

Directors' Report

The Board of Directors (the "Board") is pleased to present to the shareholders their annual report and the audited financial statements of the Company and its subsidiaries (hereinafter collectively referred to as the "Group") for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The Company acts as an investment holding company. The principal activities of its subsidiaries are research, development, manufacture and trading of modern Chinese medicines.

RESULTS

The results of the Group for the year ended 31 December 2005, prepared in accordance with the international accounting standards, are set out in the consolidated income statements on page 50 of this annual report.

DIVIDENDS

An interim dividend of RMB10 cents per share, amounting to RMB82.7 million, was paid to the shareholders on 12 September 2005.

The Board now recommends to pay a final dividend of RMB10 cents per share and a special dividend of RMB2 cents per share for the year ended 31 December 2005 to the shareholders on the register of members of the Company on 26 April 2006. The proposed final and special dividends will be voted by shareholders at the annual shareholders' meeting to be held on 26 April 2006.

On 20 March 2006, the Board approved a dividend policy to distribute to all the shareholders of the Company of not less than 40% of the distributable profit of the year. Interim and final dividends will be distributed in September and June each year.

Interim dividend and recommended final and special dividends in aggregate, amounting to RMB22 cents are equal to approximately 54% of profit attributable to shareholders of 2005.

FINANCIAL HIGHLIGHTS

A summary of the results and assets and liabilities for the last five years, as extracted from the relevant audited financial statements, is set out on page 3 of this annual report. The summary does not form part of the audited financial statements.

PROPERTY, PLANT AND EQUIPMENT

Details of the movement in the property, plant and equipment of the Group during the year are set out in note 12 to the financial statements.

SHARE CAPITAL AND RESERVE

Details of the movement in share capital and reserve of the Company during the year are set out in the consolidated statement of changes in equity and also in note 20 and note 22 to the financial statements. At the balance sheet date, the Company's reserves available for distribution to shareholders amounted to RMB954,506,000 (2004: RMB953,445,000). The Company has not issued any shares during the year.

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DEBENTURES

The Company has not issued any debentures during the year.

DIRECTORS

The directors of the Company during the year and up to the date of this report were:

Executive Directors:

Li Zhenjiang

Wang Zhihua

Xin Yunxia

Li Huimin

Hung Randy King Kuen (appointed on 7 June 2005)

Hou Jiangtao (resigned on 7 June 2005)

Independent non-executive Directors:

Li Kung Man

Wang Jianping

Zhou Chaofan

The biographical details of the directors are set out on page 26 to page 29 of this annual report.

Each of Li Zhenjiang, Wang Zhihua, Xin Yunxia and Li Huimin has entered into a service contract with the Company for a term of two years commencing from 1 October 2004, and Mr. Hung Randy King Kuen has entered into a service contract with the Company for a term commencing from 7 June 2004 to 31 May 2008. Each service contract will continue thereafter until terminated by not less than three months' notice in writing served by either party on the other.

Each of the independent non-executive directors has been appointed for a term of two years commencing on 10 November 2004. In addition, the appointment of each of the independent non-executive directors is subject to retirement by rotation in accordance with the Company's Articles of Association.

Other than disclosed above, none of the directors has entered or has proposed to enter into any service contract with the Company or any of its subsidiaries which is not expiring or determinable by the employing company within one year without payment of compensation other than statutory compensation.

The Company had received confirmation from each of the independent non-executive directors of their independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on the Stock Exchange and considered all independent non-executive directors to be independent.

In accordance with the provisions of the Company's Articles of Association, Li Zhenjiang, Wang Zhihua, Xin Yunxia and Hung, Randy King Kuen will retire from the Board at the forthcoming annual general meeting but, being eligible, will offer themselves for re-election.

Detail of directors' emoluments on a named basis are set out in note 7 to the financial statement on page 66 of this annual report.

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DIRECTORS' INTERESTS IN CONTRACTS

Save as disclosed in note 29 to the financial statements, no contracts of significance to which the Company, any of its holding companies, fellow subsidiaries or subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

DIRECTORS' INTERESTS IN SHARES

As at 31 December 2005, the interests and short positions of the Directors and their respective associates in the shares, underlying shares and debentures of the Company and its associated corporations within the meaning of Part XV of the Securities and Future Ordinance (the "SFO"), which are required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under such provisions of the SFO) or which are required pursuant to section 352 of the SFO, to be entered in the register referred therein, or which one required, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies to be notified to the Company and the Stock Exchange, were as follows:

| Name of director | Name of relevant Company | Capacity | Number of shares held | Approximate percentage of shareholding in the Company |
|-----------------------|--------------------------|---------------------------------------|-----------------------|---|
| Li Zhenjiang | Company | Founder of discretionary trust (Note) | 600,000,000 | 72.55% |
| Hung, Randy King Kuen | Company | Beneficiary owner | 50,000 | 0.01% |

Note: These 600,000,000 Shares are held by Sinovest International Investment Limited, which is owned as to approximately 79.40% by Forway Investment Limited ("Forway"). Forway is owned as to 100% by Trustcorp Limited, a trust company, in its capacity as the trustee of The Li Family 2004 Trust, a discretionary trust the founder (as defined in the SFO) of which is Mr. Li Zhenjiang and the discretionary objects of which are family members of Mr. Li Zhenjiang (excluding Mr. Li Zhenjiang himself). Accordingly, Mr. Li Zhenjiang is deemed to be interested in the 600,000,000 Shares under the SFO.

Save as disclosed above, as at 31 December 2005, none of the directors of the Company or their respective associates had any interest or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

At no time during the year was the Company, its holding company or any of its subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

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SUBSTANTIAL SHAREHOLDERS

(a) Interest in the Company

As at 31 December 2005, interest of every person (not being a director or chief executive of the Company) in the shares and underlying shares in the Company as recorded in the register required to be kept by the Company under Section 336 of the SFO were as follows:

| Name of shareholder | Capacity | Number of shares held | Approximate percentage of shareholding in the Company |
|---|--------------------------------------|-----------------------|---|
| Sinovest International Investment Limited ("Sinovest") (Notes 1 and 2) | Beneficial owner | 600,000,000 | 72.55% |
| Forway Investment Limited ("Forway") (Notes 1, 2 and 3) | Interest of a controlled corporation | 600,000,000 | 72.55% |
| Trustcorp Limited (Notes 1 to 4) | Trustee of discretionary trust | 600,000,000 | 72.55% |
| David Henry Christopher HILL (Notes 1 and 5) | Interest of controlled corporation | 600,000,000 | 72.55% |
| David William ROBERTS (Notes 1 and 6) | Interest of controlled corporation | 600,000,000 | 72.55% |
| Rebecca Ann HILL (Notes 1, 5 and 7) | Interest of spouse | 600,000,000 | 72.55% |

Notes:

- (1) All interests of Sinovest, Forway, Trustcorp Limited, David Henry Christopher HILL, David William ROBERTS and Rebecca Ann HILL were duplicated.
- (2) The 600,000,000 shares are beneficially owned by Sinovest.
- (3) The issued share capital of Sinovest is owned as to approximately 79.4% by Forway. Accordingly Forway is deemed to be interested in the 600,000,000 shares of the Company under the SFO.

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(4) The entire issued share capital of Forway is owned by Trustcorp Limited in its capacity as the trustee of The Li Family 2004 Trust, a discretionary trust the founder (as defined in the SFO) of which is Li Zhenjiang and the discretionary objects of which are family members of Li Zhenjiang (excluding Li Zhenjiang himself). Accordingly, Trustcorp Limited is deemed to be interested in the 600,000,000 shares of the Company under the SFO.

(5) The following is a breakdown of the interests in shares held by David Henry Christopher HILL:

| Name of controlled corporation | Name of controlling shareholder | Percentage of control | Total interest in Shares | |
|---|---------------------------------|-----------------------|--------------------------|-------------------|
| | | | Direct interest | Indirect interest |
| Newcorp Holdings Ltd. | David Henry Christopher HILL | 35 | – | 600,000,000 |
| Newcorp Ltd. | Newcorp Holdings Ltd. | 100 | – | 600,000,000 |
| Trustcorp Limited | Newcorp Ltd. | 100 | – | 600,000,000 |
| Forway Investment Limited | Trustcorp Limited | 100 | – | 600,000,000 |
| Sinovest International Investment Limited | Forway Investment Limited | 79.4 | 600,000,000 | – |

(6) The following is a breakdown of the interests in shares held by David William ROBERTS:

| Name of controlled corporation | Name of controlling shareholder | Percentage of control | Total interest in Shares | |
|---|---------------------------------|-----------------------|--------------------------|-------------------|
| | | | Direct interest | Indirect interest |
| Newcorp Holdings Ltd. | David William Roberts | 35 | – | 600,000,000 |
| Newcorp Ltd. | Newcorp Holdings Ltd. | 100 | – | 600,000,000 |
| Trustcorp Limited | Newcorp Ltd. | 100 | – | 600,000,000 |
| Forway Investment Limited | Trustcorp Limited | 100 | – | 600,000,000 |
| Sinovest International Investment Limited | Forway Investment Limited | 79.4 | 600,000,000 | – |

(7) This interest is in fact the same block of 600,000,000 shares disclosed by David Henry Christopher HILL.

(b) Interest in other members of the Group

As at 31 December 2005, so far as the directors or the chief executives of the Company are aware, no person will be directly or indirectly interested in 5% or more of the nominal value of any class of Shares carrying rights to vote in general meetings of any other member of the Group:

As at 31 December 2005, the Company had not been notified by any persons who had interests or short positions in the shares or underlying shares of the Company which would fall to be disclosed to the Company under Divisions 2 and 3 of Part XV of the SFO.

SHARE OPTION SCHEME

The existing share option scheme (the "Scheme"), which was adopted by the Company pursuant to a written resolution of the sole shareholder of the Company passed on 10 November 2004 is for the primary purpose of providing a flexible means of giving incentives to, rewarding, remunerating, compensating and/or providing benefits to the following participants, and for such other purposes as the Board may approve from time to time:

- (i) any executive or non-executive director including any independent non-executive director or any employee (whether full-time or part-time) of any member of the Group;
- (ii) any discretionary object of a discretionary trust established by any substantial shareholder of the Company or any employee, executive or non-executive director of any member of the Group;
- (iii) any consultant, professional and other advisers to any member of the Group;
- (iv) any chief executive or substantial shareholder of any member of the Group;
- (v) any Associate of any director, chief executive or substantial shareholder of any member of the Group; and
- (vi) any employee (whether full-time or part-time) of substantial shareholder of any member of the Group to take up Options.

The total number of shares in respect of which options may be granted under the Scheme is 82,700,000 shares, which is equivalent to 10% of the total number of shares of the Company in issue on the date of commencement of dealings in the shares of the Company on the Stock Exchange.

The maximum number of shares of the Company issued and to be issued upon exercise of the options granted to each participant (including both exercised and unexercised options) under the Scheme and any other share option scheme (if any) adopted by the Company in any 12-month period must not exceed 1% of the shares of the Company in issue unless otherwise approved by the Company's shareholders. Where any grant of options to a substantial shareholder, an independent non-executive director, or any of their respective associates (including a discretionary trust whose discretionary objects include a substantial shareholder or an independent non-executive director or a company beneficially owned by any substantial shareholder or independent non-executive director of the Company) would result in the shares of the Company issued and to be issued upon exercise of all options already granted and to be granted to such person in any 12-month period up to and including the date of the grant:

- (i) representing in aggregate over 0.1% of the shares of the Company in issue; and
- (ii) having an aggregate value, based on the closing price of the shares of the Company as stated in the daily quotations sheets issued by the Stock Exchange on the date of grant in excess of HK\$5 million,

such grant of option shall be subject to prior approval of the shareholders of the Company who are not connected persons of the Company as defined in the Listing Rules.

An option must be exercised within 10 years from the date of grant or such shorter period as the Board may notify to the grantee.

Option granted must be taken up within 14 days from the date of offer, upon payment of HK\$1 per option. Options may be exercised at any time from the date of grant of the share option to the 10th anniversary of the date of grant. The exercise price is determined by the directors of the Company, and will not be less than the higher of (i) the closing price of the Company's shares on the date of grant, (ii) the average closing price of the shares for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's share.

The Scheme has a life of 10 years and will expire on 9 November 2014 unless otherwise terminated in accordance with the terms of the Scheme.

However, no option was granted, exercised, cancelled or lapsed during the year and as at the date of this report since adoption.

PURCHASE, SALE OR REDEMPTION OF SHARES

The Group repurchased 3,000,000 ordinary shares from the public market at a price of HK\$3.175-HK\$3.450 from 4 July to 14 July 2005, with a total cost of HK\$9,873,925. These shares have been cancelled. As the Board believes that the share price cannot reflect the value of the Company at that time, it therefore decided to conduct a repurchase.

Save for the above, for the year ended 31 December 2005, the Company or its subsidiaries did not purchase, sell or redeem any shares of the Company.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Articles of Association although there are no restrictions against such rights under the laws in the Cayman Islands.

MAJOR CUSTOMERS AND SUPPLIERS

The aggregate sales attributable to the largest customer and five largest customers of the Group were 4.4% and 14.5% respectively of the Group's turnover for the year.

None of the directors, their associates, or any shareholder (which to the knowledge of the directors owns more than 5% of the Company share capital) has any interest in the five largest customers of the Group.

The aggregate purchases attributable to the largest supplier and five largest suppliers of the Group were 4.2% and 16.7% respectively of the Group's purchases for the year.

CONNECTED TRANSACTIONS

1. As disclosed in the Prospectus, the Company and Shineway Medical Science and Technology (Lang Fang) Co., Ltd. ("Shineway Lang Fang") entered into the Option Agreement on 20 November 2004 whereby Shineway Lang Fang granted to the Company and its subsidiaries the Option to acquire (or to nominate a subsidiary to acquire) all or part of the 20% equity interest held by Shineway Lang Fang in Shineway Pharmaceutical Sales Co., Ltd. ("Shineway Sales".)

On 30 March 2005 the Company has exercised the Option and Yuan Da, a wholly-owned subsidiary of the Company, and Shineway Lang Fang entered into the Equity Transfer Agreement, pursuant to which Shineway Lang Fang conditionally agreed to sell and Yuan Da conditionally agreed to purchase 20% of the equity interest held by Shineway Lang Fang in Shineway Sales at the Consideration to be calculated by multiplying the Shineway Sales 2004 Profit with 20% and the price earning ratio of 10x ("the Acquisition"). According to the audited financial statements of Shineway Sales for its financial year ended 31 December 2004 prepared according to International Financial Reporting Standards and the accounting policies adopted by the Company and audited by an international accounting firm, the Shineway Sales 2004 Profit is RMB39.8 million (equivalent to approximately HK\$37.6 million). On such basis, the amount of the Consideration is RMB80.8 million (equivalent to approximately HK\$76.2 million).

Previously, Shineway Sales, owned as to 80% by Yuan Da and as to 20% by Shineway Lang Fang, is principally engaged in providing sales and marketing services for the distribution of products manufactured by the Group. Upon Completion, Shineway Sales will become a wholly-owned subsidiary of Yuan Da and a wholly-owned foreign invested enterprise.

The Acquisition was approved by the ordinary resolution passed at the extraordinary general meeting held on 19 April 2005 by the polls of the independent shareholders.

The Company confirmed that it has complied with the disclosure requirements in accordance with Chapter 14A of the Exchange Listing Rules.

2. Pursuant to the supply agreement dated 20 November 2004 between Shineway Sales, a connected person of the Company under Rule 14A.11(5) of the Listing Rules, and 河北神威大藥房連鎖有限公司 (Hebei Shineway Chain Drugstores Co., Ltd.) ("Shineway Drugstores"), a connected person of the Company by virtue of being ultimately controlled by Mr. Li Zhenjiang, an executive director of the Company, Shineway Pharmaceutical had agreed to supply Shineway Drugstores with pharmaceutical products for a term of two years and nine months commencing on 1 April 2004 until 31 December 2006 in accordance with the terms of the sale and purchase contracts to be entered into between the parties from time to time during the term of the agreement. The continuing connected transaction contemplated under this supply agreement is subject to reporting, announcement and independent shareholders' approval requirements, but waiver from strict compliance therewith (except the reporting requirement) has been obtained from the Stock Exchange. For the year ended 31 December 2005, the total sales by Shineway Sales to Shineway Drugstores amounted to RMB2,018,000 (equivalent to approximately HK\$1,959,000), which did not exceed the annual cap of RMB9,000,000 (equivalent to approximately HK\$8,738,000) prescribed for the year ended 31 December 2005 as disclosed in the Prospectus. However, effective from 30 June 2005, Shineway Sales had become a wholly-owned subsidiary of the Group.

3. Upon listing of the Company, pursuant to the two supply agreements both dated 20 November 2004 entered into by Shineway Sales, a connected person of the Company under Rule 14A.11(5) of the Listing Rules, with each of Shineway Pharmaceutical and Hebei Shineway, two wholly-owned subsidiaries of the Company, each of Shineway Pharmaceutical and Hebei Shineway had agreed to supply Shineway Sales with pharmaceutical products for a term of two years and nine months commencing on 1 April 2004 until 31 December 2006 in accordance with the terms of the sale and purchase contracts to be entered into between the parties for wholesale purposes from time to time during the term of the agreement. The continuing connected transactions contemplated under these two supply agreements are subject to reporting, announcement and independent shareholders' approval requirements, but waiver from strict compliance therewith (except the reporting requirement) has been obtained from the Stock Exchange. For the year ended 31 December 2005, the total sales by Shineway Pharmaceutical and Hebei Shineway to Shineway Sales amounted to RMB768,570,000 (equivalent to approximately HK\$746,184,000), which did not exceed the annual cap of RMB780,000,000 (equivalent to approximately HK\$757,000,000) prescribed for the year ended 31 December 2005 as disclosed in the Prospectus. However, effective from 30 June 2005, Shineway Sales had become a wholly-owned subsidiary of the Group.
4. The independent non-executive directors of the Company have reviewed the connected transactions in paragraphs 2 and 3 above and have considered the procedures performed by the auditors of the Company in reviewing them and confirmed that:
 - (a) the transactions have been entered into by the relevant member of the Group in the ordinary and usual course of business of the Group;
 - (b) the transactions have been entered into on an arm's length basis and on normal commercial terms (to the extent that there are comparable transactions) or, if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, or terms not less favourable to the Group than terms available to or from (as the case may be) independent third parties; and
 - (c) the transactions have been entered into in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

MANAGEMENT CONTRACTS

Except for the connected transactions as stated in this directors' report, no contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

EMOLUMENT POLICY

The emolument policy of the employees of the Group is set up by the Remuneration Committee on the basis of their merit, qualification and competence.

The emolument of the directors of the Company are decided by the Remuneration Committee, having regard to the Company's operating results, individual performance and comparable market statistics.

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The directors' fees, basic salaries, housing allowances, other allowances and benefits in kind are disclosed in note 7 to the financial statements.

The contributions to pension schemes for directors and past directors for the financial year are disclosed in note 7 to the financial statements.

Pursuant to the directors' service contracts with the Company, all executive directors' annual salary, except one, will increase as from 1 January 2006 at an incremental rate of 5% per annum. All executive director, except one, shall also be entitled to an allowance of 16.5% of his or her annual salary. In addition, the executive directors may be entitled to a discretionary bonus to be determined by the Board (or its duly appointed remuneration committee) at its absolute discretion having regard to the performance of the Group, provided that the aggregate amount of the bonus payable to those directors in respect of any financial year shall not exceed 5% of the audited consolidated net profit after taxation but before extraordinary items of the Company for the relevant financial year.

There were no compensation paid during the financial year or receivable by directors or past directors for the loss of office as a director of any member of the Group or of any other office in connection with the management of the affairs of any member of the Group distinguishing between contractual and other payments.

PENSION SCHEMES

The pension schemes of the Company and its subsidiaries are primarily in form of contributions to the Hong Kong mandatory provident fund and China statutory public welfare fund.

SUFFICIENCY OF PUBLIC FLOAT

The Company has maintained a sufficient public float throughout the year of 2005.

CHARITABLE DONATIONS

During the year, neither the Company nor its subsidiaries made charitable and other donations.

AUDITORS

During the year, Messrs. Deloitte Touche Tohmatsu were appointed as auditors of the Company. A resolution will be submitted to the annual general meeting to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.

On behalf of the Board

LI ZHENJIANG

CHAIRMAN OF THE BOARD

Hong Kong, 20 March 2006