1. GENERAL AND BASIS OF PREPARATION OF FINANCIAL STATEMENTS

The Company is a listed public limited company incorporated in Hong Kong and its shares are listed on The Stock Exchange of Hong Kong Limited (the ''Stock Exchange'').

The Company's ultimate holding company is Shijiazhuang Pharmaceutical Group Company Limited (''SPG''), a state-owned enterprise established under the laws of The People's Republic of China (the ''PRC''). SPG, together with the companies under its control, other than members of the Group, will hereinafter be referred to as the ''SPG Group''.

The Company's subsidiaries are principally engaged in the manufacture and sale of pharmaceutical products.

Although the Group had net current liabilities of HK$79,024,000 as at December 31, 2004, the directors are satisfied and believe that with the existing resources and bank facilities available to the Group as disclosed in note 36, the Group has sufficient working capital to meet in full its financial obligations as they fall due in the foreseeable future. Accordingly, the financial statements have been prepared on a going concern basis.

2. POTENTIAL IMPACT ARISING FROM THE RECENTLY ISSUED ACCOUNTING STANDARDS

In 2004, the Hong Kong Institute of Certified Public Accountants (''HKICPA'') issued a number of new or revised Hong Kong Accounting Standards and Hong Kong Financial Reporting Standards (hereinafter collectively referred to as ''new HKFRSs'') which are effective for accounting periods beginning on or after January 1, 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended December 31, 2004.

Management is assessing, but has not yet determined, the potential impact of these new HKFRSs will have on its financial position and results of operations. These new HKFRSs may result in changes in the future as to how the results and financial position are presented.

3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention and in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are as follows:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to December 31 each year.

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

Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary at the date of acquisition.

3. SIGNIFICANT ACCOUNTING POLICIES – continued

Goodwill – continued

Goodwill arising on acquisitions prior to January 1, 2001 continues to be held in reserves, and will be charged to the income statement at the time of disposal of the relevant subsidiary or at such time as the goodwill is determined to be impaired.

Goodwill arising on acquisitions on or after January 1, 2001 is capitalised and amortised on a straight-line basis over its estimated useful economic life. Goodwill arising on the acquisition of subsidiaries is presented separately in the balance sheet.

Revenue recognition

Sales of goods are recognised when goods are delivered and title has passed.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the interest rate applicable.

Service income is recognised when services are rendered.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

Investments in subsidiaries

Investments in subsidiaries are included in the Company's balance sheet at cost less any identified impairment losses.

Jointly controlled entity

Joint venture arrangements which involve the establishment of a separate entity in which each venturer has an interest are referred to as a jointly controlled entity.

The Group's interests in a jointly controlled entity are included in the consolidated balance sheet at the Group's share of the net assets of the relevant jointly controlled entity less any identified impairment loss. The Group's share of post-acquisition results of the jointly controlled entity is included in the consolidated income statement.

Property, plant and equipment

Construction in progress is stated at cost which includes all construction costs and other direct costs, including borrowing costs capitalised attributable to such projects. Construction in progress is not depreciated until completion of construction. Costs on completed construction works are transferred to the relevant category of property, plant and equipment.

Property, plant and equipment other than construction in progress are stated at cost less accumulated depreciation and amortisation and accumulated impairment losses.

3. SIGNIFICANT ACCOUNTING POLICIES – continued

Property, plant and equipment – continued

Depreciation and amortisation are provided to write off the cost of items of property, plant and equipment other than construction in progress over their estimated useful lives, and after taking into account their estimated residual value, using the straight-line method, at the following rates per annum:

Buildings in the PRC	3.3% – 5%
Plant and machinery	5% – 10%
Furniture, fixtures and office equipment	20%
Motor vehicles	20%

The cost of land use rights is amortised on a straight-line basis over the period of the rights.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement.

Intangible assets

The cost of technical know-how is measured initially at cost and amortised on a straight-line basis over its estimated useful life.

The cost of rights to use utilities is measured initially at cost and amortised on a straight-line basis over their estimated useful 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 expenditure is recognised only if it is anticipated that the development costs incurred on a clearly defined project will be recovered through future commercial activity. The resultant asset is amortised on a straight-line basis over its estimated useful life.

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it incurred.

Impairment

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such 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 in prior years. A reversal of an impairment loss is recognised as income immediately.

3. SIGNIFICANT ACCOUNTING POLICIES – continued

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

Foreign currencies

Transactions in foreign currencies are initially recorded at the rates of exchange prevailing on the dates of the transactions or at the contracted settlement rate. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rates prevailing on the balance sheet date. Profits and losses arising on exchange are included in net profit or loss for the year.

On consolidation, the assets and liabilities of the Group's PRC subsidiaries and jointly controlled entity are translated at exchange rates prevailing on the balance sheet date. Income and expenses items are translated at the average exchange rates for the year as quoted by the People's Bank of China, the PRC. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

Taxation

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 net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years, and it further excludes income statement items that are never taxable or deductible.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such 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 arising on investments in subsidiaries and interests in joint ventures, 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.

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

3. SIGNIFICANT ACCOUNTING POLICIES – continued

Borrowing costs

Borrowing 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 capitalised as part of the cost of those assets. Capitalisation of such borrowing costs ceases when 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 capitalised.

All other borrowing costs are recognised as an expense in the period in which they are incurred.

Retirement benefits scheme contributions

Payments to Mandatory Provident Fund Scheme and state-managed retirement benefit scheme are charged as an expense as they fall due.

Operating leases

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the period of the relevant leases.

4. TURNOVER AND SEGMENT INFORMATION

Turnover represents the net amounts received and receivable for goods sold by the Group to outside customers, and is stated net of value-added tax and sales returns during the year.

In accordance with the Group's internal financial reporting, the Group has determined business segments are its primary reporting format and geographical segments are its secondary reporting format.

Business segments

The Group reports its primary segment information by products which are bulk drugs, including vitamin C series, penicillin series and cephalosporin series, finished drugs and others. Segment information about these products is presented below:

4. TURNOVER AND SEGMENT INFORMATION – continued

Business segments – continued

2004

	Bulk Drugs						
	Vitamin C series HK$'000	Penicillin series HK$'000	Cephalosporin series HK$'000	Finished Drugs HK$'000	Others HK$'000	Eliminations HK$'000	Consolidated HK$'000
TURNOVER							
External sales	626,124	360,782	504,670	947,785	11,288	–	2,450,649
Inter-segment sales	–	184,779	90,872	–	–	(275,651)	–
TOTAL TURNOVER	626,124	545,561	595,542	947,785	11,288	(275,651)	2,450,649

Inter-segment sales are charged at prevailing market rates.

SEGMENT RESULT	189,694	5,307	34,625	67,965	(4,326)		293,265
Unallocated corporate expenses							(20,148)
Profit from operations							273,117
Finance costs							(27,959)
Share of profit of a jointly controlled entity					4,008		4,008
Profit before taxation							249,166
Income tax expenses							(3,774)
Profit before minority interests							245,392
Minority interests							(381)
Net profit for the year							245,011

4. TURNOVER AND SEGMENT INFORMATION – continued

Business segments – continued

The following is an analysis of the carrying amount of segment assets and segment liabilities, analysed by products:

2004

	Bulk Drugs					
	Vitamin C series	Penicillin series	Cephalosporin series	Finished Drugs	Others	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
ASSETS						
Segment assets	1,241,475	1,347,706	991,293	806,552	188,427	4,575,453
Interest in a jointly controlled entity					24,654	24,654
Unallocated corporate assets						107,139
Consolidated total assets						4,707,246
LIABILITIES						
Segment liabilities	280,761	249,335	238,228	511,793	24,970	1,305,087
Unallocated corporate liabilities						1,133,062
Consolidated total liabilities						2,438,149

	Bulk Drugs						
	Vitamin C series	Penicillin series	Cephalosporin series	Finished Drugs	Others	Corporate	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
OTHER INFORMATION							
Capital expenditure	426,620	660,978	230,017	85,929	72,062	30	1,475,636
Depreciation and amortisation	42,377	48,617	67,811	22,804	1,570	645	183,824

4. TURNOVER AND SEGMENT INFORMATION – continued

Business segments – continued

2003

	Bulk Drugs						
	Vitamin C series	Penicillin series	Cephalosporin series	Finished Drugs	Others	Eliminations	Consolidated
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
TURNOVER							
External sales	684,139	548,955	455,948	786,164	3,220	–	2,478,426
Inter-segment sales	–	193,327	84,835	–	–	(278,162)	–
TOTAL TURNOVER	684,139	742,282	540,783	786,164	3,220	(278,162)	2,478,426

Inter-segment sales are charged at prevailing market rates.

SEGMENT RESULT	349,271	118,011	47,987	124,033	(3,677)		635,625
Unallocated corporate expenses							(17,336)
Profit from operations							618,289
Finance costs							(25,361)
Share of profit of a jointly controlled entity					7,610		7,610
Profit before taxation							600,538
Income tax expenses							(94,978)
Profit before minority interests							505,560
Minority interests							(1,391)
Net profit for the year							504,169

4. TURNOVER AND SEGMENT INFORMATION – continued

Business segments – continued

The following is an analysis of the carrying amount of segment assets and segment liabilities, analysed by products:

2003

	Bulk Drugs					
	Vitamin C series	Penicillin series	Cephalosporin series	Finished Drugs	Others	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
ASSETS						
Segment assets	771,996	610,855	801,229	525,243	71,898	2,781,221
Interest in a jointly controlled entity					21,235	21,235
Unallocated corporate assets						559,328
Consolidated total assets						3,361,784
LIABILITIES						
Segment liabilities	105,829	285,236	263,185	128,432	6,572	789,254
Unallocated corporate liabilities						442,561
Consolidated total liabilities						1,231,815

	Bulk Drugs						
	Vitamin C series	Penicillin series	Cephalosporin series	Finished Drugs	Others	Corporate	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
OTHER INFORMATION							
Capital expenditure	213,826	28,529	32,170	43,148	5,488	2,030	325,191
Depreciation and amortisation	27,295	43,087	53,955	20,345	859	421	145,962
Impairment of intangible assets	–	–	10,878	–	–	–	10,878

4. TURNOVER AND SEGMENT INFORMATION – continued

Geographical segments

The Group's operations are located in the PRC, the following table provides an analysis of the Group's sales by geographical market:

	Turnover	
	2004	2003
	HK$'000	*HK$'000*
The PRC	**1,793,805**	1,801,751
Asia other than the PRC	**268,898**	278,619
Europe	**188,396**	178,656
America	**171,874**	130,881
Others	**27,676**	88,519
	2,450,649	2,478,426

Analysis of carrying amounts of segment assets and capital expenditure is not presented as over 90% of amounts involved are located in the PRC.

5. PROFIT FROM OPERATIONS

	2004	2003
	HK$'000	*HK$'000*
Profit from operations has been arrived at after charging:		
Staff costs including directors' remuneration	**189,938**	170,555
Retirement benefit scheme contributions	**36,470**	27,317
Total staff costs	**226,408**	197,872
Amortisation (included in administrative expenses) of:		
– intangible assets	**12,405**	13,770
– goodwill	**3,183**	3,168
Depreciation and amortisation of property, plant and equipment	**168,236**	129,024
Total depreciation and amortisation	**183,824**	145,962
Auditors' remuneration	**1,480**	1,350
Loss on disposal of property, plant and equipment	**5,553**	9,030
Research and development expenses	**4,501**	1,870
Impairment of intangible assets (included in other operating expenses)	**–**	10,878
and after crediting:		
Bank interest income	**2,454**	1,589

6. FINANCE COSTS

	2004	2003
	HK$'000	*HK$'000*
Bank loan arrangement fee	**1,364**	333
Interest on:		
– bank loans wholly repayable within five years	**13,937**	17,853
– other loans from connected parties wholly repayable within five years *(note 34 (I))*	**3,283**	980
– bills receivable discounted without recourse	**12,714**	6,195
Total borrowing costs	**31,298**	25,361
Less: interest capitalised in construction in progress	**(3,339)**	–
	27,959	25,361

Borrowing costs capitalised during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 2.6% to expenditure on qualifying assets.

7. DIRECTORS' EMOLUMENTS AND EMPLOYEES' EMOLUMENTS

	2004	2003
	HK$'000	*HK$'000*
DIRECTORS		
Directors' fees:		
Executive	**300**	380
Non-executive	**60**	–
Independent non-executive	**420**	360
	780	740
Other emoluments of executive directors:		
Salaries and other benefits	**6,897**	4,520
Performance related incentive payments *(note)*	**2,153**	2,755
Retirement benefits scheme contributions	**243**	24
	10,073	8,039

7. DIRECTORS' EMOLUMENTS AND EMPLOYEES' EMOLUMENTS – continued

The directors' emoluments were within the following bands:

	2004 Number of directors	2003 Number of directors
Nil to HK$1,000,000	**8**	7
HK$1,500,001 to HK$2,000,000	**–**	1
HK$2,000,001 to HK$2,500,000	**1**	1
HK$2,500,001 to HK$3,000,000	**1**	1
HK$3,000,001 to HK$3,500,000	**1**	–

Note: Performance related incentive payment is determined by management at discretion.

EMPLOYEES

Of the five highest paid individuals in the Group, four (2003: four) were directors of the Company whose emoluments are set out above. The emolument of the highest paid individual and the four highest paid directors is as follow:

	2004 *HK$'000*	2003 *HK$'000*
Fees	**180**	240
Salaries and other benefits	**7,175**	5,074
Performance related incentive payments	**2,020**	2,983
Retirement benefit scheme contributions	**262**	36
	9,637	8,333

	2004 No. of individuals	2003 No. of individuals
Emolument of the remaining highest paid individual was within the following band:		
Nil to HK$1,000,000	**1**	–
HK$1,000,001 to HK$1,500,000	**–**	1
	1	1

During the year, no emoluments were paid by the Group to the five (2003: five) highest paid individuals, including directors, as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors has waived any emoluments during the year.

8. INCOME TAX EXPENSES

	2004	2003
	HK$'000	*HK$'000*
The charge comprises:		
PRC Enterprise Income Tax		
– current year	**36,711**	102,862
– overprovision in prior years	**(11,393)**	(3,249)
– tax credits/refund	**(22,133)**	(5,697)
Taxation attributable to the Company and its subsidiaries	**3,185**	93,916
Share of taxation of a jointly controlled entity	**589**	1,062
	3,774	94,978

No Hong Kong Profits Tax is payable by the Company nor its Hong Kong subsidiaries since they had no assessable profit for the years.

Taxation arising in other jurisdictions is calculated at the prevailing rate in the relevant jurisdictions.

Pursuant to the relevant laws and regulations in the PRC, certain of the Group's PRC subsidiaries and its jointly controlled entity are entitled to exemption and relief from PRC income tax starting from their initial profit-making years.

In addition, pursuant to approvals granted by the relevant tax authorities, certain of the Group's subsidiaries were granted tax credits/refund which are mainly derived from the following activities:

A subsidiary of the Company was entitled to a tax refund on the basis that such subsidiary has, instead of making distributions to its foreign shareholders, re-invested certain distributable reserves as capital contribution to a subsidiary newly set up in the PRC.

Tax credits resulted from the purchase of plant and equipment manufactured in the PRC by certain subsidiaries of the Group. The tax credits are calculated with reference to 40% of the cost of the qualifying plant and equipment approved by the relevant tax authorities. Such credits can be used to offset against current and future tax charges of the subsidiaries, subject to certain conditions as specified in each approval from the relevant tax authorities.

The taxation charge for the year represents provision for income tax which has taken into account of the above-mentioned tax incentives.

8. INCOME TAX EXPENSES – continued

The tax charge for the year can be reconciled to the profit per the consolidated income statement as follows:

	2004	2003
	HK$'000	*HK$'000*
Profit before taxation	**249,166**	600,538
Tax at the average income tax rate of 21.5% (2003: 22.1%)	**53,649**	132,855
Tax effect of income not taxable for tax purpose	**(394)**	(1,859)
Tax effect of expenses not deductible for tax purpose	**13,632**	11,930
Tax effect of tax losses not recognised	**23**	119
Effect of tax exemption and relief granted to PRC subsidiaries	**(29,117)**	(38,357)
Effect of tax exemption and relief granted to a jointly controlled entity	**(493)**	(764)
Tax credits/refund granted to PRC subsidiaries	**(22,133)**	(5,697)
Overprovision in respect of prior years	**(11,393)**	(3,249)
Tax charge for the year	**3,774**	94,978

Note: The average income tax for the years ended December 31, 2004 and 2003 represent the weighted average tax rate of the operations in different regions and industries in the PRC on the basis of the relative amounts of net profit before taxation and the relevant statutory rates.

There was no significant unprovided deferred taxation for the year or at the balance sheet date.

9. DIVIDENDS

	2004	2003
	HK$'000	*HK$'000*
Interim dividend paid HK7.0 cents per share	–	107,669
Final dividend proposed HK7.0 cents per share	–	107,669
	–	215,338

No dividend was proposed by the directors for the year ended December 31, 2004.