



YANION INTERNATIONAL HOLDINGS LIMITED

(Incorporated in Bermuda with limited liability)

Interim

Report

2004

CONTENTS

	<i>Page</i>
Corporate Information	2
Condensed Consolidated Profit and Loss Account	3
Condensed Consolidated Balance Sheet	4
Condensed Statement of Changes in Equity	5
Condensed Consolidated Cash Flow Statement	6
Notes to Condensed Consolidated Interim Financial Statements	7
Management Discussion and Analysis	17
Audit Committee	20
Directors' and Chief Executive's Interests in the Securities of the Company and its Associated Corporations	20
Directors' Rights to Acquire Shares	21
Substantial Shareholders	21
Code of Best Practice	21
Model Code for Securities Transactions	21
Purchase, Sale or Redemption of the Company's Listed Securities	22

CORPORATE INFORMATION

HONORARY DIRECTOR

Xia Zhi Wu

DIRECTORS

Executive Directors

Cheng Shu Wing

Guo Duen How, Tom

Kao Ying Lun

Wu Fred Fong

Independent non-executive Directors

Choy Tak Ho

Tsui Chun Chung, Arthur

COMPANY SECRETARY

Wu Fred Fong, MBA, FCPA

AUDITORS

Horwath Hong Kong CPA Limited

LEGAL ADVISOR

Chiu & Partners

Heller Ehrman White & McAuliffe

PRINCIPAL BANKERS

Bank of China (Hong Kong) Limited

DBS Bank (Hong Kong) Limited

Belgian Bank

The Hongkong and Shanghai Banking
Corporation Limited

REGISTRARS

Butterfield Fund Services (Bermuda) Limited

Rosebank Centre

11 Bermudiana Road

Pembroke, Bermuda

REGISTRARS IN HONG KONG

Tengis Limited

Ground floor, BEA Harbour View Centre

56 Gloucester Road

Wanchai, Hong Kong

REGISTERED OFFICE

Canon's Court, 22 Victoria Street

Hamilton, HM12, Bermuda

PRINCIPAL PLACE OF BUSINESS

3506 Gloucester Tower

The Landmark, 11 Pedder Street

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GENERAL

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Stock Code: 82

The board of directors of Yanion International Holdings Limited (the “Company”) is pleased to announce that the unaudited condensed consolidated interim results of the Company and its subsidiaries (the “Group”) for the six months ended 30 June 2004 as follows:

CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Notes	Six months ended 30 June	
		2004 (Unaudited) HK\$'000	2003 (Unaudited) HK\$'000
TURNOVER	3		
Continuing operations		12,622	16,785
Discontinuing operations		–	67,531
		<u>12,622</u>	<u>84,316</u>
Cost of sales		<u>(8,166)</u>	<u>(69,316)</u>
Gross profit		4,456	15,000
Other revenue		54	1,372
Selling and distribution costs		(6,373)	(7,094)
Administrative expenses		(22,655)	(26,580)
Amortisation of goodwill		(5,141)	(5,141)
Provision for impairment in value of fixed assets		–	(8,188)
		<u>(29,659)</u>	<u>(30,631)</u>
LOSS FROM OPERATING ACTIVITIES			
Finance costs		<u>(748)</u>	<u>(380)</u>
LOSS BEFORE TAX	4		
Continuing operations		(30,407)	(10,970)
Discontinuing operations		–	(20,041)
		<u>(30,407)</u>	<u>(31,011)</u>
Taxation	5		
Continuing operations		–	–
Discontinuing operations		–	(46)
		<u>–</u>	<u>(46)</u>
LOSS BEFORE MINORITY INTERESTS		<u>(30,407)</u>	<u>(31,057)</u>
Minority interests		<u>4,662</u>	<u>(802)</u>
NET LOSS FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS		<u>(25,745)</u>	<u>(31,859)</u>
LOSS PER SHARE	6		
Basic		<u>(4.5 cents)</u>	<u>(5.6 cents)</u>
Diluted		<u>N/A</u>	<u>N/A</u>

CONDENSED CONSOLIDATED BALANCE SHEET

	Notes	As at 30 June 2004 (Unaudited) HK\$'000	As at 31 December 2003 (Audited) HK\$'000
NON-CURRENT ASSETS			
Fixed assets	8	10,034	10,831
Intangible assets	9	31,543	33,537
Goodwill	10	83,116	88,257
		<u>124,693</u>	<u>132,625</u>
CURRENT ASSETS			
Inventories		7,063	10,159
Accounts receivable	11	6,011	13,867
Deposit for investment	12	48,879	48,879
Prepayments and other receivables		5,205	7,035
Cash and cash equivalents		12,968	2,980
		<u>80,126</u>	<u>82,920</u>
CURRENT LIABILITIES			
Accounts payable	13	2,545	2,386
Other payables and accruals		22,857	23,074
Due to related companies		–	896
Interest-bearing bank loans and other borrowings		20,606	20,606
		<u>46,008</u>	<u>46,962</u>
NET CURRENT ASSETS		<u>34,118</u>	<u>35,958</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		158,811	168,583
NON-CURRENT LIABILITIES			
Convertible notes	14	21,500	–
Interest-bearing bank loans and other borrowings		1,991	1,991
		<u>23,491</u>	<u>1,991</u>
MINORITY INTERESTS		<u>36,143</u>	40,805
		<u>99,177</u>	<u>125,787</u>
CAPITAL AND RESERVES			
Share capital	15	5,717	5,717
Reserves		93,460	120,070
		<u>99,177</u>	<u>125,787</u>

CONDENSED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium account	Contributed surplus	Statutory surplus reserve	Enterprise development fund	Exchange fluctuation reserve	Retained profits/ (Accumulated losses)	Total (Unaudited)
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2004	5,717	82,700	33,474	957	478	(606)	3,067	125,787
Convertible note issue costs	-	(865)	-	-	-	-	-	(865)
Net loss for the period	-	-	-	-	-	-	(25,745)	(25,745)
At 30 June 2004	5,717	81,835	33,474	957	478	(606)	(22,678)	99,177
At 1 January 2003	285,825	315,215	33,474	957	478	11	(456,950)	179,010
Capital reduction	(280,108)	-	-	-	-	-	280,108	-
Share premium reduction (note i)	-	(232,515)	-	-	-	-	232,515	-
Net loss for the period	-	-	-	-	-	-	(31,859)	(31,859)
At 30 June 2003	5,717	82,700	33,474	957	478	11	23,814	147,151

Notes:

- i. Pursuant to the special resolutions passed on the annual general meeting of the Company held on 30 May 2003, the share premium account of the Company would be reduced by an amount of not more than HK\$315,215,000. Upon the passing of the special resolutions, the Directors have applied \$232,515,000 from the share premium account to set off an equivalent amount of accumulated losses of the Company as at 31 December 2002.

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Six months ended 30 June	
	2004	2003
	(Unaudited)	(Unaudited)
	HK\$'000	HK\$'000
NET CASH OUTFLOW FROM OPERATING ACTIVITIES	(10,368)	(15,134)
NET CASH OUTFLOW FROM INVESTING ACTIVITIES	(279)	(3,000)
NET CASH INFLOW FROM FINANCING ACTIVITIES	20,635	2,152
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	9,988	(15,982)
Cash and cash equivalents at beginning of the period	2,980	27,020
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	12,968	11,038
 ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS		
Cash and bank balances	12,968	13,147
Bank overdrafts	-	(949)
Trust receipts and export loans with maturity within three months	-	(1,160)
	12,968	11,038

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

1. BASIS OF PREPARATION

In preparing the financial statements, the directors have given careful consideration to the following which would likely impact on the future operation and going concern of the Group.

As required by the relevant PRC regulation, all pharmaceutical manufacturers in the PRC must have obtained the Good Manufacturing Practice (“GMP”) certification by 30 June 2004 in order to manufacture and sell medicinal products. Due to a compulsory reclamation by the Beijing City Government of the land on which the manufacturing plant of Huayi Pharmaceutical Co., Ltd (“Huayi”) was located, the Huayi plant had to be relocated in June 2004. Consequently, this affected Huayi’s plan to obtain the GMP certification by the deadline. Huayi was granted an extension until the end of the year to comply with the regulation. The Group is of the reasonable belief that the resumption of Huayi’s manufacturing plant meeting GMP standards will be achieved before the extended deadline. Accordingly, the financial statements have been prepared on a going concern basis.

2. PRINCIPAL ACCOUNTING POLICIES

The unaudited condensed consolidated interim financial statements have been prepared in accordance with Hong Kong Statement of Standard Accounting Practice (“SSAP”) 25, Interim Financial Reporting, issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), and requirements of Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the “Listing Rules”).

The accounting policies and methods of computation used in the preparation of the unaudited condensed consolidated interim financial statements are consistent with those used in the annual financial statements for the year ended 31 December 2003. The condensed interim financial statements should be read in conjunction with the Company’s 2003 annual report.

3. SEGMENT INFORMATION

(a) Business segments

All the revenue and assets for the Group's business segments for the six months ended 30 June 2004 were derived from the manufacture, trading and contracting of Chinese medicine products.

The revenue and results for the Group's business segments for the six months ended 30 June 2003 is presented as follows.

	Discontinuing				Consolidated
	Manufacture, trading and contracting of Chinese medicine products 2003 <i>HK\$'000</i>	Trading of Internet phone sets and provision of related services 2003 <i>HK\$'000</i>	Manufacture and trading of CD/VCD players and mechanisms, amplifiers, computer peripherals 2003 <i>HK\$'000</i>	Manufacture and trading of car audio mechanisms, cassette deck mechanisms, personal office appliance and related products 2003 <i>HK\$'000</i>	
Segment revenue:					
Sales to external customers	16,784	–	52,950	14,582	84,316
Segment results	(4,183)	(27)	(17,077)	(2,578)	(23,865)
Interest income					96
Unallocated expenses					(6,862)
Loss from operating activities					(30,631)
Finance costs					(380)
Loss before tax					(31,011)
Taxation					(46)
Loss before minority interests					(31,057)
Minority interests					(802)
Net loss from ordinary activities attributable to shareholders					(31,859)

(b) Geographical segments

All the revenue and assets for the Group's geographical segments for the six months ended 30 June 2004 were derived from the PRC.

The revenue and results for the Group's geographical segments for the six months ended 30 June 2003 is presented as follow.

	Hong Kong	PRC	Other Asian countries	Europe	America	Consolidated
	2003	2003	2003	2003	2003	2003
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Segment revenue:						
Sales to external customers	<u>7,580</u>	<u>20,570</u>	<u>1,413</u>	<u>22,604</u>	<u>32,149</u>	<u>84,316</u>
Segment results	<u>(1,353)</u>	<u>(4,905)</u>	<u>(378)</u>	<u>(7,228)</u>	<u>(10,001)</u>	<u>(23,865)</u>

4. LOSS BEFORE TAX

Loss before tax is arrived at after charging/(crediting) the followings:

	Six months ended 30 June	
	2004	2003
	<i>HK\$'000</i>	<i>HK\$'000</i>
Other revenue:		
Interest income	(3)	(96)
Other income	<u>(51)</u>	<u>(1,276)</u>
	<u>(54)</u>	<u>(1,372)</u>
Finance costs:		
Interest on bank loans, overdrafts and other borrowings wholly repayable within five years	748	363
Interest on finance leases	<u>-</u>	<u>17</u>
	<u>748</u>	<u>380</u>
Amortisation of Chinese medicine intellectual property and knowhow	1,994	1,994
Provision against inventories	2,841	2,876
Provision for doubtful accounts	9,047	-
Loss on disposal of fixed assets	-	1,275
Staff costs (excluding directors' remuneration)	3,271	12,946
Depreciation	<u>1,087</u>	<u>6,121</u>

5. TAXATION

No provision has been made as the Group sustained tax losses during the six months ended 30 June 2004. Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

	Six months ended 30 June	
	2004	2003
	HK\$'000	HK\$'000
Hong Kong profits tax	<u> -</u>	<u> 46</u>

6. LOSS PER SHARE

The calculation of basic loss per share is based on the net loss from ordinary activities attributable to shareholders for the period of HK\$25,745,000 (Six months ended 30 June 2003: HK\$31,859,000) and the weighted average of 571,650,673 (Six months ended 30 June 2003: 571,650,673) ordinary shares in issue during the period.

Diluted loss per share for the six months ended 30 June 2003 and 30 June 2004 have not been shown as the convertible notes issued during the period had an anti-dilutive effect on the basic loss per share for both periods.

7. DIVIDENDS

The directors of the Company do not recommend the payment of any interim dividend for the six months ended 30 June 2004 (Six months ended 30 June 2003: Nil).

8. FIXED ASSETS

	30 June 2004 HK\$'000	31 December 2003 HK\$'000
Net book value at beginning of period/year	10,831	53,826
Additions	290	7,322
Disposals	–	(31,525)
Disposal of subsidiaries	–	(26,016)
Depreciation	(1,087)	(10,429)
Depreciation write back on disposal	–	25,699
Impairment	–	(8,046)
	<hr/> 10,034	<hr/> 10,831

9. INTANGIBLE ASSETS

	30 June 2004 HK\$'000	31 December 2003 HK\$'000
Balance at beginning of period/year	33,537	22,705
Additions of Chinese medicine intellectual property and knowhow	–	14,019
Amortisation for the period/year	(1,994)	(3,187)
	<hr/> 31,543	<hr/> 33,537

10. GOODWILL

	30 June 2004 HK\$'000	31 December 2003 HK\$'000
Balance at beginning of period/year	88,257	98,539
Amortisation for the period/year	(5,141)	(10,282)
	<hr/> 83,116	<hr/> 88,257

11. ACCOUNTS RECEIVABLE

The Group maintains a defined credit policy and allows credit periods ranged from 15 to 90 days to its trade customers. Under exceptional cases, the Group may extend credits to specific customer for periods beyond 90 days upon special approval. The Group seeks to maintain strict control over its outstanding receivables. Overdue balances are reviewed and monitored by senior management.

An aged analysis of accounts receivable based on payment due date and net of provisions is as follows:

	30 June 2004 HK\$'000	31 December 2003 HK\$'000
Within 1 month	1,986	1,301
2 to 3 months	1,700	858
4 to 6 months	603	736
7 to 12 months	232	467
Over 1 year	1,490	10,505
	<hr/> 6,011 <hr/>	<hr/> 13,867 <hr/>

12. DEPOSIT FOR INVESTMENT

On 21 March 2003, Huayi has entered into an agreement to acquire from an independent third party (i) 40% equity interest in two Sino-foreign joint venture companies and (ii) the right of exploitation of wild herbs (collectively referred to as the "investment") at a total consideration of approximately HK\$67,888,000. The purpose of the investment is to develop a Chinese medicinal centre and wild herbs harvesting area. Partial payments for consideration aggregating to approximately HK\$48,879,000 were made in July 2003. The vendor has agreed with Huayi on 31 December 2003 that the balance of consideration in the amount of approximately HK\$19,009,000 be payable by 31 May 2004. The current status of the Investment is detailed in note 20.

13. ACCOUNTS PAYABLE

An aged analysis of accounts payable based on payment due date is as follows:

	30 June 2004 HK\$'000	31 December 2003 HK\$'000
Within 1 month	171	611
2 to 3 months	184	115
4 to 6 months	652	163
7 to 12 months	99	31
Over 1 year	1,439	1,466
	<u>2,545</u>	<u>2,386</u>

14. CONVERTIBLE NOTES

On 20 April 2004, the Company has entered into a subscription agreement with DBS Bank Limited ("DBS"), whereby DBS has agreed to conditionally subscribe in tranches for an aggregate principal amount of up to HK\$24,940,000 of unsecured convertible notes for the period ending on 15 June 2004. On 26 April 2004, a convertible note in the amount of HK\$21,500,000 was issued. The note shall mature on 30 April 2006, unless redeemed earlier by the Company or converted into shares by the noteholder prior to the maturity date. The note has a coupon interest rate of 2% per annum and may be convertible into new conversion shares of the Company at a conversion price of HK\$0.43 per share.

15. SHARE CAPITAL

	30 June 2004 HK\$'000	31 December 2003 HK\$'000
<i>Authorized:</i>		
50,000,000,000 ordinary shares of HK\$0.01 each	<u>500,000</u>	<u>500,000</u>
<i>Issued and fully paid:</i>		
571,650,673 ordinary shares of HK\$0.01 each	<u>5,717</u>	<u>5,717</u>

16. RELATED PARTY TRANSACTIONS

Set out below are the related party transactions disclosed in accordance with SSAP 20 issued by the HKICPA.

	Six months ended 30 June	
	2004	2003
	HK\$'000	HK\$'000
Rental expenses paid/payable to related companies	540	2,765
Purchases of raw materials from a related company	–	272
Rental expenses paid/payable to a director	–	360
Consultancy fees paid/payable to a related company	–	450
	–	450

17. CONNECTED TRANSACTIONS

In addition to the related party transactions disclosed in note 16 which also constituted connected transactions under the Listing Rules, the following transactions constituted connected transactions under the Listing Rules.

		Six months ended 30 June	
		2004	2003
	<i>Note</i>	HK\$'000	HK\$'000
Purchase of raw materials/herbs from China National Group Corp. of Traditional and Herbal Medicine (“China National Medicine”)	(i)	837	–
Sales of medicinal products to China National Medicine		–	1,608
Accrual of balance of purchase consideration relating to intellectual and operating rights of twelve Chinese medicines from a minority interest, Huahe Pharmaceutical Co., Ltd. (“Huahe”)		–	9,346
Purchase of raw materials/herbs from Huahe		–	2,780
		–	2,780

(i) *China National Medicine is the controlling shareholder of Huahe.*

18. OPERATING LEASE ARRANGEMENTS

	Six months ended 30 June	
	2004	2003
	HK\$'000	HK\$'000
Minimum lease payments paid under operating leases	3,057	6,572
Less: Amount capitalised	—	(199)
	<u>3,057</u>	<u>6,373</u>
	30 June	31 December
	2004	2003
	HK\$'000	HK\$'000
Total future minimum lease payments under non-cancellable operating leases in respect of its land and buildings falling due:		
Within one year	1,962	3,084
In the second to fifth years, inclusive	—	375
	<u>1,962</u>	<u>3,459</u>

19. CAPITAL COMMITMENTS

	30 June	31 December
	2004	2003
	HK\$'000	HK\$'000
Contracted, but not provided for:		
Acquisition of investment	<u>19,009</u>	<u>19,009</u>

20. CONTINGENT LIABILITIES

As detailed in note 12, Huayi has contracted to acquire 40% equity interest in two Sino-foreign joint venture companies and the right of exploitation of wild herbs. As at 30 June 2004, a balance of approximately HK\$19,009,000 remained outstanding and was recognized as a capital commitment (note 19).

Owing to a change in management nominated by the minority shareholder of Huayi and competing financial resources due to the relocation and upgrade of manufacturing plants to GMP standards as explained elsewhere in this report, there is the uncertainty in the ability of Huayi to obtain adequate funding to settle the remaining consideration. In accordance with the sale and purchase agreement, the vendor has the right to cancel the acquisition and claim for losses to the extent the vendor has suffered, which is not quantifiable at present. Notwithstanding the above, negotiation with the vendor is on going to find a mutually satisfactory resolution which would minimize the losses to the Group.

21. APPROVAL OF THE INTERIM FINANCIAL STATEMENTS

The unaudited condensed consolidated interim financial statements were approved and authorized for issue by the board of directors on 17 September 2004.

MANAGEMENT DISCUSSION AND ANALYSIS

Business Review

Turnover of the Group for the six months period ended 30 June 2004 was HK\$12,622,000 (as compared to the corresponding period last year of HK\$84,316,000). Loss attributable to shareholders for the period was HK\$25,745,000 (HK\$31,859,000 for the corresponding period last year). Subsequent to the disposal of the electronics business, the Group operated in a streamlined structure. Turnover decreased significantly from last year primarily reflecting the exclusion of revenues from the discontinued electronics business. Net loss attributable to shareholders also decreased from that of the same period last year.

Pharmaceutical Business

As reported in the Company's 2003 interim and annual reports, the Huayi's plant, located at Zhong Guan Cun, Haidian District, Beijing (北京中關村海澱區) had to be relocated to make way for new infrastructure and main roads pursuant to the Beijing City Re-development plan. The untimely and uncontested land reclamation by the government seriously affected Huayi's application for GMP approval which was originally required to be completed by the industry deadline of 30 June 2004. However, in consideration of Huayi's plant relocation as an extenuating circumstances, the authority granted an extension of Huayi's GMP approval process to conclude by the end of December 2004.

Sales of Chinese medicine for the first half year was HK\$12,622,000, representing a 25% reduction from the same period of last year. The lower level sales was due to the significant event that the Huayi's manufacturing plant had to be temporarily shut down for two months in preparation for the relocation. In anticipation of the shutdown, no new products were proposed to be launched during the period. Despite the Group's effort in business restructuring, the less than optimal operating level resulted in a high net loss for the period due to unabsorbed fixed costs and extra relocation related expenses.

To reduce the negative impact of the temporary plant shutdown, Huayi's management began during the period to implement a skeleton organization structure to keep costs down. This is meant to be an interim measure to conserve resources. Huayi operating management has also made initial arrangements to upgrading certain manufacturing facilities at the plant at Beijing Huamiao Chinese Medicine Engineering Technology Development Center (北京華邈中藥工程技術開發中心), a related company of Huayi. This arrangement has been confirmed to be acceptable to the State Drug Administration of the Beijing office. It is aimed at allowing Huayi to obtain the GMP approval before the extended deadline and to resume normal medicine production. The Huayi board will monitor and review progress and formalize the arrangement in due course. Despite such effort, it is expected that the resumption will take a few months and revenues for the balance of the year will be at a minimal level.

Geographically, the Group's sales in the first half of 2004 comprised only of medicinal products and were sold entirely in the PRC. This compares to the same period in 2003 where the Group's products (including products from discontinued operations) were sold to America, Europe, China, Hong Kong and other Asian countries (representing 38%, 27%, 24%, 9% and 2% respectively of the total turnover in that period).

Liquidity and financial resources

In April 2004, the Company issued an unsecured convertible note to an independent financial institution in the amount of HK\$21,500,000. The note has a coupon interest of 2% per annum and shall mature on 30 April 2006. The note may be convertible into shares of the Company at a conversion price of HK\$0.43 per share. If the noteholder should exercise its right to fully convert the note, 50,000,000 new shares shall be issued. Net proceeds from the note of approximately HK\$20,800,000 improved the working capital position of the Group.

Despite financing activities from the convertible note, during the period under review, the temporary plant shutdown and the loss from operation put significant pressure on the Group's cash flow and affected its original capital commitment plan. At present, the issue relating to compensation for Huayi's plant relocation, which is being negotiated by the Chinese party to the Huayi joint venture with the government, has not been finalized. The compensation is generally expected to compensate Huayi for production stoppage and costs incurred for plant relocation and facility removal. Despite such compensation, which would enhance the working capital position of Huayi, Huayi must reconsider its capital commitment plan and need to prioritize the execution of its business and development plans to ensure, first and foremost, the GMP status shall be achieved prior to the end of the year. Difficult choices have to be made by Huayi due to competing financial resources. These included delaying the balance of an investment of HK\$19,009,000 on another business development project previously contracted for. This delay created a contingent liability against which Huayi must negotiate with the counter party to the contract to minimize its losses as detailed in the notes to the financial statements. At the same time, to conserve cash and as an alternative to committing to build a new plant, the Group had proposed that Huayi to consider the leasing alternative for acquiring its future manufacturing capability. Nevertheless, the fact that the GMP approval is paramount to Huayi means all other capital or investment plans and commitments must be put on hold and organization downsized until Huayi's production capability shall first be resumed, expected by 31 December of this year.

As at 30 June 2004, the Group had cash and cash equivalent balance of approximately HK\$12,900,000. At period end, the current ratio (represented by total current assets to total current liabilities) of the Group was 1.74. Of the total borrowings included in current liabilities, approximately HK\$20,600,000 will become due at 31 December 2004. Efforts will be made by the Company to engage early in the restructuring or extending the maturity of the loan. As both the short-term loan and the convertible note are denominated in Hong Kong dollar currency and have fixed interest rates, management believes that, for risk management purposes, no hedging of foreign currency or interest rate is considered necessary.

Pledge of assets and corporate guarantees

As a consequence of the Group's business restructuring and disposal of the electronics business at the end of the previous year, as of 30 June 2004, there were no contingencies relating to the pledged of assets and corporate guarantees provided by the Company for credit facilities granted to its subsidiaries.

Capital structure and gearing

As at 30 June 2004, the issued shares of the Company was 571,650,673 shares and the shareholders' equity amounted to approximately HK\$99,177,000. Due to the issue of the convertible note in April, the capital structure of the Company may be increased by the addition of 50,000,000 new shares convertible at an exercise price of HK\$0.43 per share should the noteholder elects to exercise its conversion right under the note. As at 30 June 2004, the overall gearing ratio (represented by the ratio of total liabilities to shareholders' equity) of the Group was approximately 70%.

Prospects

The PRC economy is enjoying steady growth and disposable income of households is increasing. The effect from the recent macro-economic control measures in the PRC would contribute to stabilize the economy and build the foundation for long-term growth. As the pharmaceutical industry in the PRC is undergoing a major regulatory transformation to protect the consumers and to introduce the quality control system to guard the industry standards, in the long run, the Chinese pharmaceutical industry is expected to prosper. Despite inhibiting circumstances in Huayi's business development due to the temporary relocation and re-prioritization of future business development plan, the Group continues to view the PRC market at large as one that offers potential in the developing pharmaceutical and other investment opportunities for growth. The Group will, in favourable capital market conditions, consider to raise additional capital to strengthen its capital base and increase its working capital for future business development purposes.

Employees

As at 30 June 2004, there were approximately 270 management, administrative, production and selling staff located in Hong Kong and the PRC. The Company has adopted an employee share option scheme and housing benefits were provided for certain Hong Kong and PRC employees. Salaries of employees were determined taking into account job performance and professional experience of the employees concerned and the general practice within the industry. Since December 2000, all employees and directors in Hong Kong Special Administrative Region have joined the mandatory provident fund scheme implemented by the Hong Kong Special Administrative Region.

AUDIT COMMITTEE

The audit committee, comprises the independent non-executive directors of the Company, has examined, together with the management, the accounting policies and practice adopted by the Group, and discussed and reviewed the financial statements of the unaudited condensed consolidated interim results of the Group for the six months ended 30 June 2004.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS IN THE SECURITIES OF THE COMPANY AND ITS ASSOCIATED CORPORATIONS

(a) Shares Capital

As at 30 June 2004, the directors and their associates had the following interests and short positions in the shares, underlying shares and debentures of the Company or any associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), as recorded in the register required to be kept pursuant to section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of the Listed Companies (the "Model Code"):

Name of director	Number of ordinary shares
	in the Company Personal interest
Cheng Shu Wing	100,000
Guo Duen How, Tom	2,800,000
Kao Ying Lun	5,000,000
Wu Fred Fong	5,000,000

(b) Share Option Scheme

Pursuant to ordinary resolutions passed on 7 June 2002, the Company approved the adoption of a new share option scheme (the "New Scheme"). Under the New Scheme, the Directors may, at their discretion, invite any eligible participants to take up options to subscribe for shares in the capital of the Company. During the period, no share option was granted by the Company. As at 30 June 2004, there was no share option outstanding.

Save as disclosed above, as at 30 June 2004, none of the directors or the chief executive of the Company and their associates had any interests or short positions in the shares, underlying shares and debentures of the Company or 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 under section 352 of the SFO; or notified to the Company and the Stock Exchange pursuant to the Model Code.

DIRECTORS' RIGHTS TO ACQUIRE SHARES

At no time during the period was the Company or any of its subsidiaries a party to any arrangement to enable the directors of the Company, their respective spouses, or children under 18 years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

SUBSTANTIAL SHAREHOLDERS

As at 30 June 2004, save as disclosed below and other than the directors and chief executive of the Company and the companies controlled by them whose interests are disclosed above, the Company did not aware of any shareholder had any interests or short positions in the shares and underlying shares as recorded in the register required to be kept by the Company under section 336 of SFO.

Long position in the shares of the Company

Name of shareholder	Number of issued shares held	% of the issued share capital
DBS Bank Ltd.	58,000,000	10.15%
Leung Wah Chai and his associates	52,614,350	9.20%
Noble Dynasty Limited	50,590,000	8.85%
Grimwood Enterprises Limited	47,450,000	8.30%

CODE OF BEST PRACTICE

None of the directors of the Company is aware of information that would reasonably indicate that the Company is not, or was not for any part of the period for the six months ended 30 June 2004, in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules. The non-executive Directors of the Company are subject to retirement by rotation and re-election at the Company's annual general meeting in accordance with the Bye-Laws of the Company.

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted the Model Code as set out in Appendix 10 of the Listing Rules during the period for the six months ended 30 June 2004. Having made specific enquiry of all directors, each of whom has complied with the required standard set out in the Model Code regarding securities transactions by the directors.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

There was no purchase, sale or redemption by the Company or any of its subsidiaries of the Company's listed securities during the six months ended 30 June 2004.

On behalf of the Board

Wu Fred Fong

Executive Director

Hong Kong,
17 September 2004