# YANION INTERNATIONAL HOLDINGS LIMITED

(Incorporated in Bermuda with limited liability)

# Interim Report 2005

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# CORPORATE INFORMATION

## HONORARY DIRECTOR

Xia Zhi Wu

## DIRECTORS

*Executive Directors*
Fung Chi Kin
Guo Duen How, Tom
Ho Yuk Ming, Hugo
Kao Ying Lun
Li Mingke
Wu Fred Fong
Zhang Zhiyuan, Nathan
Zhao Songyi

*Independent non-executive Directors*
Choy Tak Ho
Loke Yu alias Loke Hoi Lam
Loo Chung Keung, Steve
Tsui Chun Chung, Arthur

## COMPANY SECRETARY

Wu Fred Fong, FHKICPA

## AUDITORS

Horwath Hong Kong CPA Limited

## LEGAL ADVISOR

Chiu & Partners
Heller Ehrman

## PRINCIPAL BANKERS

Bank of China (Hong Kong) Limited
Bank of East Asia 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

Unit 2703, 27th Floor
Tower 1, Admiralty Center
18, Harcourt Road
Hong Kong

## WEB-SITE AND E-MAIL ADDRESS

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**Stock code: 82**

## CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

| | | Six months ended 30 June | |
|---|---|---|---|
| | | **2005** | 2004 |
| | | **(Unaudited)** | (Unaudited) |
| | | | (As restated) |
| | *Notes* | ***HK$'000*** | *HK$'000* |
| TURNOVER | *3* | **9,548** | 12,622 |
| Cost of sales | | **(4,161)** | (8,166) |
| Gross profit | | **5,387** | 4,456 |
| Other revenue | | **2** | 54 |
| Selling and distribution costs | | **(2,777)** | (6,373) |
| Administrative expenses | | **(18,752)** | (22,655) |
| Amortisation of goodwill | | **–** | (5,141) |
| LOSS FROM OPERATING ACTIVITIES | | **(16,140)** | (29,659) |
| Finance costs | | **(765)** | (748) |
| LOSS BEFORE TAX | *4* | **(16,905)** | (30,407) |
| Taxation | *5* | **–** | – |
| LOSS FOR THE PERIOD | | **(16,905)** | (30,407) |
| ATTRIBUTABLE TO: | | | |
| Shareholders of the Company | | **(15,531)** | (25,745) |
| Minority interests | | **(1,374)** | (4,662) |
| | | **(16,905)** | (30,407) |
| LOSS PER SHARE | *6* | | |
| Basic | | **(2.5 cents)** | (4.5 cents) |
| Diluted | | **N/A** | N/A |

## CONDENSED CONSOLIDATED BALANCE SHEET

| | Notes | 30 June 2005 (Unaudited) HK$'000 | 31 December 2004 (Audited) (As restated) HK$'000 |
|---|---|---|---|
| NON-CURRENT ASSETS | | | |
| Fixed assets | 8 | **6,643** | 7,532 |
| Intangible assets | 9 | **27,556** | 29,550 |
| Goodwill | 10 | **77,974** | 77,974 |
| | | **112,173** | 115,056 |
| CURRENT ASSETS | | | |
| Inventories | | **7,084** | 3,178 |
| Accounts receivable | 11 | **5,318** | 4,715 |
| Deposit for investment (net of provision) | 12 | **–** | – |
| Prepayments and other receivables | | **985** | 2,671 |
| Cash and cash equivalents | | **2,864** | 5,771 |
| | | **16,251** | 16,335 |
| CURRENT LIABILITIES | | | |
| Bank overdraft | | **811** | – |
| Accounts payable | 13 | **4,561** | 2,172 |
| Other payables and accruals | | **27,756** | 21,683 |
| Due to related companies | | **–** | – |
| Convertible notes | 14 | **–** | 11,610 |
| Interest bearing other borrowings | 15 | **22,722** | 21,957 |
| | | **55,850** | 57,422 |
| NET CURRENT ASSETS | | **(39,599)** | (41,087) |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | **72,574** | 73,969 |
| NON-CURRENT LIABILITIES | | | |
| Other borrowings | | **1,991** | 1,991 |
| | | **70,583** | 71,978 |
| EQUITY | | | |
| CAPITAL AND RESERVES | | | |
| Share capital | 16 | **6,217** | 5,947 |
| Reserves | | **54,246** | 54,537 |
| | | **60,463** | 60,484 |
| Minority interests | | **10,120** | 11,494 |
| | | **70,583** | 71,978 |

## CONDENSED STATEMENT OF CHANGES IN EQUITY

| For the six month period ended | Attributable to shareholders of the Company | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital HK$'000 | Share premium account HK$'000 | Contributed surplus HK$'000 | Statutory surplus reserve HK$'000 | Enterprise development fund HK$'000 | Employee share-based compensation reserve HK$'000 | Exchange fluctuation reserve HK$'000 | Accumulated losses HK$'000 | Minority Interests HK$'000 | Total equity HK$'000 |
| At 1 January 2005, as previously reported | 5,947 | 91,495 | 33,474 | 957 | 478 | – | (606 ) | (71,261 ) | – | 60,484 |
| As at 1 January 2005, as previously separately reported as minority interests | – | – | – | – | – | – | – | – | 11,494 | 11,494 |
| As of 1 January 2005 as restated | 5,947 | 91,495 | 33,474 | 957 | 478 | – | (606 ) | (71,261 ) | 11,494 | 71,978 |
| Shares issued on conversion of convertible notes | 270 | 11,340 | – | – | – | – | – | – | – | 11,610 |
| Employee share option scheme – value of employee services | – | – | – | – | – | 3,900 | – | – | – | 3,900 |
| Net loss for the period | – | – | – | – | – | – | – | (15,531 ) | (1,374 ) | (16,905 ) |
| **As of 30 June 2005** | **6,217** | **102,835** | **33,474** | **957** | **478** | **3,900** | **(606 )** | **(86,792 )** | **10,120** | **70,583** |

| For the six month period ended | Attributable to shareholders of the Company | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital HK$'000 | Share premium account HK$'000 | Contributed surplus HK$'000 | Statutory surplus reserve HK$'000 | Enterprise development fund HK$'000 | Employee share-based compensation reserve HK$'000 | Exchange fluctuation reserve HK$'000 | Retained profits/ (Accumulated losses) HK$'000 | Minority Interests HK$'000 | Total Equity HK$'000 |
| At 1 January 2004, as previously reported | 5,717 | 82,700 | 33,474 | 957 | 478 | – | (606 ) | 3,067 | – | 125,787 |
| As at 1 January 2004, as previously separately reported as minority interests | – | – | – | – | – | – | – | – | 40,805 | 40,805 |
| As at 1 January 2004, as restated | 5,717 | 82,700 | 33,474 | 957 | 478 | – | (606 ) | 3,067 | 40,805 | 166,592 |
| Convertible note issue costs | – | (865 ) | – | – | – | – | – | – | – | (865 ) |
| Net loss for the period | – | – | – | – | – | – | – | (25,745 ) | (4,662 ) | (30,407 ) |
| At 30 June 2004 | 5,717 | 81,835 | 33,474 | 957 | 478 | – | (606 ) | (22,678 ) | 36,143 | 135,320 |

## CONDENSED CONSOLIDATED CASH FLOW STATEMENT

| | Six months ended 30 June | |
|---|---|---|
| | **2005** | 2004 |
| | **(Unaudited)** | (Unaudited) |
| | ***HK$'000*** | *HK$'000* |
| NET CASH OUTFLOW FROM OPERATING ACTIVITIES | **(3,718)** | (10,368) |
| NET CASH OUTFLOW FROM INVESTING ACTIVITIES | **–** | (279) |
| NET CASH INFLOW FROM FINANCING ACTIVITIES | **–** | 20,635 |
| (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS | **(3,718)** | 9,988 |
| Cash and cash equivalents at beginning of the period | **5,771** | 2,980 |
| CASH AND CASH EQUIVALENTS AT END OF THE PERIOD | **2,053** | 12,968 |
| ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS | | |
| Cash and bank balances | **2,864** | 12,968 |
| Bank overdrafts | **(811)** | – |
| | **2,053** | 12,968 |

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### 1. BASIS OF PREPARATION OF FINANCIAL STATEMENTS

The unaudited condensed consolidated interim financial statements have been prepared in accordance with Hong Kong Accounting Standard ("HKAS") No 34 "Interim Financial Reporting" and other relevant HKASs and Interpretations and the Hong Kong Financial Reporting Standards ("HKFRSs") 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 condensed interim financial statements should be read in conjunction with the Company's 2004 annual report.

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 2004 except that the Group has changed certain of its accounting policies following its adoption of new and revised HKFRSs which are effective for accounting periods commencing on or after 1 January 2005.

### 2. CHANGES IN ACCOUNTING POLICIES

#### (a) Effect of adopting new HKFRSs

During the period ended 30 June 2005, the Group adopted the new and revised HKFRSs below, which are relevant to its operations:

- HKAS 1 Presentation of Financial statements
- HKAS 2 Inventories
- HKAS 7 Cash Flow Statements
- HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- HKAS 10 Events after the Balance Sheet Date
- HKAS 12 Income Taxes
- HKAS 14 Segment reporting
- HKAS 16 Property, Plant and Equipment
- HKAS 17 Leases
- HKAS 18 Revenue
- HKAS 19 Employee Benefits
- HKAS 21 The Effects of Changes in Foreign Exchange Rates
- HKAS 24 Related Party Disclosures
- HKAS 27 Consolidated and Separate Financial Statements
- HKAS 32 Financial Instruments: Disclosure and Presentation
- HKAS 33 Earnings per Share
- HKAS 36 Impairment of Assets
- HKAS 37 Provisions, Contingent Liabilities and Contingent Assets
- HKAS 38 Intangible Assets
- HKAS 39 Financial Instruments: Recognition and Measurement
- HKFRS 2 Share-based Payments
- HKFRS 3 Business Combinations

Summary of effect as a result of adoption of the above HKFRSs on the Group is as follows:

(i) The adoption of HKAS 1 has affected the presentation of minority interests and other disclosures.

(ii) HKAS 2, 7, 8, 10, 12, 14, 16, 17, 18, 19, 21, 27, 33, 36, 37 and 39 did not result in substantial changes to the accounting policies of the Group and did not have a significant impact on its results of operations and financial position.

(iii) HKAS 24 has affected the identification of related parties and some other related parties disclosures.

(iv) The adoption of HKFRS 3, HKAS 36 and HKAS 38 results in a change in the accounting policy for goodwill. Prior to this, the goodwill was:

- amortised on a straight-line basis over a period of not exceeding 20 years; and

- assessed for impairment periodically.

  In accordance with the provisions of HKFRS 3:

- the Group ceased the amortisation of goodwill from 1 January 2005;

- the accumulated amortisation of goodwill has been eliminated against cost as of 31 December 2004;

- from the year ending 31 December 2005 onwards, goodwill is tested annually for impairment, as well as when there is indication of impairment. Any impairment loss will be charged to the profit and loss account directly.

(v) The adoption of HKFRS 2 has resulted in a change in the accounting policy for share-based payments. Prior to this, the provision of share options to employees did not result in a charge to profit and loss account. Following the adoption of HKFRS 2, the cost of share option is charged to the consolidation profit and loss account.

(vi) The adoption of HKAS 32 requires an issuer of a compound financial instrument (that contains both financial liability and equity components) to separate the compound financial instrument into its liability and equity components on its initial recognition and to account for these components separately. In subsequent periods, the liability component is carried at amortised cost using the effective interest method. Previously, convertible notes were classified as liability on the balance sheet. Though HKAS 32 requires retrospective application, the adoption of HKAS 32 did not have a significant impact on the results of operation and financial position and related disclosure of the Group for the current and prior period.

The more material effect resulted from the changes in accounting policies on the consolidated profit and loss accounts for the current period is summarized as follows:

re: (iv) ceasation of amortization of goodwill of approximately HK$5,141,000 which would otherwise be recognized as an expenses under the old accounting policy; and

re: (v) introduction of an expense of HK$3,900,000 for share-based payments relating to share options.

**(b) New accounting policies**

The accounting policies used for the unaudited condensed consolidated financial statements for the six months ended 30 June 2005 are the same as those set out in 2004 annual financial statements except for the following:

*2.1 Goodwill*

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition.

Goodwill on acquisitions of subsidiaries is recognised in the consolidated balance sheet as an asset. The Group ceased amortization of goodwill from 1 January 2005. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.

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 carrying amount of goodwill and any relevant reserves, as appropriate.

Goodwill is allocated to cash-generating units for the purpose of impairment testing.

*2.2 Foreign currency translation*

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Hong Kong Dollars, which is the Company's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchanges rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit and loss account.

Translated differences on non-monetary items, such as equity instruments held at fair value through profit and loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

(c) Group companies

The Company's subsidiaries are located in the People's Republic of China (the "PRC"). Its functional and presentation currencies are in RMB.

*2.3 Financial instruments*

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contracted provision of the instrument.

(a) Accounts receivable

Accounts receivable are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the company will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the profit and loss account.

(b) Cash and cash equivalents

For the purposes of the cash flow statements, cash and cash equivalents comprise cash on hand, deposits held at call with banks, cash investments with a maturity of three months or less from date of investment and are subject to an insignificant risk of change in value.

(c) Borrowings

Borrowings are recognised initially at fair value, and are subsequently measured at amortised cost, using the effective interest rate method. Any difference between the proceeds (net of transaction costs) and the settlement or redemption of borrowings is recognised in the profit and loss account over the term of the borrowings.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement for the liability for at least 12 months after the balance sheet date.

(d) Accounts payable

Accounts payable are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method.

(e) Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

*2.4 Share-based compensation*

The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the Group revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the consolidated profit and loss account, and a corresponding adjustment to equity over the remaining vesting period.

*2.5 Critical Accounting estimates and judgements*

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

*Estimated impairment of goodwill*

The Group tests annually whether goodwill has suffered any impairment in accordance with the new accounting policy as referred to in Note 2.1 above. The recoverable amounts of cash-generating units have been determined based on value in use calculations. These calculations require the use of estimates.

## 3. SEGMENT INFORMATION

All the revenue and assets for the Group for the six months ended 30 June 2004 and 2005 were derived from the manufacture, trading and contracting of Chinese medicine products and solely in the PRC. Accordingly, no analysis by business or by geographical segment is provided.

## 4. LOSS BEFORE TAX

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

| | Six months ended 30 June | |
|---|---|---|
| | **2005** | 2004 |
| | **(Unaudited)** | (Unaudited) |
| | ***HK$'000*** | *HK$'000* |
| Other revenue: | | |
| Interest income | **(2)** | (3) |
| Other income | **–** | (51) |
| | **(2)** | (54) |
| Finance costs: | | |
| Interest on bank loans, overdrafts and other borrowings wholly repayable within five years | **765** | 748 |
| Amortisation of Chinese medicine intellectual property and knowhow | **1,944** | 1,994 |
| Provision against inventories | **370** | 2,841 |
| Loss on disposal of fixed assets | **781** | – |
| Staff costs (excluding directors' remuneration) | **3,037** | 3,271 |
| Depreciation | **653** | 1,087 |

## 5. TAXATION

No provision has been made as the Group sustained tax losses during the six months ended 30 June 2004 and 2005. 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 | |
|---|---|---|
| | **2005** | 2004 |
| | **(Unaudited)** | (Unaudited) |
| | ***HK$'000*** | *HK$'000* |
| Hong Kong profits tax | **–** | – |
| PRC income tax | **–** | – |

## 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$15,531,000 (Six months ended 30 June 2004: HK$25,745,000) and the weighted average of 619,114,761 (30 June 2004: 571,650,673) ordinary shares in issue during the period.

Diluted loss per share for the six months ended 30 June 2004 and 30 June 2005 have not been shown as they would have 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 2005 (Six months ended 30 June 2004: Nil).

## 8. FIXED ASSETS

| | **30 June 2005** | 31 December 2004 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Net book value at beginning of period/year | **7,532** | 10,831 |
| Additions | **622** | 507 |
| Disposals | **(2,783)** | (3,899) |
| Depreciation | **(653)** | (2,166) |
| Depreciation write back on disposal | **1,925** | 2,259 |
| Net book value at end of period/year | **6,643** | 7,532 |

## 9. INTANGIBLE ASSETS

| | **30 June 2005** | 31 December 2004 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Balance at beginning of period/year | **29,550** | 33,537 |
| Additions of Chinese medicine intellectual property and knowhow | **–** | – |
| Amortisation for the period/year | **(1,994)** | (3,987) |
| Balance at end of period/year | **27,556** | 29,550 |

## 10. GOODWILL

| | 30 June 2005 HK$'000 | 31 December 2004 HK$'000 |
|---|---|---|
| Balance at beginning of period/year | **77,974** | 88,257 |
| Amortisation for the period/year *(Note 2)* | **–** | (10,283) |
| Balance at end of period/year | **77,974** | 77,974 |

## 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 2005 HK$'000 | 31 December 2004 HK$'000 |
|---|---|---|
| Within 1 month | **1,702** | 1,410 |
| 2 to 3 months | **1,059** | 1,270 |
| 4 to 6 months | **360** | 668 |
| 7 to 12 months | **716** | 364 |
| Over 1 year | **1,481** | 1,003 |
| | **5,318** | 4,715 |

## 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. As of 31 December 2004, the balance of consideration in the amount of approximately HK$19,009,000 has not been paid and full provision for the deposit paid has been made then. The current status of the Investment is detailed in note 19.

## 13. ACCOUNTS PAYABLE

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

| | **30 June 2005** | 31 December 2004 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Within 1 month | **1,931** | 209 |
| 2 to 3 months | **1,201** | 58 |
| 4 to 6 months | **571** | 136 |
| 7 to 12 months | **378** | 584 |
| Over 1 year | **480** | 1,185 |
| | **4,561** | 2,172 |

## 14. CONVERTIBLE NOTES

On 20 April 2004, the Company entered into the subscription agreement with DBS Bank Limited ("DBS"), whereby DBS 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 was to 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 born a coupon interest rate of 2% per annum and might be convertible into new conversion shares of the Company at a conversion price of HK$0.43 per share.

On 28 December 2004, on conversion of HK$9,890,000 convertible notes by the noteholder, 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 18 January 2005, on conversion of the remaining balance of HK$11,610,000 of the convertible notes, 27,000,000 new shares at par value of HK$0.01 per share were issued at the same conversion price.

## 15. INTEREST BEARING OTHER BORROWS

The borrowings are unsecured and interest bearing at Hong Kong dollar prime rate plus 2% per annum. Interest is repayable monthly and the principal is due 31 August 2006 subject to the overriding right to require repayment on demand of the lender.

## 16. SHARE CAPITAL AND OPTIONS

### Share capital

| | **30 June 2005** | 31 December 2004 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| *Authorised:* | | |
| 50,000,000,000 ordinary shares of HK$0.01 each | **500,000** | 500,000 |
| *Issued and fully paid:* | | |
| 621,650,673 (31 December 2004: 594,650,673) ordinary shares of HK$0.01 each | **6,217** | 5,947 |

### Share options

Under the share option scheme adopted by the Company on 7 June 2002 (the "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.

On 11 March 2005, a total of 50,000,000 share options were granted to the directors of the Group and eligible participants pursuant to the Scheme of which 30,000,000 share options granted were accepted. The options were granted at a cash consideration of HK$1.00 per grantee and entitled the grantees to subscribe for ordinary shares (of nominal value of HK$0.01 each) of the Company at an exercise price of HK$0.86 per share. The options may be exercisable during the period from 22 March 2005 to 21 March 2007. During the period ended 30 June 2005, no share options were cancelled or exercised.

Employee share option expenses related to the above grant of share option were estimated to be HK$3,900,000 and were charged to the consolidated profit and loss account. Such expenses determined with the Black-Scholes valuation model based on the following assumptions:

| | |
|---|---|
| Date of grant | 11 March 2005 |
| Value per option | HK$0.13 |
| Price per share at date of grant | HK$0.86 |
| Exercise price per share | HK$0.86 |
| Standard deviation | 0.45 |
| Annual risk-free interest rate | 3% |
| Life of options | 2 years |
| Dividend yield | 0% |

## 17. RELATED PARTY AND CONNECTED TRANSACTIONS

Set out below are the related party transactions disclosed in accordance with HKAS 24 which also constituted connected transactions under the Listing Rules.

| | Six months ended 30 June | |
|---|---|---|
| | **2005** | 2004 |
| | ***HK$'000*** | *HK$'000* |
| Purchase of raw materials/herbs from an associate of a minority interest | **–** | 837 |
| Purchase of raw materials/herbs from the holding company of a minority interest | **863** | – |
| Rental expenses paid to related company – Sun View Company Limited | **540** | 540 |
| Share of office services from a related company – WorldVest Capital Limited | **258** | 258 |

## 18. OPERATING LEASE ARRANGEMENTS

| | Six months ended 30 June | |
|---|---|---|
| | **2005** | 2004 |
| | ***HK$'000*** | *HK$'000* |
| Minimum lease payments paid under operating leases | **474** | 3,057 |

| | **30 June** | 31 December |
|---|---|---|
| | **2005** | 2004 |
| | ***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 | **–** | 2,025 |
| In the second to fifth years, inclusive | **–** | – |
| | **–** | 2,025 |

## 19. CAPITAL COMMITMENTS

(a) As at 30 June 2005, the Group has contracted but not provided for the balance of consideration in respect of the acquisition of an investment by Huayi as detailed in note 12 in the amount of approximately HK$19,009,000 (31 December 2004: HK$19,009,000).

(b) Proposed conditional acquisition and placement

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.

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 hot-rolled medium steel plates and related products. Details of the proposed transactions were published in the Company's circular dated 20 June 2005.

## 20. CONTINGENT LIABILITIES

As detailed in note 18 to the financial statements for 2004 year-end, 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 2005, a balance of approximately HK$19,009,000 is yet to be paid and has been recognized as a capital commitment.

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 the acquisition and claim for losses to the extent the vendor has suffered, which is not quantifiable at this stage. The directors of the Company have sought advice from the PRC legal counsel as to the appropriate action course of action. No action has been made at present to resolve the matter. For conservatism, full provision against the amount of deposit paid was made during the financial year ended 31 December 2004.

## 21. FINANCIAL RISK MANAGEMENT

### Financial risk factors

The Group activities exposed it to a variety of financial risks: currency risk, fair value interest risk, credit risk and cash flow interest-rate risk.

*(a) Foreign exchange risk*

The Group mainly operates in the PRC during the period ended 30 June 2005 with most of the transactions settled in Renminbi. Renminbi is not freely convertible into other foreign currencies. The conversion of Renminbi denominated balances into foreign currencies is subject to the rates and regulations of foreign exchange control promulgated by the PRC government.

On 21 July 2005, the PRC government announced that RMB started to be floated with a basket of certain selected currencies and note to be pegged with United States Dollars on or after that day. As a result, Renminbi appreciated by approximately 2% as compared to United States Dollars based on the exchange rate announced on that date.

(b) *Credit risk*

The Group has no significant concentrations of credit risk. It has policies in place to ensure that sales of products are made to customers with an appropriate credit history.

(c) *Cash flow and fair value interest rate risk*

The Group's exposure to market risk for changes in interest rates relates primarily to the Group's interest bearing other borrowings. The Group does not hedge its interest rate fluctuations.

**Fair value estimation**

The fair values of the Group's financial instruments are not materially different from their carrying amounts. Fair value estimates are made at a specific point in time and are based on relevant market information and information about the financial instruments. These estimates are subjective in nature, involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

**22. POST BALANCE SHEET EVENT**

On 31 July 2005 a wholly-owned subsidiary of the Company entered into a leasing agreement (the "Lease") with an independent third part to secure office accommodation for the Group. The Lease is for a period of two years beginning from 1 August 2005. Total rental payments under the term of the Lease is estimated to be HK$2,380,000 exclusive of management fee and other accommodation related charges.

**23. 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 21 September 2005.

## MANAGEMENT DISCUSSION AND ANALYSIS

### Business Review

Turnover of the Group for the six months ended June 30, 2005 was HK$9,548,000 (as compared to HK$12,622,000 for the corresponding period of last year). Loss attributable to shareholders for the period amounted to HK$15,531,000 (HK$25,745,000 for the corresponding period of last year.)

### Pharmaceutical Business

Following the mandatory plant relocation and the Good Manufacturing Practice certification ("GMP") in 2004, a rather disruptive year as reported in the Company's 2004 annual report, the Group's subsidiary Huayi Pharmaceutical Co., Ltd. ("Huayi") re-established its operating base and resumed production of Chinese medicines. However, production level was at a relatively low level. Further plant upgrade/expansion was desirable but not yet implemented for reasons discussed below.

Sales of Chinese medicines during the period was mainly derived from two products out of the 16 medicines owned by Huayi. Sales for the first half of year was HK$9,548,000, representing a 24% reduction from the same period of last year. The low level sales was impacted in part by Huayi's lack of GMP status for a major part of last year disenabling it to promote at the earlier nation–wide promotional conference which impacted this period. However, with Huayi's own sales team and effort of it's agents, Huayi's products were not only sold in Beijing but also reached Zhejiang, Fujian, Dalin and other areas as far as Guandong and Guanxi. During the period, rising material cost increased production cost and the less than optimal operating level resulted in a high net loss for the period due to unabsorbed fixed costs.

To establish a more optimal operation scale, the management is faced with the options including the identification of new locations for erecting a cost effective new factory, the leasing of a well-equipped manufacturing plant, the subcontracting or licensing to outside parties to manufacture Huayi's products. The alternatives are being carefully reviewed against the limited financial resources available which very much pivots on the compensation package that Beijing City would offer Huayi due to the mandatory removal of Huayi from its plant located at Zhong Guan Cun, Haidian District (中關村海淀區). It also pivots upon the magnitude of new resources that could be secured for investing in new facilities which would support all 16 medicines. Until a decision is made, Huayi shall continue to operate as a self–sustaining and lean organization.

During last year, the Company continued its effort of identifying other worthy opportunities in the PRC. In February this year, the Company entered into the conditional sale and purchase agreement to acquire the entire share capital of Guohua International Investment Limited ("Guohua") and the proposed placement of new shares for the prospect of an established steel operation as reported in the Company's circular dated 20 June 2005. The Group has re-oriented its focus towards high growth, sustainable returns in businesses or projects that would upon completion, substantially strengthen the Group's earning base.

**Proposed Acquisition in the Steel Business**

On February 7, 2005, the Group entered into the conditional sales and purchase agreement for the purchase of the entire share capital of Guohua. To finance such purchase, the Company would issue up to 1.3 billion new shares with placees to raise an estimated HK$780 million, of which HK$50 million will be used as partial satisfaction of the purchase price of Guohua and approximately HK$615 million (Rmb640 million) for the said company's 77.4% capital contribution in its sino-foreign joint venture – Yingkou Steel JV, with Yingkou Middle Plate Factory as its other shareholder. The exercise would result in the Group having an effective 40.7% stake in Yingkou Steel Plant. Yingkou Steel Plant is one of PRC's leading producers of hot-rolled medium steel plates. It has an approximate 1.2 million tonnes annual capacity for steel plates and will soon double its steel slabs capability to 2.5 million tonnes upon the completion of its plant capacity expansion which is currently in the final phase of commission and testing.

The world oil crisis not just bit up prices to historical heights but also gave a signal to the western industrialize countries and the world's largest manufacturing hub-China a warning signal that unless their basic energy sources are secured, an untimely shortage or regional imbalance could have disastrous effects on the livelihood of the people and possibly the stability of their economic and political environment. Despite China's current austerity measures which temporarily dampened the steel industry in general, the PRC government has identified Yingkou as a desirable region for major development. This is due to Yingkou's superb natural competitive advantages: deep-sea port city, expressway network and abundance of low cost land and other resources. These simply cannot be duplicated elsewhere. Further, Yingkou's specialized products cater to sectors such as the oil and energy exploration, transmission pipelines for oil and gas, machinery production and shipbuilding etc.. These sectors are not at all affected by the austerity measures. In fact they are essential to propelling China's growth. There is no sign that PRC's appetite for these specialized products could be satisfied in the foreseeable future. Therefore the prospect of Yingkou investment is far more brighter than the recent bleak sentiment in the steel industry. Strategically, the Yingkou acquisition is also one of the very last opportunity for foreign ownership and control of a profitable steel operation in view of the recent PRC policy change which was designed to curb further foreign majority ownership of similar steel operations. The Company's proposed acquisition of an interest, through Yingkou Steel JV, in Yingkou Steel Plant was approved prior to such policy change and as such foreign control is not an applicable issue. Upon completion, it is expected that the steel business will immediately and significantly improve the Group's profit base and prospects.

### Liquidity and financial resources

During the period, with the exception of the securing of a bank overdraft facility, no financing and investing activities took place. The Group's cash flow position continued to be at a low level which restricted its expansion and capital commitment options. 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 resolved. The compensation is generally expected to give relief to Huayi for recovering losses due to production stoppage and costs incurred for plant relocation and facility removal.

As at 30 June 2005, the Group had cash and cash equivalent balance of approximately HK$2,864,000, a further deterioration from the 2004 year-end level. At period end, the current ratio (represented by total current assets to total current liabilities) of the Group was 0.29. Management was able to further extend the principal repayment date of the loan due shortly after the period end to August of next year. This temporarily relieved the pressure for repayment. However, efforts still will be required to manage the declining working capital of the Group. Plans to issue options and/or secure short terms loans are being investigated. Of the total other borrowings, approximately HK$20,500,000 principal amount of interest bearing loan will become due at 31 August 2006. The loan is denominated in Hong Kong dollar currency and its interest is prime-rate based, management considered that, for risk management purposes, no hedging of foreign currency or interest rate is considered necessary or cost effective.

In March 2005, the Company granted 30,000,000 share options under its Share Option Scheme at an exercise price of HK$0.86 per share. The cost of granting such share options was determined to be HK$3,900,000 based on an evaluation model that took into account, among other things, the time value for money, the volatility of the Company's shares and the features of the option. If all the share options were exercised, the working capital of the Company would be increased by HK$25,800,000. However, as the shares of the Company are currently trading at well below the exercise price, the injection of cash would not material at least for the present moment. And the management must seek other means to manage its more immediate working capital needs.

The Directors are of the view that, following the completion of the proposed acquisition of the steel business and the placing, taking into account the financial resources available to the Group including the present available banking facilities, the Group will have sufficient working capital for its present requirements.

### Pledge of assets and corporate guarantees

As a consequence of the Group's business restructuring in previous years, as of 30 June 2005, contingencies relating to pledged of assets and corporate guarantees provided by the Company for credit facilities granted to its subsidiaries have been totally eliminated.

## Capital structure and gearing

As at 30 June 2005, there were 621,650,673 shares issued and outstanding and the shareholders' equity of the group amounted to approximately HK$60,463,000. Due to the conversion of the remaining convertible notes in January 2005, the capital structure of the Company has been increased during the period by 27,000,000 new shares which were converted at an exercise price of HK$0.43 per share adding HK$11,610,000 to the shareholders equity. As at 30 June 2005, the overall gearing ratio (represented by the ratio of total liabilities to shareholders' equity) of the Group was approximately 96%.

## Prospects

The Group continues to view China to offer exceptional investment opportunities in a wide range of industries. And China is expected to continue gaining presence as a major global player. For PRC enterprises that have an outbound vision, Hong Kong continues to be considered as one of the attractive financial hub for them to raise the desired development capital. The Group will utilize its strength in collaborating with these enterprises (such as the proposed Yingkou steel project) in accessing the international capital market for mutual growth. A cautiously encouraging sign in recent months is that liquidity in the market appears to be improving and so does the general sentiment in the capital market. This offsets to a certain extent the general negative view of the steel industry. The Directors consider that riding on China's economic and industrial development, the steel industry should offer long term prospects. It is hope that a more positive market condition would be favourable to revitalising interests in certain profitable steel sectors, such as the proposed acquisition of the medium steel plate business contemplated by the Company.

## Employees

As at 30 June 2005, there were approximately 150 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 was established in compliance with Rule 3.21 of the Listing Rules for the purpose of reviewing and providing supervision over the Group's financial reporting process and internal controls. The audit committee comprises the independent non-executive directors of the Company and has reviewed, together with the management, the accounting policies and practice adopted by the Group and the financial statements of the unaudited condensed consolidated interim results of the Group for the six months ended 30 June 2005.

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

### (a) Share Capital

As at 30 June 2005, 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"):

**Personal interest**

| Name of director | Number of ordinary shares in the Company | % of the issued share capital |
|---|---|---|
| Cheng Shu Wing (resigned on 20 May 2005) | 100,000 | 0.01% |
| Guo Duen How, Tom | 2,800,000 | 0.45% |
| Kao Ying Lun | 5,000,000 | 0.80% |
| Wu Fred Fong | 5,000,000 | 0.80% |

### (b) Share Option Scheme

Under the share option scheme adopted by the Company on 7 June 2002 (the "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, on 11 March 2005, a total of 50,000,000 share options were granted to the directors of the Group and eligible participants pursuant to the Scheme of which 30,000,000 share options were accepted. The options were granted at a cash consideration of HK$1.00 per grantee and entitled the grantees to subscribe for ordinary shares (of nominal value of HK$0.01 each) of the Company at an exercise price of HK$0.86 per share. The options may be exercisable during the period from 22 March 2005 to 21 March 2007.

| **Name of Director/eligible participants** | **No. of Share Option Granted** |
|---|---|
| Cheng Shu Wing (resigned on 20 May 2005) | 1,700,000 |
| Fung Chi Kin | 6,000,000 |
| Guo Duen How, Tom | 700,000 |
| Ho Yuk Ming, Hugo | 6,000,000 |
| Kao Ying Lun | 1,700,000 |
| Wu Fred Fong | 1,700,000 |
| Choy Tak Ho | 600,000 |
| Tsui Chun Chung, Arthur | 600,000 |
| Wong Chun Wah (resigned on 17 May 2005) | 300,000 |
| Subtotal | 20,300,000 |
| Other eligible participants | 9,700,000 |
| | 30,000,000 |

Save as disclosed above, as at 30 June 2005, 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' right to acquire shares*

Save as disclosed above, 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 2005, 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 shares (long position) | % of the issued share capital |
|---|---:|---:|
| Mr. Chen Ven Chien *(note 1)* | 48,000,000 | 7.72% |
| Mr. Chen Nien Chong | 420,000,000 | 67.56% |
| Mr. Tran Dinh | 180,000,000 | 28.96% |

*Note 1:* By virtue of the SFO, Mr. Chen is deemed to have interest in the Company through holdings in Noble Dynasty Limited.

*Note 2:* Based on the assumption that 600,000,000 consideration shares shall be issued representing 22.7% of the enlarged share capital after completion of the proposed acquisition and placement transactions.

## CODE OF CORPORATE GOVERNANCE PRACTICES

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 2005, in compliance with the Code on Corporate Governance Practices as set out in Appendix 14 of the Listing Rules except for deviations from code provisions A.1.3, A.2.1, A.4.1 and B.1 as described below.

Under code provision A.1.3, notice of at least 14 days should be given of a regular board meeting. During the six months ended 30 June 2005, regular board meetings were held which were convened by a notice of less than 14 days. Despite shorter notice, which in part was dictated by business needs, the presence of all directors was effectively requested. Under code provision A.2.1, the roles of the chairman and the chief executive officer should be separate and should not be performed by the same individual. During the period, the position of the chairman was vacant and the responsibility for the chief executive officer of the Company was shared amongst several directors. Under code provision A.4.1, non-executive directors should be appointed for a specific term. At present, not all the independent non-executive directors of the Company are appointed for a specific term but are nevertheless subject to rotation and re-election at annual general meeting in accordance with the Company's Bye-Laws. Under code provision A.4.2, one-third of the directors for the time being (including those appointed for a specific term) should be subject to retirement by rotation at least once every three years. According to the Company's Bye-Laws, at each annual general meeting, one-third of the directors for the time being shall retire from office and that the chairman of the Company shall not be subject to retirement by rotation or be taken into account in determining the number of directors to retire in each year. Under code provisions section B.1, the Company should establish a remuneration committee comprising a majority of independent directors. During the period, the Company has yet to set up the remuneration committee. To comply with the code provisions, appropriate action will be made by the Company and/or appropriate changes to the Company's Bye-Laws shall be proposed for approval by the shareholders at the annual general meeting in due course.

## 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 2005. Having made specific enquiry of all directors, each of whom has confirmed that they have 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 2005.

On behalf of the Board
**Wu Fred Fong**
*Executive Director*

Hong Kong, 21 September 2005