephathiamidine for injection (注射用頭孢硫脒) with specification of 0.25g was granted production approval by the CFDA on 25 August 2016. The product is mainly used for the treatment of infections of respiratory system, hepatobiliary system, the five sense organs and urinary tract, endocarditis and septicemia caused by sensitive bacteria.

(4) The Group's cefotiam hydrochloride for injection (注射用鹽酸頭孢替安) with specification of 0.25g was granted production approval by the CFDA on 27 September 2016. The product is mainly used for infections caused by staphylococcus, streptococcus (genus of bacteria except for enterococci), streptococcus pneumoniae, bacillus influenza, colibacillus, klebsiella, intestinal bacteria, citrobacter, bacillus proteus mirabilis, proteus vulgaris, proteus mirabilis and proteus morganii.

(5) The Group's meropenem for injection (注射用美羅培南) with specifications of 0.25g and 0.5g were granted production approval by the CFDA on 25 October 2016. The product is mainly used for the treatment of bacterial infection caused by one or more species of meropenem sensitive bacteria for adults and children, including pneumonia (including nosocomial pneumonia), urinary tract infection, gynecological infection (e.g. endometritis and pelvic inflammatory disease), skin and soft tissue infection, meningitis and septicemia.

(6) The Group's cefoperazone sodium and tazobactam sodium for injection (注射用頭孢哌酮鈉他唑巴坦鈉) (8:1) with specifications of 1.125g and 2.25g were granted production approval by the CFDA on 23 December 2016. The product is mainly used for the treatment of medium and heavy infection caused by beta-lactamase-producing bacteria resistant to and sensitive to sole cefoperazone tablets.

3. *Patents and Achievements*

(1) As at 31 December 2016, the Group had 119 invention patents pending for registration in the PRC, and had 147 invention patents registered in the PRC.

(2) As at 31 December 2016, the Group had 313 production approvals, and six antiseptic germicide production approvals.

(3) As at 31 December 2016, the Group had 48 certificates of new drugs.

(4) For the year ended 31 December 2016, the Group had 13 research projects being admitted to various major construction projects at national, provincial and municipal levels, and independent innovation projects, and won science and technology awards at national, provincial and municipal levels for 125 product technologies.

(5) As at 31 December 2016, the Group had eight products being admitted to the National Major Innovative Drug Projects, 10 projects being admitted to the State Torch Programme, and four projects being admitted to the State Key New Products Programme.

MANAGEMENT DISCUSSION AND ANALYSIS

Production and Management

The Group continued to implement effective strategies in seven integral systems, namely, management, culture, corporate organisation, 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. The Company has been named as one of the "Top 100 Pharmaceutical Companies in China*" (中國製藥工業百強企業) since 2006. From 2011 onward, the Company has been named as the "Best Industrial Enterprise in terms of Pharmaceutical Product R&D and Production Line in China*" (中國醫藥研發產品線最佳工業企業). These recognitions demonstrated the growth in the overall corporate strength of the Group.

1. *Construction of Production Facilities*

   Currently, the Group has three production bases, including the Company itself, Yuxin and Hengxin. The Group is capable of meeting the growing demand for pharmaceutical products in the market with its strong production capacity. At the same time, it continues to increase the number of new dosage types of its pharmaceutical products and effectively complements the commercialisation of R&D results of new drugs.

   (1) *Pharmaceutical preparations:* the Company completed the civil construction of an anti-tumor drip and water injection workshop and a facility of purification and equipment, the equipment adjustment of which has been completed and entered into the early stage of certification. The 1601 solid workshop was renovated and successfully obtained GMP certification. The 1305 and 1306 mixing powder workshops have completed construction and passed the on-site inspection by SDFDA, and have both obtained approvals for mixing powder injection. Yuxin was granted the Drug Manufacturing Certificate and Sanitary License for Manufacturing Enterprise for solid injections (i.e. tablets, capsules and granules), injections (i.e. lyophilized powder injection), large-volume injections, inhalators and sprays. Installation of the automated storage system was completed and put into operation. The constructions of its infusion workshop, spray workshop, inhalator powder workshop and ancillary facilities were completed and put into operations. Solid workshop has obtained GMP certification. The 2503 and 2505 lyophilized powder injection workshops have both passed and obtained GMP certificates on 23 November 2016, and have been put to full productions.

   (2) *Pharmaceutical raw materials:* constructions of the phase I of the pharmaceutical raw materials project of Hengxin, including workshop of raw materials of cephalosporins sterile (with lyophilization); workshop of noncephalosporins sterile; workshop of raw materials of synthetic drugs and oral raw materials; workshop of raw materials of anti-tumor drugs; workshop of solvent recovery and deep water treatment projects were all completed with GMP certifications and have been put into use. The phase II of the pharmaceutical raw materials project is under construction. Two workshops of raw materials of non-sterile synthetics have entered the purification and pipeline installation phases and will be put into operations after obtaining GMP certifications; civil construction of two newly-built workshops of raw materials of cephalosporins sterile will be completed soon; newly-built research buildings and office buildings have commenced operations. Currently, 42 types of pharmaceutical raw materials have obtained GMP certifications, and one of the types has obtained Korean GMP certification.

   (3) Preparations that obtained the new GMP certifications included lyophilized powder injection, powder injection, tablets, hard capsules, low-volume injections, granules, dry suspension agent, large-volume injections and bulk pharmaceuticals (including sterile bulk medicines). Furthermore, solid injections (i.e. tablets, capsules and granules) are prepared to apply for the European Union GMP certifications.

MANAGEMENT DISCUSSION AND ANALYSIS

2. *External Investment*

In July 2016, the Company completed an acquisition of a pharmaceutical trading company Shandong Luoxin Pharmaceutical Group Runxin Pharmaceutical Company Limited* (山東羅欣藥業集團潤欣醫藥有限公司) (formerly known as 聊城惠澤醫藥有限公司) in Liaocheng, Shandong Province, the PRC. This will boost the Group's product marketing and expand the construction of distribution network of the Group's pharmaceutical products.

Sales and Marketing

The Group continued to integrate marketing resources, built an outstanding sales team and conduct refined market management to increase the market share and competitiveness of its products. Currently, the Group has an extensive and seamless sales network and marketing management system throughout the PRC. It has also formed an OTC sales network and a hospital terminal sales network. With the gradual implementation of classification treatment, the primary medical terminal market is in continuous growth. The Group boosts the development of the primary market and keeps exploring the third terminal markets, such as primary medical institutions, in order to expand its market share in the primary market. Currently, the Group's sales team in the third terminal market has been growing steadily, with increasing coverage area.

For the year ended 31 December 2016, the Group's turnover amounted to approximately RMB4,117,573,000, representing an increase of approximately 14.02% from RMB3,611,380,000 for the corresponding period of last year. The increase was mainly attributable to the Group's continuing upgrading of the product portfolio, boosting the sales of high value-added products and the acceleration of sales network development to increase the market share of its products at different levels.

A breakdown of segmental sales revenue by pharmaceutical indications and usage is shown as follows:

	Sales RMB'000		Percentage of total turnover	Percentage of total turnover	
Indications and usage	**January to December 2016**	January to December 2015	**from January to December 2016**	from January to December 2015	Growth rate (%)
System specified medicine	**1,948,667**	1,622,818	**47.33%**	44.94%	20.08%
Antibiotic medicine	**1,232,007**	1,211,250	**29.92%**	33.54%	1.71%
Other specified medicine	**936,899**	777,312	**22.75%**	21.52%	20.53%
Total	**4,117,573**	3,611,380	**100%**	100%	14.02%

Key Products

蘭川® (Lanchuan) (Lansoprazole for Injection), a category 3 new drugs developed by the Group, is a proton pump inhibitor which is mainly used for the treatment of various erosive esophagitis, reflux esophagitis, gastric ulcer, duodenal ulcer, etc. In September 2014, the Group was granted an approval (no. 2014S00718) by the CFDA, for adding three more indications, namely "gastric ulcer with hemorrhage, acute stress ulceration and acute gastric mucosa lesions" on top of its current indication for "duodenal ulcer with hemorrhage with oral intake inapplicable". As a result, the Lanchuan branded product has filled the gap left by its peers in the domestic market on indication for stress ulceration.

MANAGEMENT DISCUSSION AND ANALYSIS

羅欣津® (Luoxinjin) (Roxithromycin and Ambroxol Hydrochloride Tablets), a category 3.2 new drug developed by the Group with new drug certification by the CFDA. As proven by clinical studies, compared to sole roxithromycin tablets, the compound preparations carry greater effect in the treatment of respiratory infection with obvious relieving effect on the clinical manifestations like coughing and wheezing, and reduces the pain of the patients, thus offering strong appeal in clinical medication.

卡佩萊® (Kapeilai) (Rabeprazole Sodium for Injection), a category 3.1 new drug developed by the Group which is the 2nd generation proton pump inhibitor that is widely used in the treatment of gastric and duodenal ulcers and gastroesophageal reflux diseases. It is currently the first-line drug used for the treatment of digestive diseases. As revealed by clinical applications, it demonstrates superb stability with unique technicality, excellent safety and efficacy profile which is superior to the present national standard of the PRC. The successful development of this preparation has filled the blank in the PRC's domestic digestive medication (injection form). The product has better bioavailability and effectiveness than other dosage forms.

Financial Review

For the year ended 31 December 2016, the Group's audited turnover was approximately RMB4,117,573,000, representing an increase of approximately 14.02% from RMB3,611,380,000 of last year. Nevertheless, the overall selling prices, particularly to those products launched for some time, were in decreasing trend. The increase was attributable to the launching of high value-added products by the Group, product portfolio upgrade and the acceleration of the development of its sales network to increase the market share of its products thereby boosting its turnover.

For the year ended 31 December 2016, the audited cost of sales was approximately RMB1,000,033,000, representing a decrease of approximately 11.82% from approximately RMB1,134,104,000 of last year. The reason for decreasing cost of sales was partly due to more self-produced bulk medicines were used in productions.

For the year ended 31 December 2016, the audited gross profit margin was approximately 75.71%, representing an increase of approximately 7.11% from approximately 68.60% of last year.

For the year ended 31 December 2016, the audited operating cost was approximately RMB2,773,702,000, representing an increase of approximately 37.80% from approximately RMB2,012,890,000 of last year. The increase of operating expenditure was due to the following reasons:

1. the subsidiaries, Jinan Luoxin Pharmaceutical Company Limited* (濟南羅欣醫藥有限公司), Shandong Luoxin Pharmaceutical Group Chongqing Pharmaceutical Co., Ltd. (山東羅欣藥業集團重慶醫藥有限公司) and Shanghai R&D Centre are under further business development and were incurring overhead cost before generating revenue;

2. an increase in R&D expenses for products which may be launched in the future, among which, certain additional expenses were attributed to Shanghai R&D Centre the business of which heavily involves R&D;

3. an increase of selling and distribution expenses due to additional recruitment for business development personnel of the sales team which in turn resulted in an increase of remuneration expense.

For the year ended 31 December 2016, the audited profit attributable to the shareholders of the Company (the "Shareholders") was approximately RMB379,198,000, representing a decrease of approximately 23.07% from approximately RMB492,929,000 of last year. Weighted average earnings per share were RMB0.622 for the year ended 31 December 2016 (as at 31 December 2015: RMB0.809).

MANAGEMENT DISCUSSION AND ANALYSIS

Liquidity and Financial Resources

The Group's working capital is generally financed by its internally generated cash flow. As at 31 December 2016, the Group's cash and cash equivalents amounted to approximately RMB556,028,000 (as at 31 December 2015: RMB605,333,000). As at 31 December 2016, the Group did not have any borrowings (as at 31 December 2015: nil).

Fixed Deposits/Cash and Cash Equivalents

As at 31 December 2016, the Group did not have pledged bank deposits (as at 31 December 2015: nil).

Financial Assets at Fair Value through Profit or Loss

As at 31 December 2016, the Group had financial assets at fair value through profit or loss of investment amount of approximately RMB1,035,000,000 (as at 31 December 2015: RMB1,045,000,000). Such financial assets comprised 11 investments in wealth management products, offered by licensed banks in the PRC. A summary of the financial assets as at 31 December 2016 is as follows:

Investment amount	**Investment period**	**Fixed investment return per annum**
(RMB)		
45,000,000	12/2016–1/2017	4.00%
50,000,000	12/2016–2/2017	3.30%
50,000,000	12/2016–2/2017	3.30%
160,000,000	12/2016–3/2017	3.05%
100,000,000	9/2016–3/2017	3.00%
200,000,000	11/2016–5/2017	3.30%
100,000,000	12/2016–6/2017	3.15%
70,000,000	Redeemable on demand	2.85%
120,000,000	Redeemable on demand	2.85%
40,000,000	Redeemable on demand	2.85%
100,000,000	12/2016–3/2017	3.05%

The relevant amounts of the consolidated financial assets, being the Group's operating cash flow surplus, were previously held by the Group as cash or bank deposits prior to making the said investments with an aim to optimise utilisation of the Group's operating cash flow surplus.

MAJOR ACQUISITION AND DISPOSAL

Save as disclosed in Note 39 to the consolidated financial statements, for the year ended 31 December 2016, the Group did not have any major acquisition or disposal.

MANAGEMENT DISCUSSION AND ANALYSIS

SIGNIFICANT INVESTMENT

For the year ended 31 December 2016, the Group did not make any significant investment.

FUTURE PLAN FOR MATERIAL INVESTMENTS AND CAPITAL ASSETS

The Group does not have any concrete plan for material investments or capital assets for the coming year.

CONTINGENT LIABILITIES

As at 31 December 2016, the Group did not have any substantial contingent liabilities.

EXCHANGE RISK

As at 31 December 2016, the Group operated and conducted business in the PRC, and all of the Group's transactions, assets and liabilities were denominated in RMB, except that some imported equipment and raw materials used in R&D and Luoxin Hong Kong Holdings Limited made an investment in US dollar ("USD") in an equity investment fund established in the Cayman Islands in July 2015. Most of the Group's cash and cash equivalents and pledged deposits were denominated in RMB while bank deposits were 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. The Group's bank deposits denominated in USD were placed in offshore USD account opened by Luoxin Hong Kong Holdings Limited with banks in the PRC.

EMPLOYEES AND REMUNERATION POLICY

The Directors believe that employees' quality is the most important factor in maintaining the sustainable 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 benefits are maintained at an appropriate level. The Group has established a remuneration committee to make recommendations on the overall strategy for remuneration policy.

MAJOR EVENTS AFTER THE REPORTING PERIOD

On 7 March 2017, the Board receive a letter from the joint offerors (the "Joint Offerors") including Giant Star Global (HK) Limited and Ally Bridge Flagship LX (HK) Limited, and GL Instrument Investment L.P.("GL Instrument") and Giant Star Global Limited (for itself and on behalf of GL Instrument) that a voluntary conditional offer (the "Offer") is being contemplated by Somerley Capital Limited on behalf of the Joint Offerors for all the issued H shares in the Company (other than those already owned, controlled or agreed to be acquired by the Joint Offerors and parties acting in concert with any of them who have undertaken not to accept the Offer).

PROSPECTS

Looking forward, as one of the key industries supported by the 13th Five-Year Plan, the pharmaceutical industry will be provided with more resources by the PRC government in terms of pharmaceutical and medical equipment.

MANAGEMENT DISCUSSION AND ANALYSIS

The Opinions on the Reform of the Examination and Approval System of Drugs and Medical Devices* (《關於改革藥品醫療器械審評審批制度的意見》) and a basket of other related policies were introduced by the relevant authorities in 2015, with an aim to encourage innovative research of drugs in terms of clinical value, optimise the examination and approval procedures of new drugs, and accelerate the examination of new drugs in urgent clinical needs. Meanwhile, with the full implementation of new GMP, not only can it raise the technology standards of the industry and strengthen the regulations, but also eliminate obsolete capacity and enhance industry concentration. In addition, the State Council of the PRC issued "Made in China 2025" plan in May 2015 and announced the country's first ten-year action plan focusing on promoting manufacturing. Bio-medicine and high-end medical equipment are listed as one of the ten key sectors. It proposed to vigorously develop new chemical medicine, traditional Chinese medicine and bio-medicine intended to treat serious illnesses. At the National Health and Well-being Convention held in August 2016, the Political Bureau of Central Committee of the PRC approved the "Healthy China 2030" plan, thereby promoting the citizens' health to a national strategic level so as to provide comprehensive and all-time healthcare protection for its people. Such plan will further facilitate long-term development of various industries in the PRC's healthcare sector.

2016 was a stressful year. Due to the sustained decrease in tender prices, drug proportion, medical insurance premium control, the introduction of policies such as quality consistency evaluation for generic drugs, reform on registration category for chemical drugs and reform on assessment and approval for pharmaceutical products, the development of pharmaceutical enterprises is under glaring pressure.

In short-to-mid-term, the changes in registration of pharmaceutical products mean that the Group's products originally planned for approval and launching in two years will not be available as intended. However, it is obvious that relevant policies aimed at improving the quality of pharmaceutical products and encouraging R&D which in turn will create new demands and opportunities for pharmaceutical enterprises. In the long run, the measures favour the overall development of innovative enterprises and expand the room of development for competitive enterprises.

The Group will continue to pursue the strategic direction of a "technology-driven enterprise with determination and efforts". By fully leveraging the opportunities arising from the integration of the pharmaceutical industry, the Group will continue to expand its investments in scientific research to consolidate its standing in scientific researches and technologies, and to enhance the capabilities of its R&D team. The Group strives for developing more products with more advanced technology, of better quality and higher added value.

The Group also aims at reducing production costs and expanding production scale so as to stay competitive through economies of scale, low production costs and differentiation. With the completion of construction and the commencement of production of the Group's new production bases of Yuxin and Hengxin, our production capacity has been enhanced to satisfy the growing market demands for pharmaceutical products. Meanwhile, the Group will increase the number of new dosage types of its pharmaceutical products and effectively expand the R&D scope of new drugs, thus facilitating the comprehensive development of the Group's business.

The Group will also step up its effort on the establishment of its sales teams and proactively broaden its extensive sales network so as to enhance the market share of its products and continue to improve its competitiveness.

The management believes that in short-to-mid-term, changes in market environment and the upcoming increase of R&D efforts may put pressure on the results of the Company. Nevertheless, it shall be beneficial to the core competitiveness of the Group in the long run.

CORPORATE GOVERNANCE REPORT

Pursuant to Rule 18.44 of the GEM Listing Rules, the Board presents this corporate governance report to disclose its corporate governance practices adopted during the year ended 31 December 2016 to the Shareholders. This report highlights some of the most important corporate governance practices of the Company.

THE CORPORATE GOVERNANCE POLICY

The Board considers that good corporate governance of the Company is the key to safeguarding the interests of the Shareholders and enhancing the performance of the Company. The Board is committed to maintaining and ensuring high standards 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 processes are regulated in a proper and prudent manner.

The executive Directors, according to the corporate governance policy, perform different duties in their specialist area, which are marketing, R&D, finance, accounting and general administration.

The Board has also established an audit committee (the "Audit Committee"), under its authorised terms of reference, to review the Company's existing internal control policies and procedures, operation, investor relationship and Directors' duties and behaviour from time to time in order to ensure that the Board is managing the Company in compliance with the corporate governance policy.

In the opinion of the Board, the Company complied with all the code provisions as set out in the Corporate Governance Code (the "Corporate Governance Code") and Corporate Governance Report contained in the Appendix 15 of the GEM Listing Rules.

THE BOARD OF DIRECTORS

The Board currently comprises of five executive Directors, namely, Mr. Liu Baoqi, Ms. Li Minghua, Mr. Han Fengsheng, Mr. Chen Yu and Mr. Liu Zhenteng with Mr. Liu Baoqi acting as the chairman of the Board, one non-executive Director namely, Mr. Liu Zhenhai and four independent non-executive Directors, namely, Mr. Foo Tin Chung, Victor, Mr. Fu Hongzheng, Prof. Du Guanhua and Ms. Huang Huiwen. As the Company was established in the PRC, four supervisors, namely, Mr. Wang Jian, Ms. Song Liang Wei, Mr. Liu Zhenfei and Ms. Song Lili were also appointed to monitor the decision making of the Board.

Biographical details of the Directors and supervisors of the Company 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 service term of the Directors is three years commenced on 1 July 2016, 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 Board will meet at least 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 the 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 calls will be arranged so as to enable the Company to seek 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 out their duties imposed by the Company Law of the PRC, Hong Kong Companies Ordinance (Cap. 622 of the Laws of Hong Kong) (the "Companies Ordinance"), the Articles of Association and the GEM Listing Rules, complied with relevant requirements and strictly implemented resolutions passed at general meetings of the Company.

Executive Directors

The executive Directors were appointed based on their expertise and are responsible for different areas of the Company's business. The non-executive Director and supervisors were mostly appointed through nominations made by certain initial management Shareholders, promoters or staff unions, who could monitor the decision making of the Board and operation of the Company.

Non-executive Director

One of the promoters, Linyi People's Hospital* (臨沂市人民醫院) sold its shares in the Company to independent investors during October 2007 and its nominated non-executive Director Mr. Yin Chuangui was retired on 30 June 2016. Luoxin Pharmaceutical Group (the previous controlling Shareholder until May 2014), still play a role in the Company's performance and transactions in 2016, and will continue to play its role in subsequent events in 2017. Its nominated non-executive Director Mr. Liu Zhenhai will remain on the Board until further arrangement.

Independent Non-executive Directors

The independent non-executive Directors also serve important role in the Board. They bring independent judgment on issues of strategic direction and future development; and opinions on connected transactions and risk management on audit issues. One of the independent non-executive Directors is a qualified accountant and the rest of them possess the qualification set out in the GEM Listing Rules 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 pursuant to Rule 5.09 of the GEM Listing Rules and believes that their independence is in compliance with the GEM Listing Rules as at the date of this report.

CORPORATE GOVERNANCE REPORT

Under the code provision A.4.3 of the Corporate Governance Code, serving more than nine years could be relevant to the determination of a non-executive Director's independence and that any further appointment of such independent non-executive Director should be subject to a separate resolution to be approved by the Shareholders.

Mr. Foo Tin Chung, Victor (傅天忠), is an independent non-executive Director who was appointed in April 2005 and has carried on this role after the Company's listing on GEM since December 2005. Mr. Fu Hongzheng (付宏征), being an independent non-executive Director, is an independent non-executive Director who was appointed in June 2001 and has carried on this role after the Company's listing on GEM since December 2005. Mr. Foo and Mr. Fu have provided their annual confirmations of independence to the Company pursuant to Rule 5.09 of the GEM Listing Rules. Mr. Foo and Mr. Fu continue to demonstrate their attributions as independent non-executive Directors and there is no evidence that their tenures have had any impact on their independence. The Board considers that Mr. Foo and Mr. Fu continue to be independent and have met all the guidelines for assessing independence set out in Rule 5.09 of the GEM Listing Rules. The Board believes that they will continue to bring independent and objective perspectives to the Company's affairs free of any relationship which could materially interfere with the exercise of their independent judgment.

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 ended 31 December 2016, the Board held five 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 2016 are as follows:

	Dates of Board meetings (2016)				
Name of Directors	**21 March**	**6 May**	**1 July**	**5 August**	**8 November**
Executive Directors					
Mr. Liu Baoqi	✓	✓	✓	✓	✓
Ms. Li Minghua	✓	✓	✓	✓	✓
Mr. Han Fengsheng	✓	✓	✓	✓	✓
Mr. Chen Yu	✓	✓	✓	✓	✓
Mr. Liu Zhenteng	✓	✓	✓	✓	✓
Non-executive Directors					
Mr. Yin Chuangui (retired on 30 June 2016)	✓	✓	✗	✗	✗
Mr. Liu Zhenhai	✓	✓	✓	✓	✓
Independent Non-executive Directors					
Mr. Foo Tin Chung, Victor	✓	✓	✓	✓	✓
Mr. Fu Hongzheng	✓	✓	✓	✓	✓
Prof. Chen Yun Zhen (retired on 30 June 2016)	✓	✓	✗	✗	✗
Prof. Du Guanhua	✓	✓	✓	✓	✓
Ms. Huang Huiwen (appointed on 1 July 2016)	✗	✗	✓	✓	✓

CORPORATE GOVERNANCE REPORT

DIRECTORS' ATTENDANCE AT THE GENERAL MEETINGS

During the year ended 31 December 2016, a general meeting was held and details of Directors' attendance are as follows:

Name of Directors	AGM (2016) 22 June
Executive Directors	
Mr. Liu Baoqi	✓
Ms. Li Minghua	✗
Mr. Han Fengsheng	✓
Mr. Chen Yu	✓
Mr. Liu Zhenteng	✓
Non-executive Directors	
Mr. Yin Chuangui (retired on 30 June 2016)	✗
Mr. Liu Zhenhai	✗
Independent Non-executive Directors	
Mr. Foo Tin Chung, Victor	✗
Mr. Fu Hongzheng	✓
Prof. Chen Yun Zhen (retired on 30 June 2016)	✗
Prof. Du Guanhua	✗
Ms. Huang Huiwen (appointed on 1 July 2016)	✗

Code provision A.6.7 of the Corporate Governance Code stipulates that independent non-executive Directors and non-executive Directors should attend general meetings of the Company. Owing to overseas engagements, one executive Director, two non-executive Directors and three independent non-executive Directors were unable to attend the general meeting held on 22 June 2016 in person. However, in order to understand the view of the Shareholders, they joined the general meeting by telephone and video conference system, respectively.

CORPORATE GOVERNANCE REPORT

DIRECTORS' TRAINING

During the year ended 31 December 2016, all the Directors have fulfilled the training requirement under paragraph A.6 of the Corporate Governance Code. The summary of the Directors who attended the types of training is as follows:

	Types of training (2016)				
Name of Directors	**A**	**B**	**C**	**D**	**E**
Executive Directors					
Mr. Liu Baoqi	✓	✓	✓	✓	✓
Ms. Li Minghua	✓	✓	✓	✓	✓
Mr. Han Fengsheng	✓	✓	✓	✓	✓
Mr. Chen Yu	✓	✓	✓	✓	✓
Mr. Liu Zhenteng	✓	✓	✓	✓	✓
Non-executive Directors					
Mr. Yin Chuangui (retired on 30 June 2016)	✗	✗	✓	✓	✗
Mr. Liu Zhenhai	✓	✓	✓	✓	✗
Independent Non-executive Directors					
Mr. Foo Tin Chung, Victor	✗	✗	✓	✓	✓
Mr. Fu Hongzheng	✗	✗	✓	✓	✗
Prof. Chen Yun Zhen (retired on 30 June 2016)	✓	✓	✓	✓	✗
Prof. Du Guanhua	✓	✓	✓	✓	✗
Ms. Huang Huiwen (appointed on 1 July 2016)	✗	✗	✓	✓	✓

A. Attending seminars or workshops on marketing issue of the industry, organised internally or by external providers.

B. Attending seminars or workshops on products development and technologies updates of the industry, organised internally or by external providers.

C. Attending seminar or workshops on the GEM Listing Rules, corporate governance and compliance issues, new or amended law, legislation or ordinances of both the PRC and Hong Kong organised internally or by external providers. Topics covered on Continue Disclosures Obligation, Corporate Governance Code, Connected Transaction, Environmental & Social Responsibility Reporting, Risk Management & Internal Control Reporting, and Duties of Listed Companies' Directors.

D. Attending seminar or workshops on directors' duties and undertakings, both organised internally or by external providers.

E. Attending internal workshop and top level discussion on marketing and production, corporate finance, internal control and budgeting issues.

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 2016.

CORPORATE GOVERNANCE REPORT

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Under paragraph A.2.1 of the Corporate Governance 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 2016, Mr. Liu Baoqi served as the chairman of the Board and Ms. Li Minghua served as the general manager and chief executive officer of the Company.

COMMITTEES

As part of 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 was established on 20 November 2005 and its members during the year ended 31 December 2016 included:

Mr. Foo Tin Chung, Victor *(Chairman)*
Mr. Fu Hongzheng
Prof. Chen Yun Zhen (retired on 30 June 2016)
Prof. Du Guanhua
Ms. Huang Huiwen (appointed on 1 July 2016)

The Company has established the Audit Committee with written terms of reference in compliance with paragraph C.3 of the Corporate Governance Code. The terms of reference adopted on 20 November 2005 were amended and restated on 13 March 2012 and 31 December 2015. 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 risk management and the relationship with the Company's auditors. 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 financial reporting matters, internal control policies and procedural and risk management issues; and consider how the Company can comply with these requirements. The Audit Committee also acts as the communication bridge between the Board and the auditors of the Company in relation to the planning and scope of audit work. The audited results of the Group for the year ended 31 December 2016 have been reviewed and discussed by the Audit Committee before any disclosure and release of information.

CORPORATE GOVERNANCE REPORT

During the year ended 31 December 2016, the Audit Committee held four meetings and details of attendances of the meetings are shown below:

	Dates of meeting (2016)			
Audit Committee Meetings	**21 March**	**4 May**	**4 August**	**7 November**
Independent Non-executive Directors				
Mr. Foo Tin Chung, Victor	✓	✓	✓	✓
Mr. Fu Hongzheng	✓	✓	✓	✓
Prof. Chen Yun Zhen (retired on 30 June 2016)	✓	✓	✗	✗
Prof. Du Guanhua	✓	✓	✓	✓
Ms. Huang Huiwen (appointed on 1 July 2016)	✗	✗	✓	✓

REMUNERATION COMMITTEE

The remuneration committee of the Company (the "Remuneration Committee") was established on 20 November 2005 and its members during the year ended 31 December 2016 included:

Mr. Foo Tin Chung, Victor *(Chairman)*
Mr. Fu Hongzheng
Prof. Chen Yun Zhen (retired on 30 June 2016)
Prof. Du Guanhua
Ms. Huang Huiwen (appointed on 1 July 2016)

The Company established the Remuneration Committee with written terms of reference in compliance with paragraph B.1 of the Corporate Governance Code. The terms of reference adopted on 20 November 2005 were amended and restated on 13 March 2012. The duties of the Remuneration Committee include evaluating the performance, making recommendations on the remuneration package of the Directors and senior management and evaluating and making 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, remuneration to local workforces. Among the members of the Remuneration Committee, Mr. Fu Hongzheng is an experienced medical professional in the PRC. Prof. Chen and Prof. Du are both practising doctors and medical scholars, and Ms. Huang Huiwen is experienced finance professional in public health institution. The Remuneration Committee reviews the Directors' salaries based on their professional and education background, working experience and the prevailing salaries in the market.

During the year ended 31 December 2016, the Remuneration Committee reviewed, confirmed and recommended to the Board the remuneration package of each of the Directors and approve the terms of Directors' service contracts.

CORPORATE GOVERNANCE REPORT

During the year ended 31 December 2016, the Remuneration Committee held one meeting and detail of the attendances of the meeting is shown below:

Remuneration Committee Meeting	Date of meeting (2016) 21 March
Independent Non-executive Directors	
Mr. Foo Tin Chung, Victor	✓
Mr. Fu Hongzheng	✓
Prof. Chen Yun Zhen (retired on 30 June 2016)	✓
Prof. Du Guanhua	✓
Ms. Huang Huiwen (appointed on 1 July 2016)	✗

NOMINATION COMMITTEE

The nomination committee of the Company (the "Nomination Committee") was established on 13 March 2012 and its members during the year ended 31 December 2016 included:

Mr. Foo Tin Chung, Victor *(Chairman)*
Mr. Fu Hongzheng
Prof. Chen Yun Zhen (retired on 30 June 2016)
Prof. Du Guanhua
Ms. Huang Huiwen (appointed on 1 July 2016)

The Company established the Nomination Committee with written terms of reference in compliance with paragraph A.5 of the Corporate Governance Code. The terms of reference were adopted on 13 March 2012. The duties of the Nomination Committee include determining the policy for nomination of Directors, reviewing the structure, size and composition of the Board, making recommendations on any proposed changes to the Board, identifying individuals suitably qualified to become Board members, assessing the independence of independent non-executive Directors, and making recommendations to the Board on the appointment or re-appointment of Directors and succession planning for Directors.

The Nomination Committee, when reviewing the appointment of Directors, will also consider the benefit of diversity of the Board, including the wide range of backgrounds, such as professional and education background, geographical residence, nationality and gender. The appointments of the Nomination Committee members are based on their broad experience in the medicinal field and knowledge of directors' duties, in particular, the making of recommendations on Board composition with focus on different skills and knowledge of the Directors.

CORPORATE GOVERNANCE REPORT

During the year ended 31 December 2016, the Nomination Committee held one meeting and detail of the attendances of the meeting is shown below:

Nomination Committee Meeting	**Dates of meeting (2016)** **21 March**
Independent Non-executive Directors	
Mr. Foo Tin Chung, Victor	✓
Mr. Fu Hongzheng	✓
Prof. Chen Yun Zhen (retired on 30 June 2016)	✓
Prof. Du Guanhua	✓
Ms. Huang Huiwen (appointed on 1 July 2016)	N/A

SHAREHOLDERS' RIGHTS

Extraordinary General Meeting

According to Article 59 of the Articles of Association, Shareholders holding 10% or more of the total voting shares of the Company shall have the right to convene an extraordinary general meeting ("EGM"). Shareholders who would like to convene an EGM should send a written notice to the Board, which shall convene an EGM within two months after the receipt of the said written notice.

Shareholders of the Company who wish to make such proposal to convene an EGM should approach the secretary of the Company (the "Company Secretary") for redirecting the proposal to the Board.

Making Proposals at Shareholders' Meetings

According to Article 61 of the Articles of Association, when the Company convenes an annual general meeting ("AGM"), Shareholders holding 5% or more of the total voting shares of the Company shall have the right to propose new resolutions, and the Company shall include such proposed resolutions in the agenda for such AGM if they are matters falling within the functions and powers of and to be dealt with by the Shareholders at AGM.

Shareholders who would like to convene an EGM or to propose new resolutions in AGM should approach the Company Secretary whom shall direct such request to the Board.

CORPORATE GOVERNANCE REPORT

Contact details of the Company Secretary:

The Company Secretary
Shandong Luoxin Pharmaceutical Group Stock Co. Ltd.
Room 1110, Tower B
Southmark, 11 Yip Hing Street
Wong Chuk Hang, Hong Kong
Email: keith.vingo.lau@luoxin.cn

Enquiries to the Board

Shareholders who would like to send enquiries to the Board could approach the Company Secretary in writing and the Board will reply the enquiries in a timely manner.

Contact details of the Company Secretary:

The Company Secretary
Shandong Luoxin Pharmaceutical Group Stock Co. Ltd.
Room 1110, Tower B
Southmark, 11 Yip Hing Street
Wong Chuk Hang, Hong Kong
Email: keith.vingo.lau@luoxin.cn

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 interested parties; and
- publication of announcements on the quarterly, interim and annual results on the Stock Exchange websites, and issuance of other announcements and Shareholders' circulars in accordance with the continuing disclosure obligation under the GEM Listing Rules.

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

http://shandongluoxin.quamir.com

SIGNIFICANT CHANGES IN CONSTITUTIONAL DOCUMENT

During the year ended 31 December 2016, there has been no change in the Company's constitutional document.

CORPORATE GOVERNANCE REPORT

ACCOUNTABILITY AND AUDIT

The Board is responsible for overseeing preparation by management of accounts for each financial period. The Board is also committed to making appropriate announcements, in accordance with the GEM Listing Rules, and to disclose all information that is necessary for the Shareholders to assess the financial performance and other matters of the Company.

During the year ended 31 December 2016, the Board reviewed the engagement of auditors and their remuneration. The auditor of the Company would receive approximately RMB1,050,000 for audit services.

The accounts for the year ended 31 December 2016 were audited by HLB Hodgson Impey Cheng Limited whose term of office will expire upon the forthcoming AGM. The Audit Committee has recommended to the Board that HLB Hodgson Impey Cheng Limited be nominated for re-appointment as the auditor of the Company at the forthcoming AGM.

INTERNAL CONTROL AND RISK MANAGEMENT

The Board is responsible for the establishment and development of the internal control and risk management framework, as well as regularly reviewing the internal control procedures and policies and risk management practices of the Group. The Audit Committee is responsible for advising and overseeing on the internal control and risk management issues and take an active role in communicating the best practice in internal controls and risk management to the Directors and senior management of the Group. The senior management members are therefore responsible to execute the internal policies and procedures and risk assessment practices implemented by the Group. The Group has an internal audit department that assist the Board and senior management to review, maintain and actively advise on the internal control and risk management framework and the implementation of the internal control policies and procedures and risk management practices of the Group.

The Group's internal control policies and procedures are focusing on three major areas, namely: sales and account receivables cycles, purchase and account 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 utilisation of the Company's resources and compliance with financial reporting and disclosure requirements.

The Group's risk management practices are to manage the risks that the Group faces with both internally and externally. With the assistance of the whistle blowing policies, staff at different levels cohering goal and mission of the entire corporation, the Group manages the risks rather than eliminates them.

During the year ended 31 December 2016, the Board or personnel appointed by the Board have conducted a regular walk-through examination on internal control and risk management throughout the Group, including analysing the internal control and risk management system as a whole, interviewing and discussing with managers and frontline staff on issues which their respective departments were involved, assessing on the effectiveness of policies, procedures and practices, and taking advices from the internal audit department.

An external consultant has been engaged since the last quarter of 2015 to review the internal control and risk management framework. During the review, the overall internal control and risk management framework was assessed and the continuing connected transactions were identified as the major issues on which the Board and the senior management would reinforce the implementation of the procedures.

CORPORATE GOVERNANCE REPORT

The Board has also carried out an annual review of the enhanced internal control policies and procedures and risk management practices of the Group in accordance with Code Provision C.2.1 of the Corporate Governance Code, including financial, operational, compliance controls and risk management functions of the Group. During the year ended 31 December 2016, the Board has reviewed the effectiveness of the Group's internal control policies and procedures and risk management practices and considered that they are adequate and effective.

The Board, the Audit Committee, the senior management and the internal audit department will continue to review the policies and procedures and risk management practices in order to maintain a high level of corporate governance over the operation of the Company.

REPORT OF THE DIRECTORS

The Board is pleased to present the report of the Directors for the year ended 31 December 2016.

THE STRATEGY TO GENERATE THE VALUE

The Company is committed to launch new medicines, with its strong product R&D support, at their highest yield of product lifecycle, which would maintain the growing return to the Shareholders and advance medicine supplies to the community.

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activities of the Company and the Group are the manufacture and sale of pharmaceutical products.

RESULTS AND DIVIDENDS

The results of the Group for the year ended 31 December 2016 are set out in the consolidated statement of profit or loss and other comprehensive income on page 51 of this report.

The Directors did not recommend the payment of a final dividend for the year ended 31 December 2016 (2015 RMB0.35 per ordinary share).

CLOSURE OF REGISTER OF MEMBERS

Annual General Meeting

The Company will issue a notice of the forthcoming AGM and advise the period of the closure of register of members for attending the AGM in due course.

Entitlement to Final Dividend

The Directors did not recommend the payment of any final dividend for the year ended 31 December 2016 (2015: RMB0.35 per ordinary share).

RESERVES

Movements in the reserves of the Company during the year ended 31 December 2016 are set out in Note 34 to the consolidated financial statements.

PROPERTY, PLANT AND EQUIPMENT

Details of the movements in property, plant and equipment of the Group and the Company are set out in Note 20 to the consolidated financial statements.

SHARE CAPITAL

Details of the movements in share capital of the Company are set out in Note 33 to the consolidated financial statements.

REPORT OF THE DIRECTORS

BANK LOANS AND OTHER BORROWINGS

As at 31 December 2016, the Group did not have banking facilities (2015: nil).

GEARING RATIO

The Directors review the capital structure regularly. As part of this review, the Directors consider the cost of capital and the risk associated with each class of capital. During the year ended 31 December 2016, 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 2016 and 2015 are as follows:

	As at 31 December	
	2016	2015
	RMB'000	RMB'000
Total debt	**–**	–
Total assets	**4,367,751**	3,640,177
Gearing ratio	**N/A**	N/A

DISTRIBUTABLE RESERVES

According to the Company Law of the PRC, the distributable reserves of the Company as at 31 December 2016 amounted to approximately RMB2,689,610,000 (2015: RMB2,526,771,000).

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 124 of this report.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

The Group has not redeemed, purchased or sold any of its listed securities during the year ended 31 December 2016.

SHARE OPTIONS

The Group has not adopted any share option plan since its establishment.

REPORT OF THE DIRECTORS

DIRECTORS

The Directors during the year ended 31 December 2016 were:

Executive directors
Liu Baoqi (劉保起)
Li Minghua (李明華)
Han Fengsheng (韓風生)
Chen Yu (陳雨)
Liu Zhenteng (劉振騰)

Non-executive directors
Yin Chuangui (尹傳貴) (retired on 30 June 2016)
Liu Zhenhai (劉振海)

Independent non-executive directors
Fu Hongzheng (付宏征)
Foo Victor Tin Chung (傅天忠)
Prof. Chen Yun Zhen (陳允震) (retired on 30 June 2016)
Prof. Du Guanhua (杜冠華)
Huang Huiwen (黃慧文) (appointed on 1 July 2016)

In accordance with Article 96 of the Articles of Association adopted by the Shareholders on 20 November 2005, Directors shall be elected at a general meeting and shall serve a term of three years. A retiring Director is entitled to be re-elected to serve a consecutive term. The current service term of the Directors is for a period of three years commenced on 1 July 2016.

Mr. Liu Baoqi (劉保起), Ms. Li Minghua (李明華), Mr. Han Fengsheng (韓風生), Mr. Chen Yu (陳雨) and Mr. Liu Zhenteng (劉振騰) being the executive Directors, retired and were re-elected on 22 June 2016 with a term of three years commenced on 1 July 2016.

Mr. Liu Zhenhai (劉振海) being a non-executive Director, retired and was re-elected on 22 June 2016 with a term of three years commenced on 1 July 2016.

Mr. Fu Hongzheng (付宏征), Mr. Foo Victor Tin Chung (傅天忠) and Prof. Du Guanhua, (杜冠華) being the independent non-executive Directors, retired and were re-elected on 22 June 2016 with a term of three years commenced on 1 July 2016.

Mr. Yin Chuangui (尹傳貴), being a non-executive Director and Prof. Chen Yun Zhen (陳允震) ,being an independent non-executive Director, retired on 22 June 2016.

Ms. Huang Huiwen (黃慧文) was appointed as an independent non-executive Director on 22 June 2016 with a term of three years commenced on 1 July 2016.

REPORT OF THE DIRECTORS

DIRECTORS' AND SUPERVISORS' SERVICE CONTRACTS

Each of the executive Directors, non-executive Director, independent non-executive Directors and supervisors of the Company has entered into a service contract with the Company commenced on 1 July 2016 for a term of three years.

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

DIRECTORS', CHIEF EXECUTIVE'S 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 ended 31 December 2016.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND/OR SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY

As at 31 December 2016, the interests and short positions of each of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company and any of its associated corporation (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), as recorded in the register required to be kept by the Company under Section 352 of 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:

1. Interest in domestic shares of the Company ("Domestic Shares") as at 31 December 2016:

Name of Director	Capacity/ Nature of interest	Number of Domestic Shares(1)(2)	Approximate % of total issued Domestic Shares	Approximate % of Company's share capital
Mr. Liu Baoqi(3)	Interest of controlled corporation	293,075,954 (L) 32,563,995 (S)	65.85% 7.32%	48.07% 5.34%

Notes:

(1) The letter "L" denotes the entity's long position in the Domestic Shares.

(2) The letter "S" denotes the entity's short position in the Domestic Shares.

(3) As at 31 December 2016, Mr. Liu Baoqi was interested in 51.73% of the registered share capital of Luoxin Holdings and was entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Luoxin Holdings. For the purpose of the SFO, Mr. Liu is deemed to be interested in the Domestic Shares held by Luoxin Holdings.

REPORT OF THE DIRECTORS

2. Interest in the shares of Luoxin Holdings as at 31 December 2016:

Name of Director	Capacity/ Nature of interest	Number of shares in Luoxin Holdings[1]	Approximate % of issued share capital of Luoxin Holdings
Mr. Liu Baoqi	Beneficial Owner	25,865,000 (L)	51.73%
Ms. Li Minghua	Beneficial Owner	7,450,000 (L)	14.90%
Mr. Han Fengsheng	Beneficial Owner	1,000,000 (L)	2.00%
Mr. Liu Zhenteng	Beneficial Owner	10,685,000 (L)	21.37%

Note:

(1) The letter "L" denotes the entity's long position in such shares.

Save as disclosed above, none of the Directors or chief executives of the Company had any interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to Rule 5.46 of the GEM Listing Rules.

REPORT OF THE DIRECTORS

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

In respect of the register of substantial Shareholders (not being a Director or chief executive of the Company) required to be kept under section 336 of Part XV of the SFO shows that as at 31 December 2016, the Company had been notified of the following substantial Shareholders' interests and short positions. These interests are in addition to those disclosed above in respect of the Directors, chief executive and supervisors of the Company.

1. Interest in Domestic Shares, as at 31 December 2016:

Name	Capacity/ Nature of interest	Number of Domestic Shares(1)(2)	Approximate % of total issued Domestic Shares	Approximate % of Company's share capital
Luoxin Holdings	Beneficial owner	293,075,954 (L) 32,563,995 (S)(3)	65.85% 7.32%	48.07% 5.34%
珠海鑫沃富投資合夥企業（有限合夥）(Zhuhai New Wolf Investment Partnership (L.P.)*)(3)	Beneficial owner	32,563,995 (L)	7.32%	5.34%
Mr. Zheng Jiaxin(3)	Interest of controlled corporation	32,563,995 (L)	7.32%	5.34%

Notes:

(1) The letter "L" denotes the entity's long position in the Domestic Shares.

(2) The letter "S" denotes the entity's short position in the Domestic Shares.

(3) Mr. Zheng Jiaxin held as to 99% of the shareholding of 珠海鑫沃富投資合夥企業（有限合夥）(Zhuhai New Wolf Investment Partnership (L.P.)*).

REPORT OF THE DIRECTORS

2. Interest in H-share of the Company ("H-Share"), as at 31 December 2016:

Name	Capacity/ Nature of interest	Number of H-Shares[(1)(2)]	Approximate % of total issued H-Shares	Approximate % of Company's share capital
GL Trade Investment Limited	Beneficial owner	26,166,000 (L)	15.90%	4.29%
GL China Opportunities Fund L.P.	Interest of controlled corporation	26,166,000 (L)	15.90%	4.29%
GL Capital Management GP L.P.	Interest of controlled corporation	26,166,000 (L)	15.90%	4.29%
GL Capital Management GP Limited	Interest of controlled corporation	26,166,000 (L)	15.90%	4.29%
Lion River I N.V.	Interest of controlled corporation	26,924,000 (L)	16.36%	4.42%
GL Partners Capital Management Limited	Interest of controlled corporation	26,763,373 (L)	16.26%	4.39%
Assicurazioni Generali S.p.A	Interest of controlled corporation	26,924,000 (L)	16.36%	4.42%
Mr. Li Zhenfu	Interest of controlled corporation	26,924,000 (L)	16.36%	4.42%
Morgan Stanley	Interest of controlled corporation	7,573,941 (L) 164,000 (S)	4.60% 0.09%	1.24% 0.02%

Notes:

(1) The letter "L" denotes the entity's long position in the H-Shares.

(2) The letter "S" denotes the entity's short position in the H-Shares.

Save as disclosed above, no other interests or short positions in the shares or underlying shares of the Company were recorded in the register required to be kept by the Company under section 336 of Part XV of the SFO.

CONTRACTS OF SIGNIFICANCE

During the year ended 31 December 2016, the Company did not enter into any significant contract. However, the framework agreements of continuing connected transactions, entered into between the Company and (i) Luoxin Pharmaceutical Group, the controlling Shareholder until May 2014; (ii) Shandong Luosheng Pharmacy Co., Ltd. ("Shandong Luosheng"); and (iii) Shandong Mingxin Pharmacy Co., Ltd. ("Shandong Mingxin"), (ii) and (iii) being the fellow subsidiaries of the Company until May 2014, which remained effective until 15 December 2016. Three framework agreements with Luoxin Pharmaceutical Group, Shandong Luosheng and Shandong Mingxin have been renewed and were effective from 16 December 2015 until 31 December 2017. Please refer to the section headed "Connected Transactions and Continuing Connected Transactions" in this report for details.

REPORT OF THE DIRECTORS

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 ended 31 December 2016.

MAJOR SUPPLIERS AND CUSTOMERS

The percentages of purchases and sales for the year ended 31 December 2016 attributable to the Group's major suppliers and customers are as follows:

Purchases	
— the largest supplier	4.66%
— five largest suppliers combined	18.71%
Sales	
— the largest customer	7.28%
— five largest customers combined	13.94%

One (2015: two) of the five largest customers of the Company is Luoxin Pharmaceutical Group (2015: Luoxin Pharmaceutical Group and Shandong Luosheng) which is the related party of the Company. Luoxin Pharmaceutical Group is also the largest customer of the Company for the year ended 31 December 2016. For further details, please refer to Note 37 to the consolidated financial statements.

During the year ended 31 December 2016, the sales of chemical medicines to Luoxin Pharmaceutical Group, Shandong Luosheng and Shandong Mingxin amount to approximately RMB299,759,000, RMB45,474,000 and RMB35,963,000, respectively.

	Year ended 31 December 2016 RMB'000	Year ended 31 December 2015 RMB'000
Sales to Luoxin Pharmaceutical Group	**299,759**	442,921
Sales to Shandong Luosheng	**45,474**	49,026
Sales to Shandong Mingxin	**35,963**	39,950

The percentages of purchases and sales attributable to the Group's five largest suppliers and customers were less than 30% for the year ended 31 December 2016.

REPORT OF THE DIRECTORS

CONNECTED TRANSACTIONS AND CONTINUING CONNECTED TRANSACTIONS

During the year ended 31 December 2016, the Company had the following non-exempt, continuing connected transactions, details of which are set out below

Nature of transaction	Annual Cap for the financial years/periods ending 16/12/2015 to 31/12/2015 RMB Million	31/12/2016 RMB Million	31/12/2017 RMB Million
Sales of chemical medicines from the Company to Luoxin Pharmaceutical Group pursuant to a framework agreement dated 22 June 2015 and revised on 30 October 2015	31	300	300
Sales of chemical medicines by the Company to Shandong Luosheng pursuant to a framework agreement dated 22 June 2015 and revised on 30 October 2015	8	64	31
Sales of chemical medicines by the Company to Shandong Mingxin pursuant to a framework agreement dated 22 June 2015 and revised on 30 October 2015	3	36	39

Luoxin Pharmaceutical Group was a controlling Shareholder until May 2014, which held approximately 53.42% of the issued share capital of the Company. Shandong Luosheng and Shandong Mingxin were fellow subsidiaries of the Company until May 2014, of which Luoxin Pharmaceutical Group is holding 51% of the share capital 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 Pharmaceutical Group, Shandong Luosheng and Shandong Mingxin pursuant to the respective framework agreements constitute continuing connected transactions of the Company. All the framework agreements took effect from 16 December 2015 and would be expired on 31 December 2017 (the "Old Framework Agreements"). On 30 October 2015, the Group approved to enter into the new framework agreements (the "New Framework Agreements") with the connected parties respectively for a term commenced on 16 December 2015 and ending on 31 December 2017. The Old Framework Agreements were terminated automatically upon the New Framework Agreements became effective. The chemical medicines are provided to each of Luoxin Pharmaceutical Group, Shandong Luosheng and Shandong Mingxin respectively by the Company on normal commercial terms of suppliers offer to third parties for sale of chemical medicines of comparable application and quantity and on terms no less favourable to the Company than terms available to or from independent third parties customers. For the Old Framework Agreements, the price is agreed upon between the parties for each transaction by reference to the aforementioned pricing policy through arm's length negotiations and the respective payments by Luoxin Pharmaceutical Group, Shandong Luosheng and Shandong Mingxin to the Company will be on deferred basis according to normal credit terms within 90 days. Further details about the New Framework Agreements are set out in the announcement issued by the Company on 8 August 2012 and circular issued by the Company on 13 September 2012. For the New Framework Agreements, the sale of the pharmaceutical products to Luoxin Pharmaceutical Group, Shandong Luosheng and Shandong Mingxin shall be on fair and reasonable basis and on normal commercial terms with reference to the sale of pharmaceutical products in similar or comparable application and quantity offered to other independent third parties and shall be on terms and pricing policy no less favourable to the Group than the terms available to independent third parties. For the details of the pricing policy to be adopted by the Company, please refer to the announcements issued by the Company on 22 June 2015 and 30 October 2015, and circular issued by the Company on 30 October 2015.

REPORT OF THE DIRECTORS

On 21 May 2014, the Domestic Shares of the Company held by Luoxin Pharmaceutical Group were sold to Luoxin Holdings. As at 31 December 2016, Mr. Liu Baoqi was interested in 51.73% of the registered share capital of Luoxin Holdings and is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Luoxin Holdings. For the purpose of the SFO, Mr. Liu is deemed to be interested in the Domestic Shares held by Luoxin Holdings. As at 31 December 2016, Mr. Liu is also a director and controlling shareholder of Luoxin Pharmaceutical Group. The transactions with Luoxin Pharmaceutical Group, Shandong Luosheng and Shandong Mingxin will remain continuing connected transaction in 2015, 2016 and 2017.

During the year ended 31 December 2016, the sales of chemical medicines by the Company to Luoxin Pharmaceutical Group, Shandong Luosheng and Shandong Mingxin amounted to approximately RMB299,759,000, RMB45,474,000 and RMB35,963,000, respectively (2015: RMB442,921,000, RMB49,026,000 and RMB39,950,000), which did not exceed the annual cap for the relevant transactions. Further details are set out in Note 37 to the consolidated financial statements. The Company received confirmation from the auditors of the Company that these transactions comply with the matters stated in Rule 20.53 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:

1. in the ordinary and usual course of the business of the Company;

2. on normal commercial terms or better; and

3. in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interest of the Shareholders as a whole.

The Directors have received a letter from the auditors in respect of the continuing connected transactions as required by Rule 20.54 of the GEM Listing Rules.

The Company had complied with the relevant requirements under Chapter 20 of the GEM Listing Rules during the year ended 31 December 2016.

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.

REPORT OF THE DIRECTORS

COMPETING INTERESTS

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

Luoxin Pharmaceutical Group

Luoxin Pharmaceutical Group which previously held 53.42% of the Company's issued share capital, was the controlling Shareholder until May 2014. The chairman of the Board and executive Director, Mr. Liu Baoqi, is also the chairman and an executive director and a controlling shareholder of Luoxin Pharmaceutical Group. He holds 81.56% of the registered capital of Luoxin Pharmaceutical Group.

The principal activities of Luoxin Pharmaceutical Group, apart from being a controlling Shareholder, are trading medical equipment, Chinese medicines and health and beauty products, which are not directly or indirectly in competition with the Company's business. The Company is principally engaged in the manufacturing and trading of antibiotics and system specified medicines. Luoxin Pharmaceutical Group also engages in the trading of chemical medicines, but is restricted only to those products which are purchased from the Company under the continuing connected transactions as disclosed above. Save as trading of chemical medicines purchased from the Company, Luoxin Pharmaceutical Group does not sell any chemical medicine. The customers to whom Luoxin Pharmaceutical Group sells chemical medicines are those hospitals in Linyi City District of the PRC, which are at or below county level that the Group does not have direct access to. Luoxin Pharmaceutical Group does not engage in the manufacturing of medicines whether by itself for through any subsidiary or associate company. Luoxin Pharmaceutical Group can only be regarded as participating in the manufacturing of medicines indirectly through the Group by reason of it being a controlling Shareholder. The Company's targeted markets and customers are hospitals of all sizes and at all levels throughout the PRC. Luoxin Pharmaceutical Group's targeted markets and customers are small and medium sized hospitals at or below county level, mainly in Linyi City District of the PRC.

Notwithstanding the non-competition undertakings entered into by Luoxin Pharmaceutical Group in 2002 (as supplemented by a memorandum in 2005), whereby it agreed not to engage in any business which would be in competition with that of the Company, the Company entered into certain continuing connected transactions with Luoxin Pharmaceutical Group. The Company has been selling chemical medicines to Luoxin Pharmaceutical Group under these agreements. It is a unique feature of the PRC medicine market that certain customer groups would only deal with certain medicine traders. Owing to this unique feature, certain hospitals at or below county level in Linyi City District would not purchase medicines directly from the Company. However Luoxin Pharmaceutical Group may have business dealings with these hospitals. In those circumstances, Luoxin Pharmaceutical Group becomes the bridge between the Company and those hospitals and sells the Company's chemical medicine products to them. Therefore, the Company entered into the said continuing connected transactions with Luoxin Pharmaceutical Group for the distribution of the Company's chemical medicines to these customers.

REPORT OF THE DIRECTORS

The Directors considered that not only were the continuing connected transactions not a breach of the non-competition undertaking on the part of Luoxin Pharmaceutical Group, but rather a perfect opportunity that promoted the cooperation between the Company and Luoxin Pharmaceutical Group in opening up the chemical medicine market. It would also broaden the ultimate client base for both the Company and Luoxin Pharmaceutical Group with hospitals at or below county level in Linyi City District of the PRC. Without this opportunity and cooperation, neither the Company nor Luoxin Pharmaceutical Group have been able to sell chemical medicines to those hospitals. In reaching the above conclusion the Directors have taken into account the following:

i. Since 2005, there has been no sale of chemical medicines by Luoxin Pharmaceutical Group other than the chemical medicines purchased from the Company under the continuing connected transactions. As such, Luoxin Pharmaceutical Group has not resumed its chemical medicines business that is directly or indirectly in competition with the Company's business; and

ii. the continuing connected transactions bring mutual benefits to the Group and Luoxin Pharmaceutical Group. On one hand, the Group generates considerable revenue by distributing through Luoxin Pharmaceutical Group to particular groups of customers that the Group would not be able to gain access to without Luoxin Pharmaceutical Group. On the other hand, Luoxin Pharmaceutical Group generates revenue by selling the Group's products whilst pursuant to the undertakings, Luoxin Pharmaceutical Group is restricted from selling chemical medicine products produced by other manufacturers.

Revenue generated by the sale of products to Luoxin Pharmaceutical Group amounted to approximately 7%, 12% and 7% of the total revenue of the Company in each of the three years ended 31 December 2014, 2015 and 2016, respectively.

Despite the fact that the Group currently relies on Luoxin Pharmaceutical Group for a sizeable portion of its revenue, the Directors believe that it can source other distributors and distribute its chemical medicine products to markets other than hospitals at or below county level in Linyi City District of the PRC, even if Luoxin Pharmaceutical Group ceases to distribute products of the Group. Having said that, the Company and Luoxin Pharmaceutical Group are in a good business relationship and there is no indication that Luoxin Pharmaceutical Group will cease to cooperate with the Group.

In view of the above, the Directors consider there is no competing interest between the Group and Luoxin Pharmaceutical Group. None of the Directors, the controlling Shareholders or their respective close associates (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.

REPORT OF THE DIRECTORS

AUDITOR

The accounts for the year ended 31 December 2016 were audited by HLB Hodgson Impey Cheng Limited whose term of office will expire upon the forthcoming AGM. A resolution for the appointment of HLB Hodgson Impey Cheng Limited as the auditor of the Company for the subsequent year is to be proposed at the forthcoming AGM.

On behalf of the Board
Liu Baoqi
Chairman

PRC, 7 March 2017

INDEPENDENT AUDITORS' REPORT

HLB 國衛會計師事務所有限公司
Hodgson Impey Cheng Limited

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

INDEPENDENT AUDITORS' REPORT
TO THE SHAREHOLDERS OF SHANDONG LUOXIN PHARMACEUTICAL GROUP STOCK CO., LTD.
(Incorporated in the People's Republic of China with limited liability)
REPORT ON AUDIT OF FINANCIAL STATEMENTS

OPINION

We have audited the consolidated financial statements of Shandong Luoxin Pharmaceutical Group Stock Co., Ltd. (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 51 to 123, which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the disclosure requirements of the Hong Kong Companies Ordinance.

BASIS FOR OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the HKICPA's *Code of Ethics for Professional Accountants* (the "Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

INDEPENDENT AUDITORS' REPORT

KEY AUDIT MATTERS *(Continued)*

Key audit matter	How our audit addressed the key audit matter

Carrying values of inventories

Refer to Note 25 to the consolidated financial statements and accounting policies in Note 3 to the consolidated financial statements.

The carrying values of inventories was approximately HK$504,894,000 as at 31 December 2016, with write-down of approximately HK$6,331,000 for the year ended 31 December 2016 recorded in the consolidated statement of profit or loss and other comprehensive income. The management estimated the net realisable values of the inventories by reference to sale proceeds received after the end of the reporting period less selling expenses, which involve management estimation.

Our procedures in relation to management's determination of the carrying values of inventories included:

- assessing the appropriateness of the methodologies used by the management for the assessment of the net realizable value of inventories;
- assessing, on a sample basis, whether items in ageing report prepared by the management where classified within the appropriate ageing bracket of comparing items; and
- testing, on a sample basis, the net realisable value of selected inventory items, by comparing the subsequent selling price to year end carrying amount.

We found the carrying values of the inventories were supported by the available evidence.

Key audit matter	How our audit addressed the key audit matter

Fair value of financial assets at fair value through profit or loss

Refer to Note 28 to the consolidated financial statements and the accounting policies in Note 3 to the consolidated financial statements.

As at 31 December 2016, the Group hold financial assets at fair value through profit or loss that in total of approximately RMB1,038,006,000 represented approximately 23% of the Group's total assets and was significant to the Group's assets.

Our procedure in relation to the fair value of financial assets at fair value through profit or loss:

- obtaining amount of fair value and valuation methodology from financial institutions;
- assessing the valuation methodology;
- recalculating the fair value based on data obtained; and
- obtaining confirmation from financial institutions in relation to the fair value obtained.

We found the assumptions made by management in the fair value assessment to be reasonable based on available evidence. The significant inputs have been appropriately disclosed.

INDEPENDENT AUDITORS' REPORT

KEY AUDIT MATTERS *(Continued)*

Key audit matter	How our audit addressed the key audit matter

Impairment testing on trade receivables

Refer to Note 26 to the consolidated financial statements and accounting policies in Note 3 to the consolidated financial statements.

At 31 December 2016, the Group had trade receivables of approximately RMB634,458,000, which represented 20% of current assets and 15% of total assets of the Group. Recoverability of trade receivable was significant to the Group's operation.

In determining the recoverability of trade receivables, the Group considers any change in credit quality of the trade receivables from the date credit was initially granted up to the reporting date which may require management judgement.

Our procedure in relation to the impairment of trade receivables:

- discussing the Group's procedures on credit limits and credit periods given to customers with the management;
- evaluating the management's impairment assessment of trade receivables; and
- checking, on a sample basis, the accuracy and relevance of information included in the impairment assessment of trade receivables.

We consider management's conclusion to be consistent with the available information.

OTHER INFORMATION

The directors of the Company are responsible for the other information. The other information comprises the information included in annual report, but does not include the consolidated financial statements and our auditors' report thereon ("Other Information").

Our opinion on the consolidated financial statements does not cover the Other Information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this Other Information, we are required to report that fact. We have nothing to report in this regard.

INDEPENDENT AUDITORS' REPORT

RESPONSIBILITIES OF THE DIRECTORS AND THE AUDIT COMMITTEE FOR THE CONSOLIDATED FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA 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.

In preparing the consolidated financial statements, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The Audit Committee is responsible for overseeing the Group's financial reporting process.

AUDITORS' RESPONSIBILITIES FOR THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. This report is made 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.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

INDEPENDENT AUDITORS' REPORT

AUDITORS' RESPONSIBILITIES FOR THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement director on the audit resulting in this independent auditors' report is Ng Ka Wah.

HLB Hodgson Impey Cheng Limited
Certified Public Accountants

Ng Ka Wah
Practicing Certificate Number: P06417

Hong Kong, 7 March 2017

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

For the year ended 31 December 2016

	Notes	2016 RMB'000	2015 RMB'000
Turnover	7	**4,117,573**	3,611,380
Cost of sales		**(1,000,033)**	(1,134,104)
Gross profit		**3,117,540**	2,477,276
Other revenue	7	**43,215**	67,681
Other income	9	**76,856**	39,857
Selling and distribution expenses		**(2,309,501)**	(1,649,576)
General and administrative expenses		**(464,201)**	(363,314)
Finance costs	8	**(86)**	(52)
Profit before taxation	9	**463,823**	571,872
Taxation	10	**(83,155)**	(81,265)
Profit for the year		**380,668**	490,607
Other comprehensive income for the year, net of tax:			
Item that may be reclassified subsequently to profit or loss:			
Exchange differences on translation of foreign operations		**89**	–
Total comprehensive income for the year		**380,757**	490,607
Profit/(loss) for the year attributable to:			
Owners of the Company		**379,198**	492,929
Non-controlling interests		**1,470**	(2,322)
		380,668	490,607
Total comprehensive income/(loss) for the year attributable to:			
Owners of the Company		**379,287**	492,929
Non-controlling interests		**1,470**	(2,322)
		380,757	490,607
Earnings per share attributable to owners of the Company (RMB)			
Basic and diluted	15	**0.622**	0.809

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

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Year ended 31 December 2016

	Notes	2016 RMB'000	2015 RMB'000
Non-current assets			
Available-for-sale financial assets	17	89,335	70,287
Intangible assets	18	6,843	4,057
Prepayments to acquire technical know-how	19	–	8,021
Property, plant and equipment	20	883,703	754,293
Construction-in-progress	21	99,636	108,136
Prepaid lease payments	22	97,895	99,675
Deferred tax assets	23	1,113	1,218
Goodwill	24	165	165
		1,178,690	1,045,852
Current assets			
Inventories	25	504,894	241,986
Trade and bills receivables	26	710,277	524,848
Other receivables, deposits and prepayments	27	294,834	172,602
Financial assets at fair value through profit and loss	28	1,038,006	1,049,556
Fixed deposits	29	85,022	–
Cash and bank balances	29	556,028	605,333
		3,189,061	2,594,325
Current liabilities			
Trade and bills payables	30	227,758	130,188
Other payables and accruals	31	993,701	643,027
Deposits received		79,533	56,423
Tax payable		63,164	48,600
		1,364,156	878,238
Net current assets		1,824,905	1,716,087
Total assets less current liabilities		3,003,595	2,761,939

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Year ended 31 December 2016

	Notes	2016 RMB'000	2015 RMB'000
Non-current liability			
Deferred income	32	136,285	89,526
Net assets		2,867,310	2,672,413
Capital and reserves			
Share capital	33	60,960	60,960
Other reserves		84,416	78,128
Retained earnings			
— Proposed final dividend		–	213,360
— Others		2,673,716	2,300,705
Equity attributable to owners of the Company		2,819,092	2,653,153
Non-controlling interests		48,218	19,260
Total equity		2,867,310	2,672,413

Approved by the Board of Directors on 7 March 2017 and signed on its behalf by:

Liu Baoqi
Director

Liu Zhenteng
Director

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2016

	Attributable to owners of the Company									
	Share Capital RMB'000	Share premium RMB'000	Statutory surplus reserve fund RMB'000	Statutory public welfare fund RMB'000	Other reserve RMB'000 (note(a))	Exchange reserve RMB'000 (note(b))	Retained earnings RMB'000	Sub-total RMB'000	Non-controlling interests RMB'000	Total RMB'000
At 1 January 2015	60,960	31,139	36,390	6,033	–	–	2,208,898	2,343,420	3,796	2,347,216
Profit/(loss) for the year	–	–	–	–	–	–	492,929	492,929	(2,322)	490,607
Other comprehensive Income for the year	–	–	–	–	–	–	–	–	–	–
Total comprehensive Income/(loss) for the year	–	–	–	–	–	–	492,929	492,929	(2,322)	490,607
Transfer from retained earnings to statutory surplus reserve fund	–	–	4,882	–	–	–	(4,882)	–	–	–
Additional non-controlling interest arising on disposal of interests in a subsidiary (Note 40)	–	–	–	–	(285)	–	–	(285)	18,755	18,470
Change in ownership interests of a subsidiary (Note 40)	–	–	–	–	(31)	–	–	(31)	(969)	(1,000)
Dividend paid	–	–	–	–	–	–	(182,880)	(182,880)	–	(182,880)
At 31 December 2015 and 1 January 2016	60,960	31,139	41,272	6,033	(316)	–	2,514,065	2,653,153	19,260	2,672,413
Profit for the year	–	–	–	–	–	–	379,198	379,198	1,470	380,668
Other comprehensive income for the year: Exchange differences on translation of foreign operations	–	–	–	–	–	89	–	89	–	89
Total comprehensive income for the year	–	–	–	–	–	89	379,198	379,287	1,470	380,757
Transfer from retained earnings to statutory surplus reserve fund	–	–	6,187	–	–	–	(6,187)	–	–	–
Change in ownership interests of a subsidiary (Note 40)	–	–	–	–	12	–	–	12	(1,912)	(1,900)
Capital injection by non-controlling interest	–	–	–	–	–	–	–	–	4,900	4,900
Arising on the acquisition of subsidiary (Note 39)	–	–	–	–	–	–	–	–	24,500	24,500
Dividend paid	–	–	–	–	–	–	(213,360)	(213,360)	–	(213,360)
At 31 December 2016	60,960	31,139	47,459	6,033	(304)	89	2,673,716	2,819,092	48,218	2,867,310

Note:

(a) Other reserve

Other reserve represents the difference of the nominal amount of the shares of the subsidiaries at the date of the group reorganisation over the consideration for the acquisition and disposal of the interests in the subsidiaries.

(b) Exchange reserve

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of operations outside the People's Republic of China (the "PRC").

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

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2016

	Notes	2016 RMB'000	2015 RMB'000
Operating activities			
Profit before taxation		**463,823**	571,872
Adjustments for:			
Interest income		**(2,661)**	(1,690)
Finance costs		**86**	52
Gain on financial assets at fair value through profit or loss		**(35,803)**	(59,801)
Reversal of obsolete inventories written-down	25	**(2,031)**	(567)
Reversal of impairment loss recognised in respect of trade receivables	26	**(1,556)**	(1,087)
Reversal of impairment loss recognised in respect of other receivables	27	**(4,041)**	–
Depreciation of property, plant and equipment	20	**74,980**	60,261
Loss on disposal of property, plant and equipment	9	**2,076**	25,412
Write-down of obsolete inventories	25	**6,331**	2,366
Impairment loss recognised in respect of trade receivables	26	**3,722**	1,363
Impairment loss recognised in respect of other receivables	27	**1,334**	2,723
Impairment loss recognised in respect of prepayments to acquire technical know-how	19	**8,021**	9,383
Amortisation of prepaid lease payments	22	**2,193**	1,918
Increase in operating cash flow before movements in working capital		**516,474**	612,205
Net cash received from financial assets at fair value through profit or loss		**47,353**	237,606
(Increase)/decrease in inventories		**(267,208)**	35,816
Increase in trade and bills receivables		**(187,595)**	(196,655)
Increase in other receivables, deposits and prepayments		**(81,097)**	(30,263)
Increase/(decrease) in trade and bills payables		**97,570**	(51,653)
Increase in deposits received		**23,110**	4,417
Increase in deferred income		**46,759**	106,578
Increase in other payables and accruals		**338,172**	169,021
Net cash from operations		**533,538**	887,072
Interest paid		**(86)**	(52)
PRC income tax paid		**(68,486)**	(75,162)
Net cash generated from operating activities		**464,966**	811,858

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2016

	Notes	2016 RMB'000	2015 RMB'000
Investing activities			
Interest received		2,661	1,690
Change in ownership of a subsidiary		(1,900)	–
Purchase of property, plant and equipment	20	(105,318)	(73,499)
Additions of construction-in-progress	21	(105,459)	(110,092)
Proceeds from disposal of property, plant and equipment		13,875	400
Acquisition of assets		(5,689)	34
Purchase of available-for-sale financial asset		(19,048)	(29,287)
Net cash used in investing activities		(220,878)	(210,754)
Financing activities			
Dividend paid		(213,360)	(185,472)
Capital injection from non-controlling interests of a subsidiary		4,900	–
Increase in fixed deposits		(85,022)	–
Decrease in pledged bank deposits		–	29,189
Net cash used in financing activities		(293,482)	(156,283)
Net (decrease)/increase in cash and cash equivalents		(49,394)	444,821
Cash and cash equivalents at the beginning of the year		605,333	160,512
Effect of foreign exchange rate changes, net		89	–
Cash and cash equivalents at the end of the year		556,028	605,333
Analysis of balances of cash and cash equivalents:			
Cash and bank balances		556,028	605,333

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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 cooperative 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 Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 9 December 2005. Pursuant to the Extraordinary General Meeting held on 12 August 2014, the name of the Company was changed to Shandong Luoxin Pharmaceutical Group Stock Co., Ltd. The Company's parent and ultimate holding Company is Shandong Luoxin Holdings Co., Ltd. (山東羅欣控股有限公司) (incorporated in the PRC).

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

The principal activities of the Company are manufacturing and selling of pharmaceutical products. The principal activities of the subsidiaries are described in Note 16.

The consolidated financial statements are presented in RMB which is the same as the functional currency of the Company. All values are rounded to the nearest thousand (RMB'000), unless otherwise stated.

These consolidated financial statements were approved for issue by the board of directors on 7 March 2017.

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

In the current year, the Group has applied, for the first time, the following new and revised standard, amendments and interpretations ("new and revised HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which are effective for the Company's financial year beginning 1 January 2016. A summary of the new and revised HKFRSs are set out as below:

Amendments to HKFRS 10, HKFRS 12 and HKAS 28 (2011)	Investment Entities: Applying the Consolidation Exception
Amendments to HKFRS 11	Accounting for Acquisitions of Interests in Joint Operations
HKFRS 14	Regulatory Deferral Accounts
Amendments to HKAS 1	Disclosure Initiative
Amendments to HKAS 16 and HKAS 38	Clarification of Acceptable Methods of Depreciation and Amortisation
Amendments to HKAS 16 and HKAS 41	Agriculture: Bearer Plants
Amendments to HKAS 27 (2011)	Equity Method in Separate Financial Statements
Annual Improvements 2012–2014 Cycle	Amendments to a number of HKFRSs

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

In the opinion of directors of the Company (the "Directors"), except for the amendments to HKFRS 10, HKFRS 12 and HKAS 28 (2011), amendments to HKFRS 11, HKFRS 14, amendments to HKAS 16 and HKAS 41, amendments to HKAS 27 (2011), and certain amendments included in the Annual Improvements 2012–2014 Cycle, which are not relevant to the preparation of the Group's financial statements, the application of the new HKFRSs in the current year has had no material impact on the Group's financial performance and positions for the current and prior years and/or on the disclosures set out in these consolidated financial statements.

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

Amendments to HKFRS 2	Classification and Measurement of Share-based Payment Transactions[2]
Amendments to HKFRS 4	Applying HKFRS 9 Financial Instruments with HKFRS 4 Insurance Contracts[2]
HKFRS 9	Financial Instruments[2]
Amendments to HKFRS 10 and HKAS 28 (2011)	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture[4]
HKFRS 15	Revenue from Contracts with Customers[2]
Amendments to HKFRS 15	Clarifications to HKFRS 15 Revenue from Contracts with Customers[2]
HKFRS 16	Leases[3]
Amendments to HKAS 7	Disclosure Initiative[1]
Amendments to HKAS 12	Recognition of Deferred Tax Assets for Unrealised Losses[1]

[1] Effective for annual periods beginning on or after 1 January 2017
[2] Effective for annual periods beginning on or after 1 January 2018
[3] Effective for annual periods beginning on or after 1 January 2019
[4] No mandatory effective date yet determined but available for adoption

Further information about those HKFRSs that are expected to be applicable to the Group is as follows:

HKFRS 9 "Financial Instruments"

HKFRS 9 was amended in 2013 to include the new requirements for general hedge accounting. A revised version of HKFRS 9 was issued in 2014 mainly to include a) impairment requirements for financial assets and b) limited amendments to the classification and measurement requirements by introducing a "fair value through other comprehensive income" ("FVTOCI") measurement category for certain simple debt instruments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

HKFRS 9 "Financial Instruments" *(Continued)*

Key requirements of HKFRS 9 are described below:

- Certain financial assets held within a business model whose objective is achieved both collecting contractual cash flows and selling financial assets should be measured at FVTOCI (unless designated at fair value through profit and loss ("FVTPL") to eliminate or significantly reduce a measurement mismatch). This applies to assets passing the contractual cash flow characteristics assessment (which is the same test used to determine whether financial assets are measured at amortised cost). Interest revenue, foreign exchange gains and losses and impairment gains and losses shall be recognised in profit or loss with all other gains or losses (i.e. the difference between those items and the total change in fair value) being recognised in other comprehensive income. Any cumulative gain or loss recorded in other comprehensive income would be reclassified to profit and loss on derecognition, or potentially earlier if the asset is reclassified because of a change in business model. Interest income and impairment gains and losses would be recognised and measured in the same manner as for assets measured at amortised cost such that the amounts in other comprehensive income represents the difference between the amortised cost value and fair value. This results in the same information in profit or loss as if the asset was measured at amortised cost, yet the consolidated statement of financial position would reflect the instrument's fair value.

- In relation to the impairment of financial assets, HKFRS 9 requires an expected credit loss model, as opposed to an incurred credit loss model under HKAS 39. The expected credit loss model requires an entity to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

- The new general hedge accounting requirements retain the three types of hedge accounting. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about an entity's risk management activities have also been introduced.

The Directors is in the process of making an assessment of potential impact of the application of HKFRS 9 and it is not practicable to provide a reasonable estimate of the effect of HKFRS 9 until the Group performs a detailed review.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

HKFRS 15 "Revenue from contracts with customers"

HKFRS 15 was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. HKFRS 15 will supersede the current revenue recognition guidance including HKAS 18 Revenue, HKAS 11 Construction Contracts and the related Interpretations when it becomes effective.

The core principle of HKFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Specifically, the Standard introduces a 5-step approach to revenue recognition:

Step 1: Identify the contract(s) with a customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations in the contract

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

Under HKFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied, i.e. when "control" of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in HKFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by HKFRS 15.

The Directors is in the process of making an assessment of the potential impact of the application of HKFRS 15 and it is not practicable to provide a reasonable estimate of the effect of HKFRS 15 until the Group performs a detailed review.

The Group is in the process of assessing the potential impact of the other new and revised HKFRSs upon initial application but is not yet in a position to state whether the other new and revised HKFRSs will have a significant impact on the Group's financial performance and position.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

HKFRS 16 "Leases"

HKFRS 16 introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees. HKFRS 16 will supersede HKAS 17 Leases and the related interpretations when it becomes effective.

HKFRS 16 distinguishes lease and service contracts on the basis of whether an identified asset is controlled by a customer. Distinctions of operating leases and finance leases are removed for lessee accounting, and is replaced by a model where a right-of-use asset and a corresponding liability have to be recognised for all leases by lessees, except for short-term leases and leases of low value assets.

The right-of-use asset is initially measured at cost and subsequently measured at cost (subject to certain exceptions) less accumulated depreciation and impairment losses, adjusted for any remeasurement of the lease liability. The lease liability is initially measured at the present value of the lease payments that are not paid at that date. Subsequently, the lease liability is adjusted for interest and lease payments, as well as the impact of lease modifications, amongst others. For the classification of cash flows, the Group currently presents upfront prepaid lease payments as investing cash flows in relation to leasehold lands for owned use and those classified as investment properties while other operating lease payments are presented as operating cash flows. Under the HKFRS 16, lease payments in relation to lease liability will be allocated into a principal and an interest portion which will be presented as financing and operating cash flows respectively.

Under HKAS 17, the Group has already recognised an asset and a related finance lease liability for finance lease arrangement and prepaid lease payments for leasehold lands where the Group is a lessee. The application of HKFRS 16 may result in potential changes in classification of these assets depending on whether the Group presents right-of-use assets separately or within the same line item at which the corresponding underlying assets would be presented if they were owned.

In contrast to lessee accounting, HKFRS 16 substantially carries forward the lessor accounting requirements in HKAS 17, and continues to require a lessor to classify a lease either as an operating lease or a finance lease.

Furthermore, extensive disclosures are required by HKFRS 16.

As at 31 December 2016, the Group as lessee has non-cancellable operating lease commitments of RMB58,317,000 as disclosed in note 36. A preliminary assessment indicates that these arrangements will meet the definition of a lease under HKFRS 16, and hence the Group will recognise a right-of-use asset and a corresponding liability in respect of all these leases unless they qualify for low value or short-term leases upon the application of HKFRS 16. In addition, the application of new requirements may result changes in measurement, presentation and disclosure as indicated above. However, it is not practicable to provide a reasonable estimate of the financial effect until the Directors complete a detailed review.

Except for the above impact, the Directors do not anticipate that the application of other new and amendments to HKFRSs will have significant impact on the Group's consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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 applicable disclosure required by 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 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 has been prepared under the historical cost convention excepted for certain financial instruments that are measured at revalued amounts or fair values at the end of each reporting period, as explained in the accounting policies below.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Group takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of HKFRS 2, leasing transactions that are within the scope of HKAS 17, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in HKAS 2 or value in use in HKAS 36.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Basis of preparation *(Continued)*

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

The principal accounting policies are set out below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities (including special purpose entities) controlled by the Company (its subsidiaries). Control is achieved where the Company:

- has power to over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee;
- and has the ability to use its power to affect its returns.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Basis of consolidation *(Continued)*

When the Group has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Group considers all relevant facts and circumstances in assessing whether or not the Group's voting rights in an investee are sufficient to give it power, including:

- the size of the Group's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Group, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Group has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous patterns at previous shareholders' meetings.

Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss and other comprehensive income from the date the Group gains control until the date when the Group ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income are attributed to the owners of the Company and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Company and to the non-controlling interest even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

All intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Basis of consolidation *(Continued)*

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 (i) derecognises the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost, (ii) derecognises the carrying amount of any non-controlling interest in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them), and (iii) 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 Company had directly disposed of the related assets (i.e. reclassified to profit or loss or transferred directly to retained earnings as specified by applicable HKFRSs). The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under HKAS 39 Financial Instruments: Recognition and Measurement or, when applicable, the cost on initial recognition of an investment in an associate or a jointly controlled entity.

Subsidiaries

A subsidiary in an entity whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's statement of comprehensive income to the extent of dividends received and receivable. The Company's interests in subsidiaries that are not classified as held for sale in accordance with HKFRS 5 are stated at cost less any impairment losses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

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, except that:

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

- liabilities or equity instruments related to share-based payment arrangements of the acquiree or share-based payment arrangements of the Group entered into to replace share-based payment arrangements of the acquiree 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 acquire and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognized 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, when applicable, on the basis specified in another HKFRS.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Business combinations *(Continued)*

When the consideration transferred by the Group 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 included 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 against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the "measurement period" (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

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

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

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 at 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 as established at the date of acquisition of the business less accumulated impairment losses, if any.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Goodwill *(Continued)*

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. 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.

Property, plant and equipment

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

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

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

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

The asset's residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Construction-in-progress

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

Leasehold land

When a lease includes both land and building elements, the Group assesses the classification of each element as a finance or an operating lease separately based on the assessment as to whether substantially all the risks and rewards incidental to ownership of each element have been transferred to the Group, 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 of the lease at the inception of the lease.

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.

Intangible assets

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.

License

License with indefinite useful life that are acquired carried at cost less accumulated impairment loss.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Intangible assets *(Continued)*

License (Continued)

The license and its status are reviewed annually to determine whether events and circumstances continue to support indefinite useful life. Should the useful life of the license change from indefinite to finite, the change would be accounted for prospectively from the date of change and in accordance with the policy for amortisation of intangible assets with finite lives.

Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred. An internally generated intangible asset arising from development (or from the development phase of an internal project) is recognised if, and only if, all of the following have been demonstrated:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- the intention to complete the intangible asset and use or sell it;
- the ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- the ability to measure reliably the expenditure attributable to the intangible asset during its development.

The amount initially recognised for internally-generated intangible asset is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria listed above. Where no internally generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

Subsequent to initial recognition, internally-generated intangible asset is measured at cost less accumulated amortisation and accumulated impairment losses (if any), on the same basis as intangible assets acquired separately.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Intangible assets *(Continued)*

Derecognition of intangible assets

An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains and losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in profit or loss when the asset is derecognised.

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.

Impairment of tangible and intangible assets other than goodwill

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangible assets with finite useful lives 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.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Impairment of tangible and intangible assets other than goodwill *(Continued)*

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. An assessment is made at each reporting date as to whether there is any indication that 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.

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 or 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 market place.

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 those financial assets classified as at fair value through profit or loss.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Financial instruments *(Continued)*

Financial assets (Continued)

Financial assets at fair value though profit or loss

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

Financial assets at fair value though 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 dividend or interest earned on the financial asset and is included in the "other gains and losses" line item. Fair value is determined in the manner described in Note 5.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Financial instruments *(Continued)*

Financial assets (Continued)

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.

Equity and debt securities held by the Group that are classified as AFS financial assets and are traded in an active market are measured at fair value at the end of each reporting period. Changes in the carrying amount of AFS monetary financial assets relating to interest income calculated using the effective interest method and dividends on AFS equity investments are recognised in profit or loss. Other changes in the carrying amount of AFS financial assets are recognised in other comprehensive income and accumulated under the heading of investments revaluation reserve. Where the investment 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.

Dividends on AFS equity investments are recognised in profit or loss when the Group's right to receive the dividends is established.

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 each 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Financial instruments *(Continued)*

Financial assets (Continued)

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 when 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.

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 assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Financial instruments *(Continued)*

Financial assets (Continued)

Impairment of financial assets *(Continued)*

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.

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 investments, 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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 Financial Instruments: Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at fair value through profit or loss.

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

Other financial liabilities

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Financial instruments *(Continued)*

Financial liabilities and equity instruments (Continued)

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.

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 continues to recognise the asset to the extent of its continuing involvement and recognises an associated liability. 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, the Group allocates the previous carrying amount of the financial asset between the part it continues to recognise, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognised and the sum of the consideration received for the part no longer recognised and any cumulative gain or loss allocated to it that had been recognised in other comprehensive income is recognised in profit or loss. A cumulative gain or loss that had been recognised in other comprehensive income is allocated between the part that continues to be recognised and the part that is no longer recognised on the basis of the relative fair values of those parts.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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.

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.

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 before taxation" as reported in the consolidated statement of profit or loss and other 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Income tax *(Continued)*

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 and 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 are also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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.

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.

Employee benefits

(i) Short term employee benefits and contributions to defined contribution retirement plans Salaries, annual bonuses, paid annual leave, contributions to defined contribution plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) *Termination benefits*

Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

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.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessee

Operating lease payments are recognised as an expense on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

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.

The functional currencies of certain overseas subsidiaries are currencies other than the RMB. At the end of the reporting period, the assets and liabilities of these entities are translated into the presentation currency of the Company at the exchange rates ruling at the end of the reporting period, and their statement of comprehensive incomes are translated into Hong Kong dollars at the weighted average exchange rates for the year. Exchange differences arising are recognised in the exchange reserve.

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 profit or loss and other comprehensive income.

Related party transactions

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

(a) the party or a close member of that person's family is related to the Group if 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 reporting entity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Related party transactions *(Continued)*

(b) An entity is related to the Group if any of the following conditions applies:

(i) the entity and the Group are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others);

(ii) one entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member);

(iii) both entities 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. If the Group is itself such a plan, the sponsoring employers are also related to the Group;

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

(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); and

(viii) the entity, or any member of a group of which it is a part, provides key management personnel services to the Group or to the parent of the Group.

Close family members of an individual are those family members who may be expected to influence, or be inflecting by, that person in their dealings with 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Taxation

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

Useful lives of property, plant and equipment

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

Provision for obsolete inventories

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

Trade and other receivables

The debt profile of trade and other debtors is reviewed on a regular basis to ensure that the trade and other debtor balances are collectible and follow up actions are promptly carried out if the agreed credit periods have been exceeded. However from time to time, the Group may experience delays in collection. Where recoverability of trade and other debtor balances are called into doubts, specific provisions for trade and other receivables are made based on credit status of the debtors, the aged analysis of the receivable balances and write-off history. Certain receivables may be initially identified as collectible, yet subsequently become uncollectible and result in a subsequent write-off of the related receivable to the consolidated statement of profit or loss and other 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

Impairment of property, plant and equipment and construction in progress

Property, plant and equipment are stated at cost less accumulated depreciation and impairment. Construction in progress are stated at costs. At each period-end date or whenever an objective evidence occur, the Company will assess whether there is an indicator that property, plant and equipment and construction in progress are impaired. In making this judgment, historical data such as financial performance of the operation cash generating unit will take into account.

Impairment of intangible assets

The Directors reconsidered the recoverability of the Group's intangible assets. The recoverable amounts of the intangible assets have been determined based on value-in-use calculations. The value-in-use calculation requires the Group to estimate the future cash flows expected to arise from the intangible assets and a suitable discount rate in order to calculate the present value. The management refers to the valuation performed by independent qualified valuers. In performing the valuation, the valuers have based on method of valuation which involves certain estimates and assumptions.

Impairment of available-for-sale financial assets

Available-for-sale investments are stated at cost less impairment. At each period-end date or whenever an objective evidence occur, the Company will assess whether there is an indicator that available-for-sale financial assets are impaired. In making this judgment, historical data and factors such as industry and sector performance and financial information regarding the investee and certain specific conditions surrounding the transactions giving rise to the investments are taken into account.

5. FINANCIAL INSTRUMENTS AND CAPITAL RISK MANAGEMENT

(a) Categories of financial instruments

	2016 RMB'000	2015 RMB'000
Financial assets		
Available-for-sale investments	**89,335**	70,287
Loan and receivables (including cash and cash equivalents)	**1,571,943**	1,232,058
Financial assets at fair value through profit or loss	**1,038,006**	1,049,556
Financial liabilities		
Amortised cost	**1,221,459**	773,215

(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 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

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

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 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 profit or loss and other comprehensive income as incurred.

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 ("HK$"), which expose the Group to foreign currency risk. The Group does not have any formal hedging policy.

No sensitivity analysis on foreign currency risk is performed since the Group's has no material foreign currency denominated monetary assets and liabilities at the end of the reporting period.

Other price risk

The Group is exposed to equity 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 or loss

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

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

Other price risk (Continued)

If prices had been 10% higher/lower (2015: 10%):

— post-tax profit for the year ended 31 December 2016 would increase/decrease by RMB103,800,000 (2015: RMB104,956,000). 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 2016, the Group's maximum exposure to credit risk which will cause a financial loss to the Group due to failure to discharge an obligation by the counterparties is arising from the carrying amount of the respective recognised financial assets as stated in the consolidated statement of financial position.

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

The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies. Other than concentration of credit risk on liquid funds which are deposited with several banks with high credit ratings, the Group does not have any other significant concentration of credit risk. Trade receivables consist of a large number of customers.

Liquidity risk

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

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

Liquidity risk (Continued)

	Weighted average interest rate %	On demand or within one year RMB'000	More than one year but less than two years RMB'000	More than two years but less than five years RMB'000	Total undiscounted cash flow RMB'000	Carrying amount RMB'000
As at 31 December 2016						
Non-derivative financial liabilities						
Trade and bill payables	–	181,702	46,056	–	227,758	227,758
Other payables and accruals	–	993,701	–	–	993,701	993,701
		1,175,403	46,056	–	1,221,459	1,221,459
As at 31 December 2015						
Non-derivative financial liabilities						
Trade and bill payables	–	101,346	28,842	–	130,188	130,188
Other payables and accruals	–	643,027	–	–	643,027	643,027
		744,373	28,842	–	773,215	773,215

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.

Some of the Group's financial asset are measured at fair value at the end of each reporting period. The following table give information about how the fair values of these financial assets are determined (in particular, the valuation technique(s) and inputs used).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

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

Fair value of financial instruments (Continued)

	2016 RMB'000	2015 RMB'000	Fair value hierarchy	Valuation technique(s) and key input(s)
Financial assets at fair value though profit or loss	1,038,006	1,049,556	Level 2	Based on expected rate of return quoted from financial institution

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

The Directors consider that the carrying amounts of financial assets and liabilities recognised in the consolidated financial statements approximate their fair value.

(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.

6. SEGMENT INFORMATION

Information reported to the board of Directors, being the chief operating decision makers, 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 makers who comprehensively manage the entire business. The reportable operating results report to the chief operating decision makers are the net profit of the Group and the reportable assets and liabilities report to the chief operating decision makers are the Group's assets and liabilities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

6. SEGMENT INFORMATION *(Continued)*

Revenue from major products

	2016 RMB'000	2015 RMB'000
Pharmaceutical products	**4,117,573**	3,611,380

Information about major customers

Included in revenues arising from sales of pharmaceutical products of approximately RMB4,117,573,000 (2015: RMB3,611,380,000) are revenues of approximately RMB299,759,000 (2015: RMB442,921,000) which arose from sales to the Group's largest customer. For the year ended 31 December 2016, no individual customer contributed over 10% of the total revenue of the Group (2015: one customer amounting to approximately RMB442,921,000).

Geographical information

The Group mainly operates in the PRC. During the year ended 31 December 2016, except for revenue of approximately RMB1,473,000 (2015: RMB1,592,000) is generated from external customers located in overseas, all of the Group's revenue is derived from external customers located in the PRC. As the non-current assets of the Group are all located in the PRC in each of the year ended 31 December 2016 and 2015, so no geographical analysis was presented.

7. TURNOVER AND OTHER REVENUE

	2016 RMB'000	2015 RMB'000
Turnover		
Sales of manufactured pharmaceutical products	**4,117,573**	3,611,380
Other revenue		
Gain on financial assets at fair value through profit or loss		
— Realised	**32,797**	55,245
— Unrealised	**3,006**	4,556
	35,803	59,801
Interest income on bills receivables	**129**	143
Interest income on bank deposits	**2,532**	1,547
Sundry income	**4,751**	6,190
	43,215	67,681
Total revenue	**4,160,788**	3,679,061

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

7. TURNOVER AND OTHER REVENUE *(Continued)*

The sales of product mix of the Group are as follows:

	2016 RMB'000	2015 RMB'000
Turnover		
System specified medicine	1,948,667	1,622,818
Anti-biotic medicine	1,232,007	1,211,250
Other specified medicine	936,899	777,312
	4,117,573	3,611,380

8. FINANCE COSTS

	2016 RMB'000	2015 RMB'000
Bills payables	86	52

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

9. PROFIT BEFORE TAXATION

Profit before taxation has been arrived after charging:

	Notes	2016 RMB'000	2015 RMB'000
Cost of inventories recognised as expenses		933,306	1,080,425
Depreciation of property, plant and equipment	20	74,980	60,261
Amortisation of prepaid lease payments	22	2,193	1,918
Write-down of obsolete inventories	25	6,331	2,366
Impairment loss recognised in respect of trade receivables	26	3,722	1,363
Impairment loss recognised in respect of other receivables	27	1,334	2,723
Employees benefit expenses (excluding Directors' and supervisors' remuneration)		1,607,786	1,267,725
Loss on disposal of property, plant and equipment		2,076	25,412
Research and development costs		314,315	253,607
Rental expenses		3,245	1,751
Advertising costs		10,718	4,368
Auditors' remuneration		1,050	1,151
and after crediting:			
Other income			
Waiver of trade payables		29	552
Net exchange gain		20,556	8,362
Government grant		40,047	27,184
Penalty income		8,596	2,105
Reversal of obsolete inventories written-down	25	2,031	567
Reversal of impairment loss recognised in respect of trade receivables	26	1,556	1,087
Reversal of impairment loss recognised in respect of other receivables	27	4,041	–
		76,856	39,857

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 ended 31 December 2016 (2015: Nil).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

10. TAXATION *(Continued)*

(ii) As described in the paragraph below, the Company is subjected to the PRC Enterprise Income Tax at a rate of 15% (2015: 15%). The subsidiaries of the Group are subjected to the PRC Enterprise Income Tax at a rate of 25% (2015: 25%).

The Company received confirmation from the recognition authority that the Company has been recognised as the High and New Technology Enterprise. Pursuant to the new Enterprise Income Tax Law, the Enterprise Income Tax applicable to the High and New Technology Enterprise is reduced to be levied at 15%. The Company has since been enjoying the tax concession rate of 15% for the years ended 31 December 2016 and 2015.

(iii) The Group is subjected to the PRC value-added tax ("VAT") at 17% (2015: 17%) of revenue from sale of goods in the PRC. Input VAT paid on purchases can be used to offset output VAT levied on sales to determine the net VAT recoverable/payable.

(iv) The amount of taxation charged to the consolidated statement of profit or loss and other comprehensive income represents:

	2016 **RMB'000**	2015 RMB'000
Current taxation — Enterprise income tax	**83,050**	81,960
Deferred taxation (Note 23)	**105**	(695)
	83,155	81,265

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:

	2016 **RMB'000**	2015 RMB'000
Profit before taxation	**463,823**	571,872
Calculated at a taxation rate of 25% (2015: 25%)	**115,956**	142,968
Tax effect of income not taxable for tax purpose	**(9,005)**	(16,980)
Tax effect of expenses not deductible for tax purpose	**1,773**	139
Tax effect of tax concession	**(43,091)**	(51,844)
Tax effect of different jurisdiction	**(164)**	–
Tax effect of tax losses utilised	**(4,870)**	(376)
Tax effect of unutilised tax losses	**3,070**	6,830
Tax effect of temporary difference	**19,486**	528
Taxation charge for the year	**83,155**	81,265

The Group has tax losses of approximately RMB38,443,000 (2015: RMB45,643,000), that are available for five years for offsetting against future taxable profits of the companies in which the loses arise. Deferred tax assets have not been recognised in respect of these losses because it is not considered probable that taxable profits will be available against which the tax losses can be utilised.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

11. DIVIDENDS

The dividend paid in 2016 and 2015 were RMB213,360,000 (RMB0.35 per share) and RMB182,880,000 (RMB0.30 per share) respectively.

The Directors did not recommend the payment of a final dividend of the year ended 31 December 2016 (2015: RMB213,360,000, RMB0.35 per share in respect of year ended 31 December 2015).

12. EMPLOYEE SALARIES, WAGES, COMMISSION AND PENSION

	2016 RMB'000	2015 RMB'000
Salaries and wages	**1,573,084**	1,254,734
Pension costs — defined contribution plans	**24,517**	6,332
	1,597,601	1,261,066

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 RMB1,210 (equivalent to HK$1,500) per month with effect from 1 June 2014, and thereafter contributions are voluntary.

During the year ended 31 December 2016, the Group has contributed approximately RMB14,520 (2015: RMB14,520) to the MPF Scheme.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

14. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

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

	2016 RMB'000	2015 RMB'000
Basic salaries and allowances	1,248	1,084
Retirement benefit costs	54	60
	1,302	1,144

Individual emoluments paid and payable to the directors for the year ended 31 December 2016 are as follows:

	Year ended 31 December 2016			
	Fees RMB'000	Salaries, and other benefits RMB'000	Retirement scheme contributions RMB'000	Total RMB'000
Executive director:				
Liu Baoqi (Chairman)	–	473	9	482
Li Minghua	–	172	9	181
Liu Zhenteng	–	154	9	163
Han Fengsheng	–	107	9	116
Chen Yu	–	111	9	120
Non-executive Directors:				
Yin Chuangui (retired on 30 June 2016)	12	–	–	12
Liu Zhenhai	24	–	9	33
Independent non-executive director:				
Foo Tin Chung, Victor	123	–	–	123
Fu Hongzheng	24	–	–	24
Prof. Du Guanhua	24	–	–	24
Huang Huiwen (appointed on 1 July 2016)	12	–	–	12
Prof. Chen Yun Zhen (retired on 30 June 2016)	12	–	–	12
	231	1,017	54	1,302

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

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

Individual emoluments paid and payable to the directors for the year ended 31 December 2015 are as follows:

	Year ended 31 December 2015			
	Fees RMB'000	Salaries, and other benefits RMB'000	Retirement scheme contributions RMB'000	Total RMB'000
Executive director:				
Liu Baoqi (Chairman)	–	446	10	456
Li Minghua	–	115	10	125
Liu Zhenteng	–	144	10	154
Han Fengsheng	–	72	10	82
Chen Yu	–	72	10	82
Non-executive Directors:				
Yin Chuangui	24	–	–	24
Liu Zhenhai	24	–	10	34
Independent non-executive director:				
Foo Tin Chung, Victor	115	–	–	115
Fu Hongzheng	24	–	–	24
Prof. Chen Yun Zhen	24	–	–	24
Prof. Du Guanhua	24	–	–	24
	235	849	60	1,144

The number of directors whose emoluments fell within the following band is as follows:

	Number of individuals	
	2016	2015
Nil – RMB806,000 (equivalent to Nil – HK$1,000,000)	**12**	11

None of the directors have waived or agreed to waive any emoluments during the year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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

(ii) The five individuals whose emoluments were the highest in the Group for the year did not include (2015: five) director whose emoluments are reflected in the analysis presented above. The emoluments payable (excluding amounts paid or payable by way of commissions on sales generated by the individual) to the five (2015: five) non-director, highest paid individual during the year are as follows:

	2016 RMB'000	2015 RMB'000
Basic salaries and allowances	1,200	4,790
Retirement benefit costs	50	115
	1,250	4,905

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

	Number of individuals	
	2016	2015
Nil – RMB806,000 (equivalent to Nil – HK$1,000,000)	5	3
RMB806,000 – RMB1,613,000 (equivalent to HK$1,000,000 to HK$2,000,000)	–	2

(iii) During the year, no emoluments have been paid to the Directors or the five highest individuals as an inducement to join or as compensation for loss of office (2015: Nil).

(iv) Ms. Li Minghua was also the chief executive of the Company during the years ended 31 December 2016 and 2015.

The number of senior management (excluding directors) whose emolument fell within the following band is as follows:

	Number of individuals	
	2016	2015
Nil – RMB806,000 (equivalent to Nil – HK$1,000,000)	1	1

(v) Mr. Liu Baoqi was also the chairman of the Board of the Company during the years ended 31 December 2016 and 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

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.

	2016	2015
Profit attributable to owners of the Company (RMB'000)	379,198	492,929
Weighted average number of ordinary shares in issue ('000)	609,600	609,600
Basic and diluted earnings per share (RMB)	0.622	0.809

During the year ended 31 December 2016 and 2015, there is no instrument with potential dilutive share issued by the Company. Therefore, the basic and diluted earnings per share for the respective years are equal.

16. PARTICULARS OF SUBSIDIARIES

As at 31 December 2016 and 2015, the Company had interests in the following subsidiaries:

Name of the entity	Form of business structure	Place of incorporation and operation	Paid-up capital	Proportion of registered capital held by the Company		Proportion of voting power held		Principal activities
				2016	2015	2016	2015	
Directly held:								
Sichuan Luoxin Pharmacy Company Limited* (四川羅欣醫藥有限公司) ("Sichuan Luoxin")	Incorporated	PRC	RMB6,000,000	51%	51%	51%	51%	Wholesale of biochemical products and Chinese medicine
Shandong Yuxin Pharmaceutical Company Limited* (山東裕欣藥業有限公司) ("Shandong Yuxin")	Incorporated	PRC	RMB50,000,000	100%	100%	100%	100%	Wholesale and manufacture of biochemical products and Chinese medicine
Shandong Luoxin Pharmaceutical Group Hengxin Pharmaceutical Company Limited** (山東羅欣藥業集團恒欣藥業有限公司) ("Shandong Hengxin")	Incorporated	PRC	RMB50,000,000	100%	100%	100%	100%	Wholesale and manufacture of biochemical products and Chinese Medicine

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

16. PARTICULARS OF SUBSIDIARIES *(Continued)*

Name of the entity	Form of business structure	Place of incorporation and operation	Paid-up capital	Proportion of registered capital held by the Company 2016	2015	Proportion of voting power held 2016	2015	Principal activities
Directly held: (Continued)								
Luoxin Biological Technology (Shanghai) Co., Ltd.*# (羅欣生物科技（上海）有限公司) ("Biological Technology")	Incorporated	PRC	RMB165,000,000	100%	100%	100%	100%	Development, technology transfer, technology consultancy and technology services of biological products, Pharmaceutical Products and medical equipments
Jinan Luoxin Pharmacy Co., Ltd.* 濟南羅欣醫藥 ("Jinan Luoxin")	Incorporated	PRC	RMB50,000,000	68.86%	65.06%	68.86%	65.06%	Wholesale of biochemical products and Chinese medicine, development technology transfer, technology consultancy and technology services of biological products
Shandong Luoxin Pharmaceutical Group Chongqing Pharmaceutical Co., Ltd.* 山東羅欣藥業集團重慶醫藥有限公司	Incorporated	PRC	RMB10,000,000	51.00%	–	51.00%	–	Sales of chemical raw medicine and preparations, antibiotic raw medicine and preparations, biochemical medicine, Chinese Traditional Patent Medicine, biological products, food, medical equipments, general merchandise, disinfection supplies, medicine consulting and import and export of goods
Shandong Luoxin Pharmaceutical Group Runxin Pharmaceutical Company Limited* 山東羅欣藥業集團潤欣醫藥有限公司 ("Shandong Runxin")	Incorporated	PRC	RMB50,000,000	51.00%	–	51.00%	–	Sales of Chinese medicine, biochemical products, medical equipments and health care products
Indirectly held:								
Luoxin Hong Kong Holdings Limited ("Hong Kong Luoxin")	Incorporated	Hong Kong	HK$10,000	100%	100%	100%	100%	Investment holding
Gaotang County Runxin Large Pharmacy Co., Ltd.* 高唐縣潤欣大藥房有限公司	Incorporated	PRC	RMB500,000	51%	–	51%	–	Dormant

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

16. PARTICULARS OF SUBSIDIARIES *(Continued)*

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

Shandong Hengxin, Shandong Yuxin, Biological Technology and Hong Kong Luoxin were incorporated on 11 April 2012, 19 December 2012, 25 June 2014 and 28 May 2015 respectively.

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

The table below shows details of non-wholly owned subsidiary of the Group that have material non-controlling interest:

Name of subsidiary	Profit/(loss) allocated to non-controlling interest		Accumulated non-controlling interests		Percentage of equity interest held by non-controlling interest	
	2016	2015	**2016**	2015	**2016**	2015
	RMB'000	RMB'000	**RMB'000**	RMB'000	**%**	%
Sichuan Luoxin	**637**	(1,298)	**3,131**	2,498	**49**	49
Jinan Luoxin	**2,102**	(1,024)	**16,952**	16,762	**31.14##**	34.94##
Shandong Runxin	**(1,050)**	–	**23,450**	–	**49**	–
Others	**(219)**	–	**4,685**	–	**–**	–

For the changes in percentage of equity interest of Jinan Luoxin, please refer to Note 40.

Summarised financial information in respect of each of the Group's subsidiary that has material non-controlling interest is set out below. The summarised financial information below represents amounts before intra-group eliminations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

16. PARTICULARS OF SUBSIDIARIES *(Continued)*

Sichuan Luoxin

	2016 RMB'000	2015 RMB'000
Current assets	74,613	38,370
Non-current assets	380	355
Current liabilities	(68,603)	(33,636)
Equity attributable to owners of the company	6,390	5,089
Revenue	196,261	113,554
Expenses	(194,960)	(116,202)
Profit/(loss) for the year	1,301	(2,648)
Total comprehensive income/(loss) for the year	1,301	(2,648)
Net cash generated from/(used in) operating activities	24	(2,922)
Net cash used in investing activities	(166)	(207)
Net cash generated from financing activities	–	2,939
Net decrease in cash and cash equivalents	(142)	(190)

Jinan Luoxin

	2016 RMB'000	2015 RMB'000
Current assets	65,853	73,081
Non-current assets	5,815	5,853
Current liabilities	(17,232)	(30,963)
Equity attributable to owners of the company	54,436	47,971
Revenue	322,581	172,275
Expenses	(316,116)	(175,016)
Profit/(loss) for the year	6,465	(2,741)
Total comprehensive income/(loss) for the year	6,465	(2,741)
Net cash generated from/(used in) operating activities	2,200	(39,062)
Net cash used in investing activities	(397)	(1,415)
Net cash generated from financing activities	–	47,000
Net increase in cash and cash equivalents	1,803	6,523

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

16. PARTICULARS OF SUBSIDIARIES *(Continued)*

Shandong Runxin

	2016 RMB'000
Current assets	52,934
Non-current assets	25,605
Current liabilities	(30,683)
Equity attributable to owners of the company	47,856
Revenue	20,291
Expenses	(22,435)
Loss for the year	(2,144)
Total comprehensive loss for the year	(2,144)
Net cash used in operating activities	(28,422)
Net cash used in investing activities	(23,391)
Net cash generated from financing activities	51,820
Net increase in cash and cash equivalents	7

17. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2016 RMB'000	2015 RMB'000
Unlisted securities — Equity securities *(Note)*		
At cost	89,335	70,287

Note:

1. Amount of RMB1,000,000 represented 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.

2. As at 31 December 2014, the investment cost of RMB40,000,000 represent 40% of the capital of Second Hospital of Fei County (費縣第二醫院). On July 2015, the Group further invested RMB15,000,000 to acquired 15% of the capital on it.

   As at 31 December 2016 and 2015, although the Group hold 55% capital on the Second Hospital of Fei County, the Directors confirmed that the Group does not involve into the daily operation decision and financial decision of the Second Hospital of Fei County. Therefore the Group does not have any control or significant influence on the Second Hospital of Fei County.

3. On 13 July 2015, the Group entered into subscription agreements to acquire the capital of WuXi Healthcare Ventures II, L.P. The partnership makes capital investments, primarily in privately-owned life sciences companies in PRC, Hong Kong and Taiwan ("Greater China") or United States. At 31 December 2015, the Group contributed approximately RMB14,287,000 (USD2,200,000). During the year ended 31 December 2016, the Group further contributed approximately RMB19,048,000 (USD2,600,000), represented 3.46% of the capital of WuXi Healthcare Ventures II, L.P.

The available-for-sale financial assets are measured at cost less impairment at the end of the reporting period because the range of reasonable fair value estimates is so significant that the Directors are of the opinion that the fair value cannot be reliably measured. No impairment was recognised as at 31 December 2016 and 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

18. INTANGIBLE ASSETS

	Purchased Technical Know-how RMB'000	License RMB'000	Total RMB'000
Cost:			
At 1 January 2015	17,450	–	17,450
Acquisition of assets (Note 39)	–	4,057	4,057
At 31 December 2015 and 1 January 2016	17,450	4,057	21,507
Acquisition of assets (Note 39)	–	2,786	2,786
At 31 December 2016	17,450	6,843	24,293
Accumulated amortisation and impairment:			
At 1 January 2015, 31 December 2015, 1 January 2016 and 31 December 2016	17,450	–	17,450
Net carrying amount:			
At 31 December 2016	**–**	**6,843**	**6,843**
At 31 December 2015	–	4,057	4,057

The licenses will expire on December 2020 and subject to renewal. The Directors are not aware of any expected impediment with respect to the renewal of the licenses and consider that the possibility of failing in renewal is remote and the licenses will generate net cash flows for the Group for an indefinite period. Therefore, the licenses are treated as having an indefinite useful life.

The purchased technical know-how with estimated useful life of 5 years was fully amortised for the year ended 31 December 2014.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

18. INTANGIBLE ASSETS *(Continued)*

Impairment testing of intangible assets

Intangible assets with indefinite useful life acquired through acquisition of subsidiaries is allocated to the following cash generating units (the "CGU") for impairment testing.

— Jinan Luoxin
— Shandong Runxin

Jinan Luoxin

The recoverable amount of Jinan Luoxin has been determined based on a value in use calculation using cash flow projections based on financial budgets covering a five-year period approved by senior management. The discount rate applied to the cash flow projections is 16.78% (2015: 17.20%). Other key assumptions for the value in use calculations are related to the estimation of cash inflows/ outflows which include budgeted sales with a compound average growth rate of 5% (2015: 5%) and stable gross margin, such estimation is based on the CGU's past performance and its management's expectations for the market development. The management believes that any reasonable possible change in any of these assumptions would not cause the aggregate carrying amount of Jinan Luoxin to exceed aggregate recoverable amount of Jinan Luoxin.

Shandong Runxin

The recoverable amount of Shandong Runxin has been determined based on a value in use calculation using cash flow projections based on financial budgets covering a five-year period approved by senior management. The discount rate applied to the cash flow projections is 16.78%. Other key assumptions for the value in use calculations are related to the estimation of cash inflows/outflows which include budgeted sales with a compound average growth rate of 5% and stable gross margin, such estimation is based on the CGU's past performance and its management's expectations for the market development. The management believes that any reasonable possible change in any of these assumptions would not cause the aggregate carrying amount of Shandong Runxin to exceed aggregate recoverable amount of Shandong Runxin.

19. PREPAYMENTS TO ACQUIRE TECHNICAL KNOW-HOW

As at 31 December 2015, the amounts are prepayments to third parties to acquire technical know-how. For the year ended 31 December 2016 and 2015, amount of approximately RMB8,021,000 and RMB9,383,000 respectively were impaired which was included in research and development expenses. The Directors have considered that the amount of the prepayment to acquire technical know-how of RMB8,021,000 (2015: RMB9,383,000) was not recoverable as the research and development process was not successful and would not bring any future economic benefit to the Group. The Directors 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

20. PROPERTY, PLANT AND EQUIPMENT

	Building RMB'000	Plant and machinery RMB'000	Motor vehicles RMB'000	Office equipment RMB'000	Total RMB'000
Cost					
At 1 January 2015	274,556	401,996	33,895	25,436	735,883
Acquisition of assets (Note 39)	–	–	–	734	734
Additions	7,626	38,719	2,875	24,279	73,499
Disposals	(23,500)	(13,121)	(2,558)	(3,943)	(43,122)
Transfer from construction-in-progress (Note 21)	113,610	103,987	–	4,261	221,858
At 31 December 2015 and 1 January 2016	**372,292**	**531,581**	**34,212**	**50,767**	**988,852**
Acquisition of assets (Note 39)	**29**	**540**	**40**	**455**	**1,064**
Additions	**23,417**	**58,022**	**6,445**	**17,434**	**105,318**
Disposals	**(10,361)**	**(11,202)**	**(2,285)**	**(2,528)**	**(26,376)**
Transfer from construction-in-progress (Note 21)	**58,058**	**48,054**	**–**	**7,847**	**113,959**
At 31 December 2016	**443,435**	**626,995**	**38,412**	**73,975**	**1,182,817**
Accumulated depreciation and impairment					
At 1 January 2015	36,009	124,005	14,719	16,875	191,608
Charge for the year	9,854	36,110	7,560	6,737	60,261
Written back on disposals	(3,878)	(11,546)	(1,118)	(768)	(17,310)
At 31 December 2015 and 1 January 2016	**41,985**	**148,569**	**21,161**	**22,844**	**234,559**
Charge for the year	**11,010**	**47,621**	**4,792**	**11,557**	**74,980**
Written back on disposals	**(365)**	**(6,553)**	**(1,908)**	**(1,599)**	**(10,425)**
At 31 December 2016	**52,630**	**189,637**	**24,045**	**32,802**	**299,114**
Net carrying value					
At 31 December 2016	**390,805**	**437,358**	**14,367**	**41,173**	**883,703**
At 31 December 2015	330,307	383,012	13,051	27,923	754,293

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

21. CONSTRUCTION-IN-PROGRESS

	RMB'000
At 1 January 2015	219,902
Additions	110,092
Transfer to property, plant and equipment (Note 20)	(221,858)
At 31 December 2015 and 1 January 2016	**108,136**
Additions	**105,459**
Transfer to property, plant and equipment (Note 20)	**(113,959)**
At 31 December 2016	**99,636**

Construction-in-progress is reclassified to the appropriate category of property, plant and equipment when completed and ready to use.

Analysis of construction-in-progress as follows:

	2016 **RMB'000**	2015 RMB'000
Construction cost of buildings	**55,164**	56,448
Cost of plant and machinery	**44,316**	51,688
Office equipment	**156**	–
	99,636	108,136

22. PREPAID LEASE PAYMENTS

Prepaid lease payments represent 48-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 2015	52,597
Addition of prepaid lease payments	50,927
Amortisation of prepaid lease payments (Note 9)	(1,918)
At 31 December 2015 and 1 January 2016	**101,606**
Addition of prepaid lease payments	**675**
Amortisation of prepaid lease payments (Note 9)	**(2,193)**
At 31 December 2016	**100,088**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

22. PREPAID LEASE PAYMENTS *(Continued)*

Analysed for reporting purposes as:

	2016 **RMB'000**	2015 RMB'000
Current assets (included in other receivables, deposits and prepayments) (Note 27)	**2,193**	1,931
Non-current assets	**97,895**	99,675
	100,088	101,606

	2016 **RMB'000**	2015 RMB'000
Long-term lease	**8,774**	8,914
Medium-term lease	**91,314**	92,692
	100,088	101,606

23. DEFERRED TAX ASSETS

Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 25% (2015: 25%).

	Provision RMB'000
At 1 January 2015	523
Credited to the consolidated statement of profit or loss and other comprehensive income (Note (10))	695
At 31 December 2015 and 1 January 2016	**1,218**
Charged to the consolidated statement of profit or loss and other comprehensive income (Note (10))	**(105)**
At 31 December 2016	**1,113**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

24. GOODWILL

The carrying amount of goodwill was allocated to cash-generating unit as follows:

	2016 RMB'000	2015 RMB'000
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 16.78% (2015: 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.

25. INVENTORIES

	2016 RMB'000	2015 RMB'000
Raw materials	19,023	1,506
Work-in-progress	205,551	97,526
Finished goods	287,231	145,565
	511,805	244,597
Less: Write-down of obsolete inventories	(6,911)	(2,611)
	504,894	241,986

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

	2016 RMB'000	2015 RMB'000
Balance at the beginning of the year	2,611	812
Write-down of obsolete inventories during the year (Note 9)	6,331	2,366
Reversal of obsolete inventories written-down (Note 9)	(2,031)	(567)
Balance at the end of the year	6,911	2,611

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

25. INVENTORIES *(Continued)*

The reversal of obsolete inventories written-down arose from sales of obsolete inventories recognised during the year. The amount reversed has been included in other income to the statement of profit or loss.

The Directors have assessed the net realisable values and conditions of the Group's inventories as at 31 December 2016 and have considered a write-down of obsolete inventories of approximately RMB6,911,000 (2015: RMB2,611,000) be made in respect of the net realisable value of the inventories.

26. TRADE AND BILLS RECEIVABLES

	2016 RMB'000	2015 RMB'000
Trade receivables	**638,215**	475,570
Bills receivables	**75,819**	50,869
	714,034	526,439
Less: Provision for impairment loss recognised in respect of trade receivables	**(3,757)**	(1,591)
	710,277	524,848

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

	2016 RMB'000	2015 RMB'000
1 to 90 days	**615,006**	443,720
91 to 180 days	**81,674**	63,087
181 to 365 days	**13,597**	18,041
	710,277	524,848

Customers are generally granted with credit term of 90–180 days. Bills receivables are all due to mature within 180 days. Trade and bills receivables as at 31 December 2016 and 2015 are denominated in RMB.

As at 31 December 2016, amount of approximately RMB130,306,000 was receivable from two connected parties (Note 37). The amounts due are unsecured, interest-free and receivable within 90 days.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

26. TRADE AND BILLS RECEIVABLES *(Continued)*

As at 31 December 2015, amount of approximately RMB101,852,000 was receivable from three connected parties (Note 37). The amounts due are unsecured, interest-free and receivable within 90 days.

(a) Included in the Group's trade and bills receivables balance are debtors with a carrying amount of approximately RMB13,597,000 (2015: RMB18,041,000) 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 in the opinion of Directors, based on historical experience in collection of debts 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:

	2016 **RMB'000**	2015 RMB'000
181 to 365 days	**13,597**	18,041

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

	2016 **RMB'000**	2015 RMB'000
Balance at the beginning of the year	**1,591**	1,315
Impairment loss recognised during the year (Note (9))	**3,722**	1,363
Reversal of impairment loss recognised in respect of trade receivables (Note (9))	**(1,556)**	(1,087)
Balance at the end of the year	**3,757**	1,591

In determining the recoverability of trade receivables, the Group considers any change in the credit quality of the trade receivables from the date credit was initially granted up to the reporting date. Accordingly, the Directors have considered provision for impairment is made to reduce the trade receivables to their recoverable amount and believed that there is no further provision for impairment loss recognised in respect of trade receivables is need.

The reversal of impairment loss recognised was due to the recovery of impaired trade debts during the years ended 31 December 2016 and 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

27. OTHER RECEIVABLES, DEPOSITS AND PREPAYMENTS

	2016 RMB'000	2015 RMB'000
Other receivables and deposits	**221,950**	105,918
Prepayments *(Note)*	**74,218**	70,725
	296,168	176,643
Less: Provision for impairment loss recognised in respect of other receivables	**(1,334)**	(4,041)
	294,834	172,602

Note:

Prepayments mainly comprised of prepayment of value-added tax, acquisition of plant and machinery, raw materials, packing materials and consumables, and acquisition of prepaid lease payments of approximately RMB19,676,000 (2015: RMB14,920,000), RMB30,548,000 (2015: RMB12,231,000) and RMB2,192,000 (2015: RMB30,566,000) respectively.

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

	2016 RMB'000	2015 RMB'000
Balance at the beginning of the year	**4,041**	1,468
Impairment loss recognised during the year (Note (9))	**1,334**	2,723
Written off during the year	**–**	(150)
Reversal of impairment loss recognised in respect of other receivables (Note (9))	**(4,041)**	–
Balance at the end of the year	**1,334**	4,041

The reversal of impairment loss recognised due to the recovery of other receivables during the year ended 31 December 2016.

In determining the recoverability of other receivables, the Directors considers any change in the credit quality of the other receivables. Included in the provision for impairment loss recognised in respect of other receivables are individually impaired other receivables with a balance of approximately RMB1,334,000 (2015: RMB4,041,000) which have been in financial difficulty. The impairment recognised represents the difference between the carrying amount of these other receivables and the present value of the expected recoverable amounts. The Company does not hold any collateral over these balances.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

28. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2016 RMB'000	2015 RMB'000
Held for trading	**1,038,006**	1,049,556

2016

As at 31 December 2016, the financial assets at fair value through profit or loss represent eleven principal and return-protected financial products ("Financial Products 2016") issued by several financial institutions in the PRC. The Financial Products 2016 were all matured within one year and were classified as current assets.

These financial products were classified as financial assets designated as at financial assets at fair value through profit or loss. The Directors recognised the fair value of the Financial Products 2016 as at the end of reporting period with reference to the discounted of expected return provided by those financial institutions.

2015

As at 31 December 2015, the financial assets at fair value through profit or loss represent eight principal and return-protected financial products ("Financial Products 2015") issued by several financial institutions in the PRC. The Financial Products 2015 were all matured within one year and were classified as current assets.

These financial products were classified as financial assets designated as at financial assets at fair value through profit or loss. The Directors recognised the fair value of the Financial Products 2015 as at the end of reporting period with reference to the discounted of expected return provided by those financial institutions.

29. FIXED DEPOSITS/CASH AND BANK BALANCES

As at 31 December 2016, no bank deposits of the Group (2015: nil) are pledged as collateral for bills payables.

Fixed deposit represent the bank deposit mature over three months and carry interest at market rates of 3.30% per annum during the year ended 31 December 2016 (2015: nil).

Cash and cash equivalents of the Group are denominated in RMB and HK$ 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

30. TRADE AND BILLS PAYABLES

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

	2016 **RMB'000**	2015 RMB'000
1 to 90 days	**158,157**	88,021
91 to 180 days	**14,021**	6,587
181 to 365 days	**9,525**	6,738
Over 365 days	**46,055**	28,842
	227,758	130,188

Trade payables as at 31 December 2016 and 2015 are denominated in RMB.

The average credit period on trade payables is 90 days. The Group has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

31. OTHER PAYABLES AND ACCRUALS

	2016 **RMB'000**	2015 RMB'000
Accrued salaries	**94,882**	43,992
Other payables	**749,515**	550,850
Receipt in advance	**149,304**	48,185
	993,701	643,027

As at 31 December 2016, other payables mainly consist of accrued sales and distribution expenses of approximately RMB531,881,000 (2015: RMB309,766,000), accrued social insurance and staff benefit of approximately RMB1,119,000 (2015: RMB52,600,000) and other tax and fee payable of approximately RMB68,463,000 (2015: RMB39,897,000).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

32. DEFERRED INCOME

Deferred income represent the government grant received by the Group.

During the years ended 31 December 2002 and 2003, the Group 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 Group to construct a new manufacturing plant to produce Chinese medicines. As at 31 December 2016 and 2015, the Group has not commenced the construction of the new manufacturing plant.

During the year ended 31 December 2016, the Group received certain government grants of approximately RMB253,074,000 related to enable the Group to commence technical know-how research and development and construction of plant and equipment.

The government grant received for the Group to commence technical know-how research and development were recognised as income in profit or loss when the related research and development incurred. The government grant received for the Group to construct of plant and equipment were recognised as income in profit or loss on a systematic basis over useful life of related plant and machinery.

33. SHARE CAPITAL

		Nominal value		
	Number of shares	Domestic shares	H-shares	Total
	'000	RMB'000	RMB'000	RMB'000
Registered, issued and fully paid:				
At 31 December 2015 and 2016				
(nominal value of RMB0.10 each)	609,600	44,504	16,456	60,960

34. RESERVES

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.

35. BANKING FACILITIES

The Group did not have banking facilities as at 31 December 2016 (2015: nil).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

36. COMMITMENTS AND CONTINGENCIES

The Group had the following significant commitments:

(a) Operating leases

At 31 December 2016, the total future minimum lease payments under non-cancellable operating leases in respect of land and buildings are payable as follows:

	2016 RMB'000	2015 RMB'000
Within one year	11,632	878
In the second to fifth years, inclusive	46,685	–
	58,317	878

The Group leases office premises under operating lease arrangements which are negotiated and fixed for an average term of a year. The lease payments are fixed and pre-determined.

(b) Capital commitments

Capital commitments outstanding at 31 December 2016, not provided for in the consolidated financial statements were as follows:

	2016 RMB'000	2015 RMB'000
Contracted but not provided for:		
— Purchase of technical know-how	–	140,134
— Purchase of property, plant and equipment	84,014	74,215

37. RELATED PARTY TRANSACTIONS

Key management compensation for the year ended 31 December 2016 and 2015 was disclosed in Note 14.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

37. RELATED PARTY TRANSACTIONS *(Continued)*

Apart from those as disclosed under Note 26 and elsewhere in the consolidated financial statements, the Group had the following material transactions with related parties during the year:

	2016 RMB'000	2015 RMB'000
Sales of chemical medicine to Luoxin Pharmaceutical Group Co., Ltd. ("Luoxin Pharmaceutical Group") *(note (i))*	**299,759**	442,921
Sales of chemical medicines to Shandong Luosheng Pharmacy Co., Ltd. ("Shandong Luosheng") *(note (ii))*	**45,474**	49,026
Sales of chemical medicines to Shandong Mingxin Pharmacy Co., Ltd. ("Shandong Mingxin") *(note (iii))*	**35,963**	39,950

Notes:

(i) Luoxin Pharmacy Group Company Limited is the promoter of the Company. Mr. Liu Baoqi is the director and controlling shareholder for both Luoxin Pharmacy Group Company Limited and the Company. Mr. Liu Zhenhai is the director for both Luoxin Pharmacy Group Company Limited and the Company (resigned as the director of Luoxin Pharmacy Group Company Limited on 29 February 2016). As at 31 December 2016, amount of approximately RMB122,400,000 (2015: RMB72,871,000) due from Luoxin Pharmaceutical Group is included in trade and bills receivables, the terms of the outstanding balance is set out in Note 26.

(ii) Shandong Luosheng Pharmacy Co., Ltd. is the fellow subsidiary of which Luoxin Pharmacy Group Company Limited is holding 51% of the equity interests of Shandong Luosheng Pharmacy Co., Ltd. Mr. Liu Baoqi and Mr. Liu Zhenhai are the directors for both Shandong Luosheng Pharmacy Co., Ltd. and the Company (Mr. Liu Zhenhai resigned as the director of Shandong Luosheng Pharmacy Co., Ltd on 18 July 2016). As at 31 December 2016, amount of approximately RMB7,906,000 (2015: RMB12,421,000) due from Shandong Luosheng is included in trade and bills receivables, the terms of the outstanding balance is set out in Note 26.

(iii) Shandong Mingxin Pharmacy Co., Ltd. is the fellow subsidiary of which Luoxin Pharmacy Group Company Limited is holding 51% of the equity interests of Shandong Mingxin Pharmacy Co., Ltd. Mr. Liu Baoqi and Mr. Liu Zhenhai are the directors for both Shandong Mingxin Pharmacy Co., Ltd. and the Company (Mr. Liu Zhenhai resigned as the director of Shandong Mingxin Pharmacy Co., Ltd. on 5 July 2016). As at 31 December 2016, amount of approximately RMB159,000 (2015: RMB16,560,000 due from) Shandong Mingxin is included in other payables and accruals (2015: included in trade and bills receivables), the terms of the outstanding balance is set out in Note 26.

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".

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

38. STATEMENT OF FINANCIAL POSITION AND RESERVES OF THE COMPANY

Information about the statement of financial position of the Company at the end of the reporting period is as follows:

	2016 RMB'000	2015 RMB'000
Non-current assets		
Interests in subsidiaries	333,750	166,250
Available-for-sale financial assets	56,000	56,000
Prepayments to acquire technical know-how	–	8,021
Property, plant and equipment	319,918	393,385
Construction-in-progress	14,913	54,851
Prepaid lease payments	17,633	18,046
Deferred tax assets	1,113	1,218
	743,327	697,771
Current assets		
Inventories	507,138	271,696
Amounts due from subsidiaries	692,774	660,555
Trade and bills receivables	585,477	480,488
Other receivables, deposits and prepayments	175,784	112,991
Financial assets at fair value through profit and loss	937,811	999,514
Fixed deposits	50,172	–
Cash and bank balances	206,730	284,048
	3,155,886	2,809,292
Current liabilities		
Trade and bills payables	177,188	113,107
Other payables and accruals	645,537	580,021
Amount due to a subsidiary	18,540	–
Deposits received	77,330	56,061
Tax payable	61,281	48,135
	979,876	797,324

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

38. STATEMENT OF FINANCIAL POSITION AND RESERVES OF THE COMPANY *(Continued)*

	2016 RMB'000	2015 RMB'000
Net current assets	**2,176,010**	2,011,968
Total assets less current liabilities	**2,919,337**	2,709,739
Non-current liability		
Deferred income	**101,115**	54,356
Net assets	**2,818,222**	2,655,383
Capital and reserves		
Share capital	**60,960**	60,960
Other reserve	**67,652**	67,652
Retained earnings		
— Proposed final dividend	**–**	213,360
— Others	**2,689,610**	2,313,411
Total equity	**2,818,222**	2,655,383

Approved by the Board of Directors on 7 March 2017 and signed on its behalf by:

Liu Baoqi
Director

Liu Zhenteng
Director

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

38. STATEMENT OF FINANCIAL POSITION AND RESERVES OF THE COMPANY *(Continued)*

A summary of the Company's reserves is as follows:

	Share Premium RMB'000	Statutory surplus reserve fund RMB'000 *(Note (i))*	Statutory public welfare fund RMB'000 *(Note (ii))*	Retained earnings RMB'000	Total RMB'000
At 1 January 2015	31,139	30,480	6,033	2,253,266	2,320,918
Profit and total comprehensive income for the year	–	–	–	456,385	456,385
Dividend paid	–	–	–	(182,880)	(182,880)
At 31 December 2015 and 1 January 2016	31,139	30,480	6,033	2,526,771	2,594,423
Profit and total comprehensive income for the year	–	–	–	376,199	376,199
Dividend paid	–	–	–	(213,360)	(213,360)
At 31 December 2016	**31,139**	**30,480**	**6,033**	**2,689,610**	**2,757,262**

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 years ended 31 December 2016 and 2015, no appropriation has been made by the Company because the statutory surplus reserve fund of the Company has reached 50% of the Company's registered capital.

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 2016 and 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

39. ACQUISITION OF ASSETS

(a) Shandong Runxin

On 1 July 2016, the Group acquired 51% of the entire capital of Shandong Runxin, for an aggregate consideration of approximately RMB25,500,000 (the "Acquisition of Shandong Runxin"). The purpose of the Acquisition of Shandong Runxin is for the Group to develop the wholesales business in Shandong province and as such, the Acquisition of Shandong Runxin has been accounted for as acquisition of assets rather than businesses and such acquisition did not give rise to goodwill.

	RMB'000
Consideration paid during the year ended 31 December 2016	25,500

The assets acquired and liabilities recognised at the date of the Acquisition of Shandong Runxin are as follows:

	RMB'000
Intangible assets — License (Note 18)	2,786
Cash and bank balances	19,811
Prepayment, deposit and other receivables	38,841
Property, plant and equipment	1,064
Accruals and other payable	(12,502)
Total identifiable net assets at fair value	50,000
Non-controlling interest	(24,500)
	25,500
Net cash outflow arising on acquisition:	
— Cash and cash equivalent paid	(25,500)
— Cash and cash equivalent acquired	19,811
	(5,689)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

39. ACQUISITION OF ASSETS *(Continued)*

(b) Jinan Luoxin

On 28 February 2015, the Group acquired the entire capital of Jinan Luoxin, for an aggregate consideration of approximately RMB3,711,000 (the "Acquisition of Jinan Luoxin"). The purpose of the Acquisition of Jinan Luoxin is for the Group to develop the wholesales business in Shandong province and as such, the Acquisition has been accounted for as acquisition of assets rather than businesses.

	RMB'000
Consideration paid during the year ended 31 December 2014 (Note)	3,711
The assets acquired and liabilities recognised at the date of the Acquisition of Jinan Luoxin are as follows:	
Intangible assets — Licenses (Note 18)	4,057
Cash and bank balances	34
Trade and bills receivables	3,672
Prepayment, deposit and other receivables	2,614
Inventories	1,318
Property, plant and equipment	734
Trade and bills payables	(2,722)
Accruals and other payable	(5,996)
	3,711
Net cash inflow arising on acquisition:	
— Cash and cash equivalent acquired	34

Note: The consideration paid was recognised as prepayment as at 31 December 2014.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2016

40. CHANGE IN OWNERSHIP INTERESTS IN A SUBSIDIARIES

On 20 April 2015, the Group disposed 36.94% equity interest of Jinan Luoxin by way of increasing the registered capital of Jinan Luoxin from RMB3,000,000 to RMB50,000,000. The Group agreed to pay RMB28,530,000 of the increased capital of Jinan Luoxin. The non-controlling interests of Jinan Luoxin agreed to pay RMB18,470,000 for the increase capital of Jinan Luoxin. The Group recognised an increase of non-controlling interests and decrease in other reserve of approximately RMB18,755,000 and RMB285,000 respectively.

On 12 August 2015, the Group further acquired 2.00% equity interest of Jinan Luoxin by way of paying RMB1,000,000 of the capital of Jinan Luoxin. The Group recognised a decrease of non-controlling interest and decrease in other reserve of approximately RMB969,000 and RMB31,000 respectively.

On 24 June 2016, the Group further acquired 3.80% equity interest of Jinan Luoxin by way of paying RMB1,900,000 of the capital of Jinan Luoxin. The Group recognised a decrease of non-controlling interest and increase in other reserve of approximately RMB1,912,000 and RMB12,000 respectively.

41. APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements were approved and authorised for issue by the Board of Directors on 7 March 2017.

FIVE YEARS FINANCIAL SUMMARY

	For the year ended 31 December				
	2016 RMB'000	2015 RMB'000	2014 RMB'000	2013 RMB'000	2012 RMB'000
Results					
Turnover	**4,117,573**	3,611,380	2,766,788	2,529,464	2,228,257
Cost of sales	**(1,000,033)**	(1,134,104)	(874,060)	(884,393)	(725,977)
Gross profit	**3,117,540**	2,477,276	1,892,728	1,645,071	1,052,280
Other revenue	**43,215**	67,681	78,743	49,838	29,878
Other income	**76,856**	39,857	26,585	12,046	6,267
Selling and distribution expenses	**(2,309,501)**	(1,649,576)	(1,259,076)	(1,066,095)	(896,150)
General and administrative expenses	**(464,201)**	(363,314)	(211,034)	(137,364)	(124,031)
Finance costs	**(86)**	(52)	(21)	(9)	(90)
Profit before taxation	**463,823**	571,872	527,925	503,487	518,154
Taxation	**(83,155)**	(81,265)	(84,060)	(74,785)	(78,045)
Profit for the year	**380,668**	490,607	443,865	428,702	440,109
Profit/(loss) attributable to:					
Owners of the Company	**379,198**	492,929	443,553	428,585	439,874
Non-controlling interest	**1,470**	(2,322)	312	117	235
	380,668	490,607	443,865	428,702	440,109
Proposed dividends	**–**	213,360	182,880	182,880	182,880
Earnings per share attributable to owners of the Company (RMB)	**0.622**	0.809	0.728	0.703	0.722
Assets & Liabilities					
Total assets	**4,367,751**	3,640,177	3,073,693	2,667,700	2,288,547
Total liabilities	**(1,500,441)**	(967,764)	(726,477)	(581,469)	(449,608)
	2,867,310	2,672,413	2,347,216	2,086,231	1,838,939
Capital and reserves					
Equity attributable to owners of the Company	**2,819,092**	2,653,153	2,082,747	1,837,042	1,519,088
Non-controlling interests	**48,218**	19,260	3,484	1,897	6,662
	2,867,310	2,672,413	2,086,231	1,838,939	1,525,750