

REPORT OF THE DIRECTORS

The directors have the pleasure in presenting their annual report together with the audited financial statements of Sanyuan Group Limited (the “Company”) and its subsidiaries (together the “Group”) for the year ended 31 December 2004.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. Its subsidiaries are currently and principally engaged in property investment and pharmaceutical/healthcare businesses.

The analysis of the principal activities of the operations of the Group during the year is set out in note 28 to the accompanying financial statements.

CUSTOMERS AND SUPPLIERS

During the year ended 31 December 2004, the five largest suppliers of the Group accounted for approximately 90% of the Group’s total purchases while the five largest customers of the Group accounted for approximately 32% of the Group’s total turnover. In addition, the largest supplier of the Group accounted for approximately 50% of the Group’s total purchases whilst the largest customer of the Group accounted for approximately 13% of the Group’s total turnover. None of the directors, their associates, or any shareholders (which to the knowledge of the directors owned more than 5% of the Company’s share capital) had a beneficial interest in the Group’s five largest customers or the five largest suppliers.

RESULTS AND APPROPRIATIONS

Details of the Group’s results for the year ended 31 December 2004 are set out in the consolidated income statement on page 21 of this annual report.

No interim dividend was paid to the shareholders of the Company during the year.

The board of directors of the Company does not recommend the payment of any final dividend for the year ended 31 December 2004 (2003: Nil).

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SUMMARY FINANCIAL INFORMATION

A summary of the results and of the assets and liabilities of the Group for the last five financial years, as extracted from the audited financial statements, is set out below:

	As at/For the year ended 31 December				
	2004 HK\$'000	2003 HK\$'000	2002 HK\$'000	2001 HK\$'000	2000 HK\$'000
Results					
Turnover	<u>1,169</u>	<u>1,355</u>	<u>6,785</u>	<u>25,215</u>	<u>42,498</u>
Profit (Loss) from operations	225,898	125,949	(115,781)	(265,731)	(383,775)
Finance costs	(9,641)	(29,450)	(24,875)	(37,518)	(64,117)
Share of results of associates	–	31	16	–	–
Profit (Loss) from ordinary activities before taxation	216,257	96,530	(140,640)	(303,249)	(447,892)
Taxation	–	6	806	771	–
Minority interests	1,290	(304)	441	4,267	505
Profit (Loss) attributable to shareholders	<u>217,547</u>	<u>96,232</u>	<u>(139,393)</u>	<u>(298,211)</u>	<u>(447,387)</u>
Assets and liabilities					
Property, plant and equipment	643	424	29,560	135,591	363,541
Deposit paid	–	–	–	–	5,000
Goodwill	–	–	1,548	1,548	11,200
Interest in associates	–	45	12,010	23,074	24,500
Investment securities	–	–	1	1	1
Net current liabilities	(48,589)	(308,101)	(447,287)	(423,742)	(201,274)
	(47,946)	(307,632)	(404,168)	(263,528)	202,968
Bank and other borrowings, non-current portion	–	–	–	–	(160,987)
Deferred taxation	–	–	–	(806)	(1,334)
Minority interests	–	(1,290)	(986)	(1,427)	(8,197)
Net (liabilities)/assets	<u>(47,946)</u>	<u>(308,922)</u>	<u>(405,154)</u>	<u>(265,761)</u>	<u>32,450</u>
Capital and reserves					
Issued capital	19,078	6,201	6,201	1,240,285	1,240,285
Reserves	57,176	3,789	3,789	479,279	479,279
Accumulated losses	(124,200)	(318,912)	(415,144)	(1,985,325)	(1,687,114)
	<u>(47,946)</u>	<u>(308,922)</u>	<u>(405,154)</u>	<u>(265,761)</u>	<u>32,450</u>

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SHARE CAPITAL

Details of share capital of the Company are set out in note 19 to the accompanying financial statements.

SHARE OPTION SCHEME

A new Company's share option scheme (the "Scheme") was approved by shareholders of the Company on 29 June 2004. The Scheme is yet to take effect and is subject to the Listing Committee of the Stock Exchange granting the approval of listing of and permission to deal in the shares of the Company which may be issued pursuant to the exercise of the options under the Scheme up to 10 per cent. of the total issued share capital of the Company as at the date of adoption of the Scheme. The following is a summary of the major terms of the Scheme:

- (i) The purpose of the Scheme is to provide the eligible participants with the opportunity to acquire proprietary interests in the Company and to encourage the eligible participants to work towards enhancing the value of the Company and its shares of the Company for the benefit of the Company and the shareholders of the Company as a whole.
- (ii) Eligible participants of the Scheme include employees, directors (including executive, non-executive and independent non-executive directors), shareholders, advisors and consultants of the Group.
- (iii) The Scheme, unless otherwise cancelled or amended, shall be valid and effective for a period of ten years commencing on the adoption date of the Scheme.
- (iv) The overall limit on the number of shares of the Company which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Scheme must not exceed 30 per cent. of the shares of the Company in issue from time to time.
- (v) The maximum number of shares of the Company issued and to be issued upon exercise of the options granted to any one eligible participant in any 12-month period must not exceed 1 per cent. of the shares of the Company in issue from time to time.
- (vi) The subscription price shall be determined by the board of directors (the "Board") of the Company in its absolute discretion and shall be no less than the highest of:
 - (a) the closing price of the share of the Company as stated in the daily quotations sheet issued by the Stock Exchange on the date of the grant;
 - (b) the average closing price of the share of the Company as stated in the daily quotations sheets issued by the Stock Exchange for the 5 trading days immediately preceding the date of grant; or
 - (c) the nominal value of the share of the Company on the date of grant.
- (vii) The options must be taken up within 30 days from the date on which the letter containing the offer to the eligible participant to take up an option is delivered to the eligible participant upon payment of HK\$1 and are exercisable over a period to be determined and notified by the Board to each grantee.

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RESERVES

Movements in reserves of the Group and the Company during the year are set out in note 20 to the accompanying financial statements.

In the opinion of the directors, the Company had no reserves available for distribution to shareholders at 31 December 2004 (2003: Nil).

PURCHASE, SALE OR REDEMPTION OF SHARES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed shares during the year ended 31 December 2004.

SUBSIDIARIES

Particulars of the Company's subsidiaries are set out in note 11 to the accompanying financial statements.

PROPERTY, PLANT AND EQUIPMENT

Details of movements in property, plant and equipment during the year are set out in note 9 to the accompanying financial statements.

BANK LOANS AND OVERDRAFTS

Particulars of bank loans and overdrafts as at 31 December 2004 are set out in note 15 to the accompanying financial statements.

BORROWING COST CAPITALIZATION

No borrowing cost was capitalized by the Group during the year (2003: Nil).

DIRECTORS AND DIRECTORS' SERVICE CONTRACTS

The directors who held office during the year and up to the date of this report were:

Executive:

Mr. Wu Kwai Yung (*Chairman*)
(*Appointed on 30 September 2004*)
Mr. Zhao Tie Liu (*Managing Director*)
(*Appointed on 30 September 2004*)
Dr. Wan Kwong Kee
Mr. Chan Peng Kuan
(*Resigned on 4 December 2004*)

Independent Non-executive:

Mr. Zhou Haijun
Mr. Ng Wai Hung
Mr. Xu Zhi
(*Appointed on 13 September 2004*)

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In accordance with article 103 of the Company's Articles of Association, Messrs. Wan Kwong Kee and Ng Wai Hung retire by rotation at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

The appointments of non-executive directors are not for specific terms. They are subject to retirement by rotation in accordance with the Company's Articles of Association.

None of the directors has an unexpired contract with the Company which is not terminable by the Company within one year without payment of compensation (other than statutory compensation).

INTERESTS IN EQUITY SECURITIES OF THE DIRECTORS AND CHIEF EXECUTIVE

As at 31 December 2004, the interests of the directors and the Company's chief executive in the equity or debt securities of the Company or any associated corporation (within the meaning of the Securities and Future Ordinance ("SFO")) which were required to be notified to the Company and the Stock Exchange pursuant to section 347 of the SFO (including interests which they were deemed or taken to have under sections 344 and 345 of the SFO) or pursuant to the Model Code for Securities Transactions by Directors of Listed Companies in the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules"), or which were recorded in the register required to be kept under section 352 of the SFO, were as follows:

Name of director/ chief executive	Number of ordinary shares held	Nature of interest	Percentage of issued share capital
Wu Kwai Yung	643,835,616	Corporate (Note 1)	67.5%
Leung Hon Man	54	Nominee (Note 2)	0.0%

Note:

- (1) The corporate interest is held by Hong Jin Holdings Limited, the controlling shareholder of the Company, which is owned as to 70% and 30% by Mr. Wu Kwai Yung and Mr. Wu Lui Yip, the son of Mr. Wu Kwai Yung, respectively.
- (2) Mr. Leung was authorised to hold the fractions of the consolidated shares arising from the share consolidation effective on 18 October 2002.

Save as disclosed above, as at 31 December 2004, none of the directors or their associates had any personal, family, corporate or other interest in the equity securities or debentures of, or has a short position in shares in the relevant share capital of the Company or any of its associated corporations (as defined in the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to section 347 of the SFO (including the interests which they were deemed or taken to have under sections 344 and 345 of the SFO) or pursuant to the Model Code for Securities Transactions by Directors of Listed Companies contained in the Listing Rules or which are required, pursuant to section 352 of the SFO, to be entered in the register referred to herein.

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INTEREST OF SHAREHOLDERS HOLDING 5% OR MORE OF THE SHARE CAPITAL OF THE COMPANY

As at 31 December 2004, the following interests (whether direct or indirect) of 5% or more of the shares comprised in the share capital of the Company were recorded in the register of interests in shares and short positions required to be kept by the Company pursuant to section 336 of the SFO:

Name of shareholder	Number of shares held	Approximate percentage of existing issued share capital of the Company
Hong Jin Holdings Limited	643,835,616 (<i>Note 1</i>)	67.5%

Note:

- (1) Hong Jin Holdings Limited, the controlling shareholder of the Company, which is owned as to 70% and 30% by Mr. Wu Kwai Yung and Mr. Wu Lui Yip, the son of Mr. Wu Kwai Yung, respectively.

According to the register of interests in shares and short positions kept by the Company under section 336 of the SFO and so far as was known to the directors, other than the interests disclosed above, there was no other person (other than a director or chief executive of the Company) who, as at 31 December 2004, was directly or indirectly, beneficially interested in 5% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meeting of the Company or in any options in respect of such capital.

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.

DIRECTORS' INTERESTS IN CONTRACTS

- (a) During the year, the Group had the following transactions with ReliaLab Medical Laboratory & X-Ray Centre Limited ("ReliaLab"). Dr. Wan Kwong Kee, a director of the Company, and Mr. Chow Wing Cho, a director of a wholly-owned subsidiary of the Company, are also directors and indirect minority shareholders of ReliaLab.

	2004 HK\$'000	2003 HK\$'000
Rental expenses recharged (<i>note i</i>)	(45)	(45)
Salaries received for shared staff (<i>note i</i>)	(52)	(50)
Salaries paid for shared staff (<i>note i</i>)	59	33
Management fee recharged (<i>note i</i>)	(12)	–
Electricity fee recharged (<i>note i</i>)	(6)	–
Testing fee expenses (<i>note ii</i>)	26	7
Laboratory testing service income (<i>note ii</i>)	(43)	(4)

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Note:

- (i) These expenses were recharged/shared with reference to the actual expenses incurred.
 - (ii) These transactions were carried out at market prices.
 - (iii) The above transactions did not fall under the definition of “connected transaction” or “continuing connected transaction” in Chapter 14A of the Listing Rules.
- (b) On 15 March 2004, a wholly-owned subsidiary of the Company as tenant entered into a tenancy agreement on normal commercial terms with Dr. Wan Kwong Kee, director of the Company and director of such wholly-owned subsidiary, as landlord in respect of the continued use and occupation of a property for a period of two years from 1 April 2004 to 31 March 2006 with monthly rental of HK\$11,250. This transaction constituted exempt continuing connected transaction of the Company under Rule 14A.33(3) of the Listing Rules which was exempt from the reporting, announcement and independent shareholders’ approval requirements.

Apart from the foregoing, no contract of significance to which the Company or any of its subsidiaries was a party, in which a director of the Company had a material interest, subsisted at the end of the year or at any time during the year.

USE OF PROCEEDS FROM CAPITAL RAISED

In September 2004, 643,835,616 shares were issued at HK\$0.073 per share to Hong Jin Holdings Limited. Of the total subscription money of HK\$47,000,000, (i) HK\$7,000,000 was used to repay the indebtedness owed by the Company to Mr. Wu Kwai Yung; (ii) approximately HK\$36,000,000 was used for settlement of bank loans and amount due to a finance company; and (iii) the remaining balance was used as the Group’s general working capital.

CODE OF BEST PRACTICE

In the opinion of the directors, the Company has complied with the Code of Best Practices (the “Code”) as set out in Appendix 14 of the Listing Rules of the Stock Exchange throughout the accounting period covered by this annual report, except that the independent non-executive directors of the Company are not appointed for specific terms but are subject to retirement by rotation in accordance with the Company’s Articles of Association. The Company has established an audit committee in accordance with paragraph 14 of the Code. In the opinion of the directors, this has met the objective of the Code.

AUDIT COMMITTEE

The audit committee has reviewed with management the accounting principles and practices adopted by the Group and discussed auditing, internal control and financial reporting matters including the review of the audited financial statements for the year ended 31 December 2004.

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AUDITORS

Arthur Andersen & Co acted as auditors of the Company for the financial year ended 31 December 2000 and resigned on 19 February 2002.

Moores Rowland were appointed as auditors of the Company on 22 February 2002.

The auditors, Messrs. Moores Rowland merged with Messrs. Mazars on 1 October 2003 and are now practicing under the name of Moores Rowland Mazars.

The accompanying financial statements were audited by Messrs. Moores Rowland Mazars. A resolution for the appointment of Messrs. Moores Rowland Mazars as the Company's auditors for the ensuing year is to be proposed at the forthcoming annual general meeting.

On behalf of the Board,

Wu Kwai Yung

Chairman

Hong Kong, 21 April 2005