

Report of the Provisional Liquidators

The joint and several provisional liquidators of the Company (the “Provisional Liquidators”) present their report and the audited financial statements for the year ended 31 March 2004.

The Provisional Liquidators were appointed on 13 October 2004 pursuant to an order of the High Court of Hong Kong and as such, do not have the same detailed knowledge of the financial affairs of the Company and its subsidiaries (the “Group”) as the directors of the Company would have, particularly in relation to the transactions entered into by the Group prior to the appointment date.

The Provisional Liquidators are responsible for the accuracy and completeness of the contents of this report and the audited financial statements for the year ended 31 March 2004 in relation to (i) the affairs of the Group after the appointment of the Provisional Liquidators; and (ii) the preparation of the contents of this report and the audited financial statements for the year ended 31 March 2004 on the basis of the books and records made available to the Provisional Liquidators.

The Provisional Liquidators make no representation as to the completeness of the information contained in this report.

PRINCIPAL ACTIVITIES

The Company is an investment holding company.

Details of the principal activities of the principal subsidiaries as at 31 March 2004 are set out in Note 18 to the financial statements.

RESULTS

The results of the Group are set out in the consolidated profit and loss account on page 13 of the annual report and in the accompanying notes to the financial statements.

FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the past five financial years, as extracted from the audited financial statements and reclassified as appropriate, is set out on page 62 of the annual report. This summary does not form part of the audited financial statements.

BUSINESS REVIEW

The Group’s principal business comprises the purchasing, processing, wholesaling and retailing of Traditional Chinese Medicine (“TCM”) and other medicines, health products, dried seafood, brand name health foods and the provision of medical clinic services.

For the financial year ended 31 March 2004, the Group recorded a consolidated turnover of approximately HK\$142.0 million which was mainly attributable to the sale of the principal subsidiary’s products amounting to HK\$116.4 million. The net loss for the year was approximately HK\$91.9 million compared to HK\$59.3 million in the year 2003. The loss from operations was approximately HK\$83.5 million for the year, compared with approximately HK\$72.2 million in the year 2003.

The Group’s financial position has deteriorated due to, among other things, the strategy to invest in businesses in PRC that are not integrated, do not offer any economies of scale, cost savings or create additional business opportunities for the Group. Legal disputes have also caused a strain on the Group’s financial resources and distracted the attention of management. These issues culminated in the appointment of the Provisional Liquidators. The Company has also endured a lack of working capital to fund and expand the business. There has also been a lack of control over the PRC pharmacy operations arising from a dispute with the local joint venture partners.

Report of the Provisional Liquidators

RESTRUCTURING OF THE GROUP

On 23 December 2004, the Provisional Liquidators entered into an escrow and exclusivity agreement (the “Exclusivity Agreement”) with a preferred investor (the “Investor”) regarding the implementation of a restructuring proposal for the Company (the “Restructuring Proposal”).

Pursuant to the Exclusivity Agreement, the Provisional Liquidators granted the Investor an exclusive right to negotiate a legally binding agreement (the “Restructuring Agreement”) for the implementation of the Restructuring Proposal.

On 8 February 2005, the Company was notified by The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) that the Company had been placed into the second stage of the delisting procedure in accordance with Practice Note 17 of the Rules Governing the Listing on the Stock Exchange (the “Listing Rules”). As such, the Company was required to submit a resumption proposal to the Stock Exchange within six months.

On 25 February 2005, the Company submitted a proposal to the Listing Division of the HKEx (the “Listing Division”), setting out the principal terms of the proposed restructuring and requesting the HKEx’s conditional approval for the resumption of trading in the shares in the Company (the “Resumption Proposal”). On 15 August 2005, a final revised Resumption Proposal and supporting business plan, profit forecast memorandum and financial projections were submitted to the Listing Division, incorporating additional information, clarification and disclosures in response to queries from the Listing Division. The Resumption Proposal set out the principal terms of the proposed restructuring.

On 7 September 2005, a restructuring agreement was entered into by the Company and the Investor for the implementation of the restructuring proposal. A subscription agreement was also entered into by the Company, the Provisional Liquidators and the Investor pursuant to which the Investor has agreed to subscribe for and the Company has agreed to issue and allot the subscription shares and the subscription preference shares.

The Proposed Restructuring, if successfully implemented, will, among other things, result in:

- (i) a restructuring of the share capital of the Company through par value reduction, share consolidation and increase in authorised share capital as contained in the capital restructuring;
- (ii) all the creditors of the Company discharging and waiving their claims against the Company by way of schemes of arrangements under section 166 of the Hong Kong Companies Ordinance and section 99 of the Bermuda Companies Act (“Schemes”);
- (iii) the entire interest of the Company in its dormant or insolvent subsidiaries being transferred to a nominee of the scheme administrators of the Schemes for a nominal consideration; and
- (iv) the resumption of trading in the new shares of the Company upon completion of the Proposed Restructuring (“Completion”) subject to sufficient public float being restored.

Having reviewed and considered the operations and affairs of the Company and its subsidiaries, the magnitude of the claims against the Company and the second stage delisting procedures, the Provisional Liquidators concluded that the proposed restructuring represents the best means available for the Company to be returned to solvency and to continue with the development and enhancement of its business. As at the date of this report, the Provisional Liquidators have received in-principle support from creditors representing more than 75% of the total indebtedness of the Company.

Report of the Provisional Liquidators

The Provisional Liquidators have carefully considered and analysed the commercial and other aspects of each restructuring proposal received from potential investors, including the recovery to the creditors of the Company (the “Creditors”), the returns to the shareholders of the Company (the “Shareholders”) and the time required to complete the proposal. The Provisional Liquidators are of the view that, in the absence of unforeseen circumstances and subject to Completion, the Restructuring Proposal provides more favourable terms than the other proposals and therefore represents the best option currently available to the Company, its Creditors and Shareholders as:

- (i) all liabilities will be compromised and discharged through the Schemes and/or by specific agreement;
- (ii) the pro forma consolidated net tangible asset value and revenues of the restructured Group are expected to be improved;
- (iii) the restructured group will have sufficient working capital for its on-going operations following Completion.

Upon Completion, the Company’s shares will resume trading on the Stock Exchange subject to the approval of the Listing Division.

PROSPECTS

Subject to the approval of the Resumption Proposal by the Listing Division and upon Completion, it is anticipated that the financial position of the Company will be substantially improved as all liabilities of the Company will be compromised and discharged through the Schemes.

The Investor is confident that the Group’s business can be revitalised by discharging its present liabilities and injecting sufficient working capital. The Restructuring Proposal has been structured to restore the financial health of the Company. The Investor has thus far injected preliminary working capital to meet the Group’s working capital requirements for its operations prior to and after Completion.

Considering the popularity of dietary supplements and the increasing ability of the Chinese population to consume precious food items during recent years in Hong Kong, the Investor is confident in the outlook and growth potential of the TCM business and seeks to take advantage of the Company’s principal subsidiary’s business profile and its well established reputation. The Investor has developed strategies to improve the operations and to expand the existing business, including plans to open new stores in both Hong Kong and the PRC and to conduct new marketing, packaging, distribution and product sourcing activities. New product development to expand its existing range of products, Sum Yung which is the hallmark product, will also be invested in.

MAJOR CUSTOMERS AND SUPPLIERS

The percentage of turnover attributable to the Group’s five largest customers combined accounted for less than 30% and the percentage of purchases attributable to the Group’s five largest suppliers combined accounted for approximately 19% whereby purchases from the largest supplier included therein amounted to approximately 5%.

None of the directors of the Company or any of their associates or any shareholders (which, to the best knowledge of the Provisional Liquidators, own more than 5% of the Company’s issued share capital) had any beneficial interest in the Group’s five largest customers and suppliers.

Report of the Provisional Liquidators

SEGMENT INFORMATION

Details of the segment information are set out in Note 5 to the financial statements.

FIXED ASSETS AND INVESTMENT PROPERTIES

Details of movements in the fixed assets and investment properties of the Group and the Company during the year are set out in Notes 14 and 15 to the financial statements.

PRINCIPAL SUBSIDIARIES

Particulars of the Company's principal subsidiaries as at 31 March 2004 are set out in Note 18 to the financial statements.

SHARE CAPITAL

Details of the Company's share capital are set out in Note 32 to the financial statements.

POST BALANCE SHEET EVENTS

Details of the Group's post balance sheet events are set out in Note 41 to the financial statements.

BORROWINGS

Details of the Group's and the Company's borrowings as at 31 March 2004 are set out in Notes 28 and 29 to the financial statements.

RESERVES

Details of movements in the reserves of the Group and the Company during the year are set out in Note 34 to the financial statements.

SUSPENSION OF TRADING

Trading in the securities of the Company has been suspended since 5 August 2004 and will remain suspended until further notice. See also section above entitled "Restructuring of the Group" on page 4.

PROVISIONAL LIQUIDATORS

Cosimo Borrelli and Kelvin Edward Flynn were appointed as Joint and Several Provisional Liquidators of the Company pursuant to an Order of the High Court of Hong Kong Special Administrative Region dated 13 October 2004.

Report of the Provisional Liquidators

DIRECTORS

The directors of the Company (the “Directors”) during the year and up to the date of this report were:

Executive Directors

Mr Sun Hiu Lu
Ms Huang Shuyun
Mr Chu Kwan
Mr Zhao Dake
Mr Zhange Ke, Winston

Independent Non-Executive Directors

Mr Ng Wing Hang
Dr Melvin Wong
Mr Chu Yu Lin, David

In accordance with article 86(2) of the Company’s bye-laws, Mr Zhang Ke, Winston, Dr Melvin Wong and Mr Chu Yu Lin, David will retire and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

In accordance with article 87 of the Company’s bye-laws, Mr Zhao Dake and Mr Ng Wing Hang will retire by rotation and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

The independent non-executive directors do not have specific terms of appointment but are subject to retirement on the same basis as the executive directors as required by the Company’s bye-laws.

However, in view of the Restructuring Proposal, and in the absence of specific resignations, it is proposed that the directors be removed from office by way of special resolution in the forthcoming special general meeting upon Completion. New directors will be appointed at their place.

DIRECTORS’ SERVICE CONTRACTS

Mr Zhang Ke, Winston has a service contract with a subsidiary of the Company commencing on 9 July 2001 which is subject to termination by either party giving not less than 3 months’ written notice. Apart from the foregoing, no director has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

The powers of these directors have been suspended since the appointment of the Provisional Liquidators.

DIRECTORS’ INTERESTS IN CONTRACTS

Save as disclosed in Note 40 to the financial statements, the Provisional Liquidators are not aware of any material interest in any contract of significance to the business of the Group to which the Company or any of its holding companies and subsidiaries was a party during the year.

Report of the Provisional Liquidators

DIRECTORS' INTERESTS IN SHARES AND UNDERLYING SHARES

To the best knowledge of the Provisional Liquidators, having made all reasonable enquiries, as at 31 March 2004, there is no significant change in the directors' interests in shares from the annual report for year 2003 and interim report for September 2003.

The interests of the directors in the share options of the Company are separately disclosed in Note 33 to the financial statements.

Save as disclosed above, the Provisional Liquidators are not aware that the Directors and their associates had any interest in the shares or underlying shares of the Company and its associate corporations, within the meaning of Part XV of the SFO, which (i) were required to be notified to the Company and the Stock Exchange pursuant to section 341 of the SFO (including interests which they were deemed or taken to have under section 344 of the SFO) or (ii) were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein as at 31 March 2004, or (iii) were required, pursuant to the Model Code for Securities Transactions by Directors adopted by the Company to be notified to the Company and the Stock Exchange.

DIRECTORS' REMUNERATION AND THE FIVE HIGHEST PAID EMPLOYEES

Details of the Directors' remuneration and of the five highest paid employees in the Group are set out in Notes 9 and 10 to the financial statements.

DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

To the best knowledge of the Provisional Liquidators, the Provisional Liquidators are not aware of any contracts of significance to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interests, whether directly or indirectly, subsisted at the end of the year or any time during the year.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Save as disclosed in Note 33 to the financial statements, to the best knowledge of the Provisional Liquidators having made all reasonable enquiries, as at 31 March 2004, at no time during the year were rights to acquire benefits by means of the acquisition of shares in or debentures of the Company granted to any directors or their respective spouse or children under 18 years of age, or were any such rights exercised by them, or was the Company or any of its subsidiaries a party to any arrangement to enable the directors to acquire such rights in any other body corporate.

SUBSTANTIAL SHAREHOLDERS

To the best knowledge of the Provisional Liquidators, having made all reasonable enquiries, as at 31 March 2004, there is no significant change in the substantial shareholders from the annual report for year 2003.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's bye-laws, or the laws of Bermuda, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

Report of the Provisional Liquidators

CORPORATE GOVERNANCE

The Provisional Liquidators were appointed to the Company on 13 October 2004. Consequently, the Provisional Liquidators are unable to comment as to whether the Company complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules throughout the financial year.

AUDIT COMMITTEE

To the best knowledge of the Provisional Liquidators, the Company has an audit committee which was established in accordance with the requirements of the Code of Best Practice, for the purposes of reviewing and providing supervision over the Group's financial reporting process and internal controls. The audit committee comprises two independent non-executive directors of the Company.

AUDITORS

On 16 February 2005, Ernst & Young resigned as auditors of the Company. Moore Stephens have been appointed with effect thereafter as auditors of the Company. Moore Stephens retire and a resolution for their re-appointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

For and on behalf of

Hong Kong Pharmaceutical Holdings Limited
(Provisional Liquidators Appointed)

Kelvin Flynn

Cosimo Borrelli

Joint and Several Provisional Liquidators without personal liability

Hong Kong

8 February 2006