NOTES TO FINANCIAL STATEMENTS

31 December 2004

1. CORPORATE INFORMATION

The registered office of Yanion International Holdings Limited is located at Canon's Court, 22 Victoria Street, Hamilton HM12, Bermuda.

During the year, the principle activity of the Group's subsidiaries was manufacture, trading and contracting of Chinese medicine products in the PRC.

2. PRINCIPAL ACCOUNTING POLICIES

(a) Basis of preparation

These financial statements have been prepared in accordance with the accounting standards issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention.

(b) Recently issued accounting standards

The HKICPA has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("new HKFRSs") which are effective for accounting periods beginning on or after 1 January 2005.

The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

(c) Basis of consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries for the year ended 31 December 2004.

The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant inter-company transactions and balances have been eliminated on consolidation.

(d) Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The Company's interests in subsidiaries are stated at cost less any impairment losses.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

2. PRINCIPAL ACCOUNTING POLICIES (continued)

(e) Goodwill

Goodwill arising on the acquisition of subsidiaries represents the excess of the cost of the acquisition over the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition.

Goodwill arising on acquisition is recognised in the consolidated balance sheet as an asset and amortised on the straight-line basis over its estimated useful life of five to ten years. In the case of associates, any unamortised goodwill is included in the carrying amount thereof, rather than as a separately identified asset on the consolidated balance sheet.

On disposal of subsidiaries, the gain or loss on disposal is calculated by reference to the net assets at the date of disposal, including the attributable amount of goodwill which remains unamortised and any relevant reserves, as appropriate.

The carrying amount of goodwill is reviewed annually and written down for impairment where it is considered necessary. A previously recognised impairment loss for goodwill is not reversed unless the impairment loss was caused by a specific external event of an exceptional nature that was not expected to recur, and subsequent external events have occurred which have reversed the effect of that event.

(f) Fixed assets and depreciation

Fixed assets are stated at cost less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the asset has been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is provided to write off the cost of fixed assets over their anticipated useful lives on a straight-line basis. The principal annual rates used for this purpose are as follows:

Plant, machinery and equipment	10% – 15%
Furniture and fixtures	10%

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying value of the relevant asset.

(g) Chinese medicine intellectual property and knowhow

Chinese medicine intellectual property and knowhow is stated at cost less impairment losses and are amortised using the straight-line basis over the commercial lives of the underlying medicine products ranging from seven to twenty years, commencing from the date of acquisition.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

2. PRINCIPAL ACCOUNTING POLICIES (continued)

(h) Impairment of assets

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises.

(i) Investments

(i) Short term investments

Short term investments in unlisted securities are carried at fair value. At each balance sheet date, the net unrealised gain or losses arising from the changes in fair value of short term investments are recognised in the profit and loss account. Profit and loss on disposal of short term investment representing the difference between the net sales proceeds and the carrying amounts, are recognised in the profit and loss account as they arise.

(ii) Long term investments

Long term investments in unlisted equity securities, intended to be held for a continuing strategic or long-term purpose, are stated at cost less any provisions for impairments in values deemed necessary by the directors, other than those considered to be temporary in nature or an individual basis.

(j) Inventories

Inventories are valued at the lower of cost and net realisable value. Cost includes cost of purchase of materials computed using the FIFO method and, in the case of work in progress and finished goods, comprise direct materials, direct labour and an appropriate proportion of production overheads. Net realisable value is determined by reference to the sales proceeds of items sold in the ordinary course of business after the balance sheet date or to management estimates based on prevailing market conditions.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

2. PRINCIPAL ACCOUNTING POLICIES (continued)

(k) Deferred taxation

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred taxation is provided for on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

(l) Operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the lessor are accounted for as operating leases. Rentals under operating leases are charged to the profit and loss account on a straight line basis over the lease term.

(m) Foreign currencies

Foreign currency transactions are recorded at the applicable rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable rates of exchange ruling at that date. Exchange differences are dealt with in the profit and loss account.

On consolidation, the balance sheet of subsidiaries denominated in foreign currencies are translated into Hong Kong dollars at the applicable rates of exchange ruling at the balance sheet date while the profit and loss is translated at an average rate. The resulting translation differences are included in the exchange fluctuation reserve.

(n) Retirement benefit costs

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for those employees who are eligible to participate in the MPF Scheme. The MPF Scheme has operated since 1 December 2000. Contributions are made based on a percentage of the employees' basic salaries and are charged to the profit and loss account as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in independently administered funds. The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme. Prior to the MPF Scheme being effective, the Group did not have any pension arrangements for its employees.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

2. PRINCIPAL ACCOUNTING POLICIES (continued)

(n) Retirement benefit costs (continued)

The employees of the Group's subsidiaries in the PRC are members of central pension schemes operated by the local governments in the PRC and these subsidiaries make mandatory contributions to these central pension schemes to fund the employees' retirement benefits. The retirement contributions paid by the PRC subsidiaries are based on certain percentages of the employees' salaries cost in accordance with the relevant regulations in the PRC, and are charged to the profit and loss account as incurred. The Group discharges its retirement obligations upon payment of the retirement contributions to the central pension schemes operated by the local governments in the PRC.

(o) Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(i) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

(ii) from contracting revenues, when services have been rendered or substantially performed in accordance with the terms of the contract; and

(iii) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.

(p) Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party, or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

(q) Cash equivalents

For the purpose of the consolidated cash flow statement, cash equivalents represent short term highly liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from banks repayable within three months from the date of the advance. For the purpose of balance sheet classification, cash equivalents represent assets similar in nature to cash, which are not restricted as to use.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

3. SEGMENT INFORMATION

Segment information is presented by way of two segment formats: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

The Group's operating businesses are structured and managed by product segments. Each of the Group's product segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of other product segments.

During the year ended 31 December 2004, the turnover and operating profit of the Group are entirely derived from one business segment which is the manufacturing, trading and contracting of Chinese Medicine products in the PRC. Summary details of the business segments by products for the year ended 31 December 2003 were as follows:

Continuing operations

a. the manufacture, trading and contracting of Chinese medicine products;

Discontinuing operations

b. the trading of Internet phone sets and provision of related services;

c. the manufacture and trading of CD/VCD players and mechanisms, amplifiers, and computer peripherals; and

d. the manufacture and trading of car audio mechanisms, cassette deck mechanisms and related products.

In determining the Group's geographical segments, revenues and results are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets.

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

3. SEGMENT INFORMATION (continued)

(a) Business segments

All the revenue and assets for the Group's business segments for the year ended 31 December 2004 were derived from the manufacture, trading and contracting of Chinese medicine products.

The revenue, results and certain assets, liabilities and expenditure information for the Group's business segments for the year ended 31 December 2003 is presented as follows:–

Group

	Continuing operations	Discontinuing operations			
	Manufacture, trading and contracting of Chinese medicine products 2003 HK$'000	Trading of Internet phone sets and provision of related services 2003 HK$'000	Manufacture and trading of CD/VCD players and mechanisms, amplifiers, and mini-audio products 2003 HK$'000	Manufacture and trading of car audio mechanisms, cassette deck mechanisms, personal office appliance, and related products 2003 HK$'000	Consolidated 2003 HK$'000
Segment revenue:					
Sales to external customers	20,954	–	131,690	25,305	177,949
Segment results	(32,039)	(27)	(21,596)	(890)	(54,552)
Interest income					92
Gain on discontinuing operations					10,566
Unallocated expenses					(15,906)
Loss from operating activities					(59,800)
Finance costs					(2,341)
Loss before tax					(62,141)
Taxation					(188)
Loss before minority interests					(62,329)
Minority interests					9,723
Net loss from ordinary activities attributable to shareholders					(52,606)

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

3. SEGMENT INFORMATION (continued)

(a) Business segments (continued)

Group

	Continuing operations	Discontinuing operations			
	Manufacture, trading and contracting of Chinese medicine products 2003 HK$'000	Trading of Internet phone sets and provision of related services 2003 HK$'000	Manufacture and trading of CD/VCD players and mechanisms, amplifiers, and mini-audio products 2003 HK$'000	Manufacture and trading of car audio mechanisms, cassette deck mechanisms, personal office appliance, and related products 2003 HK$'000	Consolidated 2003 HK$'000
Segment assets	208,435	3,181	–	–	211,616
Unallocated assets					3,929
Total assets					215,545
Segment liabilities	17,882	2,119	–	–	20,001
Unallocated liabilities					28,952
Total liabilities					48,953
Other segment information:					
Capital expenditure	1,732	–	4,504	886	7,122
Unallocated capital expenditure					200
Total capital expenditure					7,322
Amortisation of goodwill	10,282	–	–	–	10,282
Provision against inventories	823	–	902	178	1,903
Provision for impairment of fixed assets	–	–	6,722	1,324	8,046
Segment depreciation	1,933	–	6,707	1,767	10,407
Unallocated depreciation					22
Total depreciation					10,429
Amortisation and impairment loss of intangible assets	3,187	–	–	–	3,187

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

3. SEGMENT INFORMATION (continued)

(b) Geographical segments

All the revenue and assets for the Group's geographical segments for the year ended 31 December 2004 were derived from the PRC.

The revenue, results and certain assets and expenditure information for the Group's geographical segments for the year ended 31 December 2003 is presented as follows:–

Group

	Hong Kong 2003 *HK$'000*	PRC 2003 *HK$'000*	Other Asian countries 2003 *HK$'000*	Europe 2003 *HK$'000*	America 2003 *HK$'000*	Consolidated 2003 *HK$'000*
Segment revenue:						
Sales to external customers	16,409	27,183	11,426	49,961	72,970	177,949
Segment Results	(655)	(32,329)	(1,788)	(8,138)	(11,642)	(54,552)
Other segment information:						
Segment assets	2,185	213,360	–	–	–	215,545
Capital expenditure	778	6,544	–	–	–	7,322

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

4. TURNOVER AND REVENUE

Turnover represents the net invoiced value of goods sold, after allowances for goods returned and trade discounts, and contracted revenue earned. An analysis of turnover and revenue is as follows:

Group

	2004	2003
	HK$'000	*HK$'000*
Turnover		
Continuing operations	**20,863**	20,954
Discontinuing operations	**–**	156,995
	20,863	177,949
Investment income	**–**	1,115
Interest income	**9**	92
Exchange gains, net	**32**	–
Other income	**20**	243
Other revenue	**61**	1,450
Total revenue	**20,924**	179,399

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

5. LOSS FROM OPERATING ACTIVITIES

The Group's loss from operating activities is arrived at after charging:

	Group	
	2004	2003
	HK$'000	*HK$'000*
Cost of inventories sold	**8,052**	147,222
Provision against inventories*	**5,186**	1,903
Amortisation of chinese medicine intellectual property and knowhow	**3,987**	3,187
Depreciation	**2,166**	10,429
Auditors' remuneration:		
Current year	**409**	879
Under provision in prior year	**11**	106
Staff costs (excluding directors' remuneration *(note 6)*)**		
Salaries and wages (include long service payment provision)	**5,808**	29,907
Mandatory provident fund contributions	**(24)**	504
Less: Amount capitalised	**–**	(1,233)
	5,784	29,178
Loss on disposal of fixed assets	**1,640**	1,272
Exchange losses, net	**–**	746

* *Provision against inventories is included in "Cost of sales" in the consolidated profit and loss account.*

** *At 31 December 2004, the Group had no forfeited contributions available to reduce its contributions to the pension scheme in future years (2003: HK$ Nil).*

6. REMUNERATION OF DIRECTORS AND THE FIVE HIGHEST PAID INDIVIDUALS

Directors' remuneration disclosed pursuant to the Listing Rules and Section 161 of the Hong Kong Companies Ordinance is as follows:

	Group	
	2004	2003
	HK$'000	*HK$'000*
Fees	**217**	200
Basic salaries, housing, other allowances and benefits in kind	**4,770**	10,942
Mandatory provident fund contributions	**43**	122
	5,030	11,264

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

6. REMUNERATION OF DIRECTORS AND THE FIVE HIGHEST PAID INDIVIDUALS (continued)

Fees include HK$217,000 (2003: HK$200,000) payable to the independent non-executive directors. There were no other emoluments payable to the independent non-executive directors during the year (2003: Nil). The remuneration of the directors fell within the following bands:

	Number of directors	
	2004	2003
Nil – HK$1,000,000	**6**	4
HK$1,000,001 – HK$1,500,000	**–**	1
HK$1,500,001 – HK$2,000,000	**–**	–
HK$2,000,001 – HK$2,500,000	**2**	3
HK$2,500,001 – HK$3,000,000	**–**	–
HK$3,000,001 – HK$3,500,000	**–**	1
	8	9

There were no arrangements under which a director waived or agreed to waive any remuneration during the year.

During the year, no share options were granted to certain directors and eligible participants in respect of their services rendered to the Group.

Details of the emoluments paid to the five highest paid individuals during the year included three (2003: five) directors whose emoluments are set out above. Details of remuneration of the remaining two (2003: nil) highest paid employees during the year were as follows:–

	2004	2003
	HK$000	*HK$000*
Basic salaries, housing, other allowances and benefit in kind	**1,052**	–
Mandatory provident fund contributions	**(24)**	–
	1,028	–

During the year, no emoluments were paid by the Group to the highest paid employees as an inducement to join or upon joining the Group, or as compensation for loss of offices.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

7. FINANCE COSTS

	Group	
	2004	2003
	HK$'000	*HK$'000*
Interest on other borrowings wholly repayable within five years	**1,351**	2,318
Interest on finance leases	**–**	23
	1,351	2,341

8. TAXATION

(a) Hong Kong profits tax has been provided at the rate of 17.5% on the estimated assessable profits arising in Hong Kong during the year. 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.

	Group	
	2004	2003
	HK$'000	*HK$'000*
Current year's provision:		
Hong Kong	**–**	188
Elsewhere	**–**	–
Tax charge for the year	**–**	188

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

8. TAXATION (continued)

(b) The taxation charge for the year can be reconciled to the loss before taxation as stated in the financial statements as follows:–

	2004	2003
	HK$'000	*HK$'000*
Loss before tax	**(103,639)**	(62,141)
Taxation calculated at Hong Kong profits tax of 17.5%	**(18,137)**	(10,875)
Tax effect of expenses not deductible for taxation purposes	**13,499**	2,737
Tax effect of non-taxable items	**–**	(462)
Utilisation of previously unrecognized tax losses	**–**	(83)
Deferred tax assets not recognised	**3,200**	9,754
Effect of different tax rates of subsidiaries operating in other jurisdictions	**1,438**	(883)
Tax charge for the year	**–**	188

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

9. DISCONTINUING OPERATIONS

Pursuant to a sale and purchase agreement dated 18 December 2003 and as announced in the Company's announcement on 30 December 2003, the Group disposed of its entire interest in Yanion (BVI) Limited and its subsidiaries, which were mainly engaged in the electronics business for a nominal consideration of HK$1.00 to Mr. Leung Wah Chai and Madam Butt Wing Han, then connected persons. The disposal of the above businesses was completed on 31 December 2003. The Group also discontinued its internet phone business in 2003.

The turnover, other revenue, expenses and results of the discontinuing operations for the two years ended 31 December 2004 were as follows:

	Internet phone business		**Electronics business**		**Total**	
	2004	2003	**2004**	2003	**2004**	2003
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
Turnover	**–**	–	**–**	156,995	**–**	156,995
Cost of sales	**–**	–	**–**	(139,444)	**–**	(139,444)
Gross profit	**–**	–	**–**	17,551	**–**	17,551
Other revenue	**–**	–	**–**	169	**–**	169
Selling and distribution costs	**–**	–	**–**	(6,736)	**–**	(6,736)
Administrative expenses	**–**	(27)	**–**	(25,394)	**–**	(25,421)
Provision for impairment in value of fixed assets	**–**	–	**–**	(8,046)	**–**	(8,046)
Loss from operating activities	**–**	(27)	**–**	(22,456)	**–**	(22,483)
Finance costs	**–**	–	**–**	(680)	**–**	(680)
Loss before tax	**–**	(27)	**–**	(23,136)	**–**	(23,163)
Taxation	**–**	–	**–**	(188)	**–**	(188)
Loss before minority interests	**–**	(27)	**–**	(23,324)	**–**	(23,351)
Minority interests	**–**	–	**–**	(699)	**–**	(699)
Net loss from ordinary activities attributable to shareholders	**–**	(27)	**–**	(24,023)	**–**	(24,050)

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

9. DISCONTINUING OPERATIONS (continued)

The carrying amount of the total assets and liabilities relating to the discontinuing operations at 31 December 2004 were as follows:–

	Internet phone business		Electronics business		Total	
	2004	2003	**2004**	2003	**2004**	2003
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
Total assets	**–**	3,268	**–**	–	**–**	3,268
Total liabilities	**–**	(3,240)	**–**	–	**–**	(3,240)
Minority interests	**–**	(176)	**–**	–	**–**	(176)
Net assets	**–**	(148)	**–**	–	**–**	(148)

The net cash flows attributable to the discontinuing operations for the two years ended 31 December 2004 were as follows:

	Internet phone business		Electronics business		Total	
	2004	2003	**2004**	2003	**2004**	2003
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
Operating	**–**	–	**–**	4,372	**–**	4,372
Investing	**–**	–	**–**	(3,589)	**–**	(3,589)
Financing	**–**	–	**–**	1,827	**–**	1,827
Net cash inflow	**–**	–	**–**	2,610	**–**	2,610

10. NET LOSS FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net loss from ordinary activities attributable to shareholders for the year ended 31 December 2004 dealt with in the financial statements of the Company is HK$98,644,000 (2003: HK$5,066,000).

11. LOSS PER SHARE

The calculation of basic loss per share is based on the net loss from ordinary activities attributable to shareholders for the year of HK$74,328,000 (2003: HK$52,606,000) and the weighted average of 571,902,728 (2003: 571,650,673) ordinary shares in issue during the year.

Diluted loss per share amounts for the years ended 31 December 2004 and 2003 have not been shown as the share options or convertible note outstanding had an anti-dilutive effect on the basic loss per share for the relevant years.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

12. FIXED ASSETS

Group

	Plant, machinery and equipment HK$'000	Furniture and fixtures HK$'000	Total HK$'000
Cost:			
At 1 January 2004	11,961	1,480	13,441
Additions	507	–	507
Disposals	(3,808)	(91)	(3,899)
At 31 December 2004	**8,660**	**1,389**	**10,049**
Accumulated depreciation and impairment:			
At 1 January 2004	2,425	185	2,610
Charge for the year	1,918	248	2,166
Write back on disposal	(2,234)	(25)	(2,259)
At 31 December 2004	**2,109**	**408**	**2,517**
Net book value:			
At 31 December 2004	**6,551**	**981**	**7,532**
At 31 December 2003	9,536	1,295	10,831

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

12. FIXED ASSETS (continued)

Company

	Furniture and fixtures *HK$'000*
Cost:	
At 1 January 2004 and at **31 December 2004**	**253**
Accumulated depreciation:	
At 1 January 2004	25
Charge for the year	114
At 31 December 2004	**139**
Net book value:	
At 31 December 2004	**114**
At 31 December 2003	228

13. INTANGIBLE ASSETS

Group

	Chinese medicine intellectual property and knowhow *HK$'000*
Cost:	
At 1 January 2004 and at **31 December 2004**	**37,551**
Accumulated amortisation:	
At 1 January 2004	4,014
Charge for the year	3,987
At 31 December 2004	**8,001**
Net book value:	
At 31 December 2004	**29,550**
At 31 December 2003	33,537

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

14. GOODWILL

The amount of the goodwill capitalised as an asset, arising from the acquisition of subsidiaries, is as follows:

	Group
	HK$'000
Cost:	
At 1 January 2004 and at **31 December 2004**	**150,328**
Accumulated amortisation and impairment:	
At 1 January 2004	62,071
Amortisation for the year	10,283
At 31 December 2004	**72,354**
Net book value:	
At 31 December 2004	**77,974**
At 31 December 2003	88,257

15. INTERESTS IN SUBSIDIARIES

	Company	
	2004	2003
	HK$'000	*HK$'000*
Unlisted shares/capital contributions, at cost	**1**	1
Due from subsidiaries	**504,181**	493,731
	504,182	493,732
Provision for impairment	**(405,193)**	(313,907)
	98,989	179,825

The amounts due are unsecured, interest-free and are not repayable within the twelve months following the balance sheet date.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

15. INTERESTS IN SUBSIDIARIES (continued)

Particulars of the Company's principal subsidiaries are as follows:

Name	Place of incorporation/ registration and operations	Nominal value of issued ordinary/ registered and paid-up capital	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
China Medicine International Limited	Hong Kong	HK$2	100	–	Provision of administrative services
Yacata Limited	British Virgin Islands	US$1	100	–	Investment holding
Korning Investments Limited ("Korning") (Note)	British Virgin Islands	US$1	–	94	Investment holding
Star Wisdom Investments Limited	British Virgin Islands	US$1	–	94	Investment holding
Huayi Pharmaceutical Company Limited ("Huayi")	People's Republic of China	RMB126,000,000	–	56	Manufacturing, trading and contracting of Chinese medicine products

Note:

As announced in the Company's announcement dated 5 August 2003, the Group has made additional contribution of RMB8,328,000 (equivalent to HK$7,852,000) which pertained to capital contribution defaulted by the 13% minority shareholder of Korning. Pursuant to the shareholders' agreement of Korning, the Group is entitled to subscribe for additional shares in Korning with the additional contributions as the consideration for such subscription. The additional subscription, details of which was published in the Company's announcement of 3 February 2004, increased the Company's shareholding in Korning from 87% to 94% with effect from 2 January 2004.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

16. INVENTORIES

	Group	
	2004	2003
	HK$'000	*HK$'000*
Raw materials	**585**	1,318
Work in progress	**512**	3,235
Finished goods	**2,081**	5,606
	3,178	10,159

The amount of inventories carried at net realisable value included in the above balance was HK$2,666,000 (2003: HK$6,889,000) at the balance sheet date.

17. 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 aging analysis of the accounts receivable as at the balance sheet date, based on payment due date, and net of provisions is as follows:

	Group	
	2004	2003
	HK$'000	*HK$'000*
Within 1 month	**1,410**	1,301
2 to 3 months	**1,270**	858
4 to 6 months	**668**	736
7 to 12 months	**364**	467
Over 1 year	**1,003**	10,505
	4,715	13,867

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

18. 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 the consideration in the total of 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. As of 31 December 2004, the balance of consideration has not been paid and full provision for the deposit paid has been made. The current status of the investment is detailed in note 26.

19. ACCOUNTS PAYABLE

An aging analysis of the accounts payable as at the balance sheet date, based on payment due date, is as follows:

	Group	
	2004	2003
	HK$'000	*HK$'000*
Within 1 month	**209**	611
2 to 3 months	**58**	115
4 to 6 months	**136**	163
7 to 12 months	**584**	31
Over 1 year	**1,185**	1,466
	2,172	2,386

20. CONVERTIBLE NOTES

On 20 April 2004, the Company 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 ended on 15 June 2004. On 26 April 2004, convertible notes in the amount of HK$21,500,000 were 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. Costs relating to the issuance of the convertible notes in the amount of HK$865,000 was debited against share premium account.

On 28 December 2004, 23,000,000 shares at par value of HK$0.01 per share were issued at the conversion price of HK$0.43 per share on conversion of HK$9,890,000 convertible notes by the noteholder (Note 23 and 24).

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

21. OTHER BORROWINGS

	Group		Company	
	2004	2003	**2004**	2003
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
Other borrowings – unsecured	**23,948**	22,597	**20,543**	19,192
Other borrowings repayable:				
within one year *(note)*	**21,957**	20,606	**20,543**	19,192
After one year	**1,991**	1,991	**–**	–
	23,948	22,597	**20,543**	19,192
	23,948	22,597	**20,543**	19,192
Portion classified as current liabilities	**(21,957)**	(20,606)	**(20,543)**	(19,192)
Long term portion	**1,991**	1,991	**–**	–

Note:

In July 2003, the Company was granted short term credit facilities to the extent of HK$50,000,000 from an independent financial institution to finance general working capital and to partially finance the capital contributions to Huayi by the Group. The borrowings were partially repaid during 2003. The borrowings are unsecured and interest bearing at Hong Kong dollar prime rate plus 2% per annum. Principal and interest are repayable by 31 July 2005.

As at 31 December 2004, save for the unsecured other borrowings, the Group did not have any other bank debts, corporate guarantee or pledge of assets remained outstanding from the prior year.

22. DEFERRED TAXATION

	Group	
	2004	2003
	HK$'000	*HK$'000*
At beginning of year	**–**	136
Disposal of subsidiaries *(note 25(b))*	**–**	(136)
At end of year	**–**	–

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

22. DEFERRED TAXATION (continued)

The principal components of the Group's provision for deferred tax, and net deferred tax asset position not recognised in the financial statements are as follows:

	Provided		**Not Provided**	
	2004	2003	**2004**	2003
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
Accelerated capital allowances	**–**	–	**–**	–
Tax losses	**–**	–	**(10,004)**	(11,860)
	–	–	**(10,004)**	(11,860)

The Company had unprovided deferred tax assets in respect of tax losses in the amount of HK$7,180,000 at the balance sheet date (2003: HK$6,661,000).

23. SHARE CAPITAL

Shares

	2004	2003
	HK$'000	*HK$'000*
Authorised:		
50,000,000,000 ordinary shares of HK$0.01 each	**500,000**	500,000
Issued and fully paid:		
594,650,673 (2003: 571,650,673) ordinary shares of HK$0.01 each	**5,947**	5,717

The movements in the issued share capital of the Company during the year were as follows:

	Number of ordinary shares	**Share capital**
		HK$'000
At 1 January 2004	571,650,673	5,717
Shares issued on conversion of convertible notes *(note 20)*	23,000,000	230
At 31 December 2004	**594,650,673**	**5,947**

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

24. RESERVES

Company

	Share premium HK$'000	**Contributed surplus** HK$'000 (note i)	**Accumulated losses** HK$'000	**Total** HK$'000
At 1 January 2003	315,215	76,838	(512,624)	(120,571)
Capital reduction	–	–	280,108	280,108
Share premium reduction	(232,515)	–	232,515	–
Net loss for the year	–	–	(5,065)	(5,065)
At 31 December 2003	82,700	76,838	(5,066)	154,472
Convertible note issue costs *(note 20)*	(865)	–	–	(865)
Shares issued on conversion of convertible note *(note ii)*	9,660	–	–	9,660
Net loss for the year	–	–	(98,644)	(98,644)
At 31 December 2004	**91,495**	**76,838**	**(103,710)**	**64,623**

Note:

(i) The Company's contributed surplus is derived from the difference between the fair value of the shares of the subsidiaries acquired and the nominal value of the Company's shares issued in exchange therefore pursuant to the Group reorganisation in 1991. Under the Companies Act 1981 of Bermuda, a company may make distributions to its members out of its contributed surplus under certain circumstances.

(ii) On 28 December 2004, 23,000,000 new ordinary shares with a par value of HK$0.01 each were issued on conversion of convertible notes at a conversion price of HK$0.43 per share. The excess of the share consideration over the nominal value of the issued shares of HK$9,660,000 was credited to the share premium account. The new shares rank pari passu in all respects with the existing share of the Company.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

25. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of loss before tax to net cash outflow used in operating activities:

	Group	
	2004	2003
	HK$'000	*HK$'000*
Loss before tax	**(103,639)**	(62,141)
Provision for deposit for investment	**48,879**	–
Provision for impairment in value of fixed assets	**–**	8,046
Provision against inventories	**5,186**	1,903
Provision for doubtful debts	**9,089**	9,832
Depreciation	**2,166**	10,429
Amortisation of intangible assets	**3,987**	3,187
Amortisation of goodwill	**10,283**	10,282
Loss on disposal of fixed assets	**1,640**	1,272
Interest income	**(9)**	(92)
Interest expense	**1,351**	2,341
Gain on disposal of short term investment	**–**	(1,115)
Gain on disposal of subsidiaries	**–**	(10,566)
Operating loss before working capital changes	**(21,067)**	(26,622)
Decrease/(increase) in inventories	**1,795**	(4,437)
Decrease/(increase) in accounts receivable	**63**	(3,752)
Decrease in prepayments and other receivables	**4,364**	3,633
(Decrease)/increase in accounts payable	**(214)**	8,393
(Decrease)/increase in other payables and accruals	**(1,391)**	14,524
(Decrease)/increase in amounts due to related companies	**(896)**	719
Decrease in trust receipt and export loans with maturity over three months	**–**	(439)
Net cash outflow used in operations	**(17,346)**	(7,981)

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

25. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(b) Disposal of subsidiaries

	Group 2003 *HK$'000*
Net assets disposed:	
Fixed assets	26,016
Inventories	28,330
Accounts receivable	12,624
Prepayments and other receivables	4,040
Cash and bank balances	2,866
Pledged deposits	3,866
Accounts payable	(42,818)
Other payables and accruals	(22,964)
Due to a related company	(1,118)
Minority interests	(1,709)
Due to a director	(9,550)
Bank loans and overdraft	(7,168)
Tax payable	(2,645)
Deferred taxation	(136)
Reversal of exchange fluctuation	(200)
	(10,566)
Gain on disposal of subsidiaries	10,566
Satisfied by cash consideration *(note)*	–

An analysis of the net outflow of cash and cash equivalents in respect of the disposal of subsidiaries is as follows:–

	Group 2003 *HK$'000*
Cash consideration *(note)*	–
Cash and bank balances disposed	(2,866)
Bank overdrafts	1,913
Trust receipt and export loans with maturity within three months	649
Net outflow of cash and cash equivalents in respect of the disposal of subsidiaries	(304)

Note: Consideration for the disposal of subsidiaries was satisfied by cash of HK$1.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

25. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(c) Analysis of changes in financing during the year:

	Issued capital, (including share premium) HK$'000	Finance lease payables HK$'000	Convertible notes HK$'000	Bank and other borrowings HK$'000	Minority interests HK$'000
At 1 January 2003	601,040	332	–	11,194	52,237
Net cash inflow/(outflow) from financing	–	(355)	–	20,373	–
Capital reduction	(280,108)	–	–	–	–
Share premium reduction	(232,515)	–	–	–	–
Accrued interest	–	–	–	721	–
Interest element of finance lease payment	–	23	–	–	–
Share of net loss for the year	–	–	–	–	(9,723)
Arising from disposal of subsidiaries	–	–	–	(9,691)	(1,709)
At 31 December 2003	88,417	–	–	22,597	40,805
Net cash inflow from financing	–	–	21,500	–	–
Convertible notes issue costs	(865)	–	–	–	–
Shares issued on conversion of convertible note	9,890	–	(9,890)	–	–
Capitalisation of accrued interest	–	–	–	1,351	–
Share of net loss for the year	–	–	–	–	(29,311)
At 31 December 2004	**97,442**	**–**	**11,610**	**23,948**	**11,494**

26. CONTINGENT LIABILITIES

As detailed in note 18 to the financial statements, Huayi has contracted for the acquisition of (i) 40% equity interest in two Sino-foreign joint venture companies and (ii) the right of exploitation of wild herbs for the purpose of development of a Chinese medicinal centre and wild herbs harvesting area. As of 31 December 2004, partial payments of approximately HK$48,879,000 have been made and the remaining consideration of approximately HK$19,009,000 has been disclosed under capital commitments (note 28).

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

26. CONTINGENT LIABILITIES (continued)

Owing to a change in senior management of Huayi resulting from a change of representatives nominated by the minority shareholder, the board of Huayi which includes members nominated by the minority shareholder has not resolved to complete the above mentioned acquisition. The situation is further exasperated due to competing financial resources and settled the remaining consideration by the extended deadline of 31 May 2004. In accordance with the sale and purchase agreement, the vendor has the right to cancel acquisition and claim for losses to be extent the vendor has suffered, which is not quantifiable at this stage. The directors of the Company have sought advice from PRC legal counsel as to appropriate course of action. No action has been made at this stage to resolve the matter. At the date of approval of these financial statements, the directors are in the opinion that the chance of recovering the deposit paid was in doubt and, for conservatism, full provision has been made against the amount of deposit paid.

27. OPERATING LEASE ARRANGEMENTS

	Group	
	2004	2003
	HK$'000	*HK$'000*
Minimum lease payments paid under operating leases	**2,859**	13,264
Less: Amount capitalised	**–**	(414)
	2,859	12,850

At 31 December 2004, the Group had total future minimum lease payments under non-cancellable operating leases in respect of its land and buildings falling due as follows:

	Group	
	2004	2003
	HK$'000	*HK$'000*
Within one year	**2,025**	3,084
In the second to fifth years, inclusive	**–**	375
	2,025	3,459

Operating lease payments represent rentals payable by the Group on certain of its leased properties. Leases are negotiated for an average term of 1 to 2 years at fixed rental.

The Company did not have any operating lease commitments at the balance sheet date (2003: HK$Nil).

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

28. CAPITAL COMMITMENTS

	Group	
	2004	2003
	HK$'000	*HK$'000*
Contracted, but not provided for:		
Acquisition of investment *(note 18)*	**19,009**	19,009

The Company did not have any contracted capital commitments at the balance sheet date (2003: HK$Nil).

29. RELATED PARTY TRANSACTIONS

Set out below are the related party transactions disclosed in accordance with SSAP 20 issued by the Hong Kong Institute of Certified Public Accountants:–

		Group	
		2004	2003
	Notes	***HK$'000***	*HK$'000*
Purchases of raw materials from a related company:			
Simple Link Company Limited ("Simple Link")	*(i)*	–	658
Rental expenses paid to related companies:	*(ii)*		
Sun View Company Limited ("Sun View")		**1,080**	1,080
Bestbond Company Limited ("Bestbond")		–	1,650
Well Hero Industries Limited ("Well Hero")		–	216
Kamga Investment Limited ("Kamga")		–	216
WorldVest Capital Limited ("WorldVest")		–	603
Rental expenses paid to a director:			
Leung Wah Chai	*(ii)*	–	720
Consultancy fees paid/payable to a related company:			
WorldVest	*(iii)*	–	900
Purchases of fixed assets from a related company:			
WorldVest	*(iv)*	–	200
Sharing of office services paid to a related company:			
WorldVest	*(v)*	**516**	–

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

29. RELATED PARTY TRANSACTIONS (continued)

(i) The directors considered that the purchases of raw materials during the year ended 31 December 2003 related to the discontinuing operation (note 9) were made at prices and on conditions similar to those offered by other independent suppliers of the Group.

(ii) The rental expenses related to properties rented for the purpose of providing quarters to the directors and for office purposes, and were charged in accordance with the terms of the related rental agreements. In October 2003, the lease of the office premise and the related rental deposit of approximately HK$246,000 was assigned by an agreement from WorldVest to the Group. The related balance due to WorldVest at 31 December 2003 in the amount of HK$246,000 was settled during the year.

(iii) The consultancy fees were charged in accordance with the terms of the service and management fee agreements. The balance due to WorldVest at 31 December 2003 in the amount of HK$450,000 was settled during the year.

(iv) The Directors have reviewed the lists of the breakdown of used fixed assets and physically inspected the condition of the assets and considered that the terms and offer price of these used fixed assets were in accordance with general commercial practice and were fair and reasonable to the Company. The amount due to WorldVest in respect of purchase of fixed assets at 31 December 2003 in the amount of HK$200,000 was settled during the year.

(v) Sharing of office expenses were charged in accordance with the actual costs incurred by the Group.

Leung Wah Chai, ex-director of the Company was a director and controlling shareholder of Simple Link and Bestbond. Leung Wah Chai and Butt Wing Han, ex-directors of the Company were directors and controlling shareholders of Well Hero and Kamga. Cheng Shu Wing, Guo Duen How, Tom and Wu Fred Fong were the directors of WorldVest. Sun View was owned by an associated person of Kao Ying Lun.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

30. CONNECTED TRANSACTIONS

In addition to the related party transactions disclosed in note 29 which also constituted connected transactions under the Listing Rules, the following transactions constitute connected transactions under the Listing Rules.

		Group	
		2004	2003
	Notes	***HK$'000***	*HK$'000*
Deposit paid/payment & accrual in respect of purchase of intellectual and operating rights of twelve Chinese medicines from a minority interest:			
Huahe Pharmaceutical Co., Limited ("Huahe")	*(i)*	–	9,346
Purchase of raw materials/herbs from Huahe	*(i)*	–	1,622
Sales of medicine products to China National Group Corporation of Traditional and Herbal Medicine ("China National Medicine")	*(ii)*	–	4,104
Purchase of raw materials/herbs from China National Medicine	*(ii)*	**986**	–

Note:

(i) The directors consider that the acquisition of the twelve Chinese medicines and purchase of raw materials/herbs were based on arm's length negotiation with Huahe. These transactions were made in the ordinary and usual course of business with terms made on normal commercial terms.

(ii) China National Medicine is the controlling shareholder of Huahe. The Directors consider that these sales and purchase were made in the ordinary and usual course of business with terms made on normal commercial terms.

31. POST BALANCE SHEET EVENTS

(a) On 18 January 2005, 27,000,000 new shares at par value of HK$0.01 per share were issued on conversion of the remaining balance of convertible notes at the conversion price of HK$0.43 per share for a total of HK$11,610,000. Accordingly, the total number of issued and fully paid ordinary shares of the Company was increased to 621,650,673 shares.

(b) On 7 February 2005, the Company entered into the sale and purchase agreement (the "Agreement") pursuant to which the Company has conditionally agreed to purchase the entire issued share capital of Guohua International Investment Limited ("Guohua") from the vendors. The consideration for the acquisition shall be satisfied partly in cash of HK$50,000,000 and partly by the allotment and issue of such number of consideration shares which will represent approximately 22.7% of the enlarged share capital of the Company. The completion of the Agreement is subject to a number of condition precedents including the raising of not less than HK$780,000,000 from the placing of new shares of the Company. Proceeds of the placing shall primarily be used to pay up the committed portion of capital contribution by Guohua to the joint venture and for general working capital purposes of the Group.

NOTES TO FINANCIAL STATEMENTS (continued)

31 December 2004

31. POST BALANCE SHEET EVENTS (continued)

(b) (continued)

Guohua is the controlling shareholder of a sino-foreign joint venture established in the PRC and has undertaken to contribute approximately Rmb632,330,000 to the joint venture which shall represent approximately 77.4% of the registered capital of the joint venture. The joint venture shall in turn contribute approximately Rmb620,000,000 to a steel plant at Yingkou, Liaoning province, the PRC and shall own approximately 52.6% interest. The steel plant is engaged in the manufacturing and sale of steel plates and related products. Details of the proposed transactions were published in the Company's announcement dated 7 March 2005.

32. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 26 April 2005.