# YANION INTERNATIONAL HOLDINGS LIMITED

(Incorporated in Bermuda with limited liability)

(Stock Code: 82)

# Interim Report 2006

**CONTENTS**

## CORPORATE INFORMATION

### DIRECTORS

*Executive Directors*
Mr. Guo Duen How, Tom
Mr. Kao Ying Lun
Ms. Wang Chun
Mr. Wu Fred Fong
Mr. Yu Jianmeng
Dr. Zhang Lijun

*Independent non-executive Directors*
Mr. Choy Tak Ho
Dr. Loke Yu alias Loke Hoi Lam
Mr. Tsui Chun Chung, Arthur

### COMPANY SECRETARY AND QUALIFIED ACCOUNTANT

Mr. Wu Fred Fong, FCPA

### AUDITORS

Horwath Hong Kong CPA Limited

### LEGAL ADVISORS

Chiu & Partners
Jones Day

### PRINCIPAL BANKERS

Bank of China (Hong Kong) Limited
Industrial and Commercial Bank of China (Asia) Limited
The Bank of East Asia, Limited
The Hongkong and Shanghai Banking Corporation Limited

### REGISTRARS

Butterfield Fund Services (Bermuda) Limited
Rosebank Centre
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Pembroke, Bermuda

### REGISTRAR IN HONG KONG

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### REGISTERED OFFICE

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### PRINCIPAL PLACE OF BUSINESS

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### STOCK EXCHANGE LISTING

Main Board of The Stock Exchange of Hong Kong Limited – Stock code: 82

The board of directors of Yanion International Holdings Limited (the "Company") is pleased to announce that the unaudited condensed consolidated interim results of the Company and its subsidiaries (the "Group") for the six months ended 30 June 2006 as follows:

## CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

| | | Six months ended 30 June | |
|---|---|---|---|
| | | **2006** | 2005 |
| | | **(Unaudited)** | (Unaudited) |
| | *Notes* | ***HK$'000*** | *HK$'000* |
| TURNOVER | *4* | **7,540** | 9,548 |
| Cost of sales | | **(3,965)** | (4,161) |
| Gross profit | | **3,575** | 5,387 |
| Other revenue | | **21** | 2 |
| Selling and distribution costs | | **(3,297)** | (2,777) |
| Administrative expenses | | **(13,200)** | (18,752) |
| Impairment of goodwill | | **(12,044)** | – |
| LOSS FROM OPERATING ACTIVITIES | | **(24,945)** | (16,140) |
| Finance costs | | **(170)** | (765) |
| LOSS BEFORE TAX | *5* | **(25,115)** | (16,905) |
| Taxation | *6* | **–** | – |
| LOSS FOR THE PERIOD | | **(25,115)** | (16,905) |
| ATTRIBUTABLE TO: | | | |
| Shareholders of the Company | | **(23,306)** | (15,531) |
| Minority interests | | **(1,809)** | (1,374) |
| | | **(25,115)** | (16,905) |
| LOSS PER SHARE | *7* | | |
| Basic | | **(3.2 cents)** | (2.5 cents) |
| Diluted | | **N/A** | N/A |

## CONDENSED CONSOLIDATED BALANCE SHEET

| | Notes | As at 30 June 2006 (Unaudited) HK$'000 | As at 31 December 2005 (Audited) HK$'000 |
|---|---|---|---|
| NON-CURRENT ASSETS | | | |
| Fixed assets | 9 | **5,972** | 6,604 |
| Intangible assets | 10 | **24,248** | 26,300 |
| Goodwill | 11 | **24,980** | 37,024 |
| | | **55,200** | 69,928 |
| CURRENT ASSETS | | | |
| Inventories | | **7,741** | 5,874 |
| Accounts receivable | 12 | **4,254** | 4,745 |
| Prepayments and other receivables | | **351** | 801 |
| Cash and cash equivalents | | **2,858** | 4,794 |
| | | **15,204** | 16,214 |
| CURRENT LIABILITIES | | | |
| Accounts payable | 13 | **3,072** | 1,316 |
| Other payables and accruals | | **33,459** | 35,214 |
| Amount due to a related company | | **430** | 171 |
| Other borrowings | 14 | **1,414** | 21,957 |
| Tax payable | | **1,030** | – |
| | | **39,405** | 58,658 |
| NET CURRENT LIABILITIES | | **(24,201)** | (42,444) |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | **30,999** | 27,484 |
| NON-CURRENT LIABILITIES | | | |
| Other borrowings | | **2,048** | 2,048 |
| | | **28,951** | 25,436 |
| EQUITY | | | |
| CAPITAL AND RESERVES | | | |
| Share capital | 15 | **7,610** | 6,367 |
| Reserves | | **13,894** | 9,813 |
| | | **21,504** | 16,180 |
| Minority interests | | **7,447** | 9,256 |
| | | **28,951** | 25,436 |

## CONDENSED STATEMENT OF CHANGES IN EQUITY

| For the six month period ended | Attributable to shareholders of the Company | | | | | | | | Minority Interests | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium account | Contributed surplus | Statutory surplus reserve | Enterprise development fund | Employee share-based compensation reserve | Exchange fluctuation reserve | Accumulated losses | | |
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| As of 1 January 2006 | 6,367 | 109,885 | 33,474 | 983 | 491 | 3,971 | (135 ) | (138,856 ) | 9,256 | 25,436 |
| Issue of new share | 1,243 | 27,974 | | | | | | | | 29,217 |
| Share issue expense | | | (584 ) | | | | | | | (584 ) |
| Exchange difference | | | | | | | (3 ) | | | (3 ) |
| Net loss for the period | – | – | – | – | – | – | – | (23,306 ) | (1,809 ) | (25,115 ) |
| **As of 30 June 2006** | **7,610** | **137,275** | **33,474** | **983** | **491** | **3,971** | **(138 )** | **(162,162 )** | **7,447** | **28,951** |

| For the six month period ended | Attributable to shareholders of the Company | | | | | | | | Minority Interests | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium account | Contributed surplus | Statutory surplus reserve | Enterprise development fund | Employee share-based compensation reserve | Exchange fluctuation reserve | Accumulated losses | | |
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| As of 1 January 2005 | 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 |

## CONDENSED CONSOLIDATED CASH FLOW STATEMENT

| | Six months ended 30 June | |
|---|---|---|
| | **2006** | 2005 |
| | **(Unaudited)** | (Unaudited) |
| | ***HK$'000*** | *HK$'000* |
| NET CASH OUTFLOW FROM OPERATING ACTIVITIES | **(9,917)** | (3,718) |
| NET CASH OUTFLOW FROM INVESTING ACTIVITIES | **(107)** | – |
| NET CASH INFLOW FROM FINANCING ACTIVITIES | **8,090** | – |
| (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS | **(1,934)** | (3,718) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD | **4,792** | 5,771 |
| CASH AND CASH EQUIVALENTS AT END OF THE PERIOD | **2,858** | 2,053 |
| ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS | | |
| Cash and bank balances | **2,858** | 2,864 |
| Bank overdrafts | **–** | (811) |
| | **2,858** | 2,053 |

## 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 the 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").

### 2. ACCOUNTING POLICIES

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 2005. The condensed interim financial statements should be read in conjunction with the Company's 2005 annual report.

In the current interim period, the Group has applied, for the first time, a number of new standards, amendments and interpretations ("new HKFRSs") issued by HKICPA, which are effective for accounting periods beginning on 1 January 2006 and which are relevant to its operations. The adoption of the new HKFRSs has no significant impact on these condensed consolidated interim financial statements.

The Group has not early applied the following new standard, amendment or interpretations that have been issued but not yet effective. The directors of the Company anticipate that the application of these standard, amendment or interpretations will have no material impact on the financial position and the results of the Group.

| | |
|---|---|
| HKAS 1 (Amendment) | Capital disclosures[1] |
| HKFRS 7 | Financial instruments: disclosures[1] |
| HK(IFRIC) – Int 7 | Applying the restatement approach under HKAS 29, financial reporting in hyperinflationary economies[2] |
| HK (IFRIC) – Int 8 | Scope of HKFRS 2[3] |
| HK (IFRIC) – Int 9 | Reassessment of embedded derivatives[4] |

[1] Effective for annual periods beginning on or after 1 January 2007
[2] Effective for annual periods beginning on or after 1 March 2006
[3] Effective for annual periods beginning on or after 1 May 2006
[4] Effective for annual periods beginning on or after 1 June 2006

## 3. 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.

In determining whether an asset is impaired or the event previously causing the impairment no longer exist, the Group has to exercise judgement in the area of asset impairment, particularly in assessing: (1) whether an event has occurred that may effect the asset value or such event affecting the asset value has not been in existence; (2) whether the carrying value of an asset can be supported by net present value of future cash flows which are estimated based upon the continued use of the asset or derecognition; and (3) the appropriate key assumptions to be applied in preparing cash flow projections including whether these cash flow projections are discounted using an appropriate rate. Changing the assumptions selected by management to determine the level of impairment, including the discount rates or the growth rate assumptions in the cash flow projections, could materially affect the net present value used in the impairment test.

**Estimation uncertainty**

The Group also makes estimates and assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date. 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:–

(i) The Group tests at least annually whether goodwill has suffered any impairment. The recoverable amounts of cash-generating units have been determined based on value in use calculations. These calculations require the use of estimates.

(ii) Share option expense is subject to the limitations of the Black Scholes pricing model and the uncertainty in estimates used by management in the assumptions. The Black Scholes pricing model is modified for the early exercise of share options in limited open exercise periods. Should the estimates including limited early exercise behaviour, expected interval and frequency of open exercise periods in the share option life and the relevant parameters of the share option model be changed, there would be material changes in the amount of share option benefits recognised in the profit and loss account and employee share-based compensative reserve.

## 4. SEGMENT INFORMATION

All the revenue and assets for the Group for the six months ended 30 June 2005 and 2006 were derived from the manufacture, trading and contracting of Chinese medicine products in the PRC. Accordingly, no analysis by business or by geographical segment is provided.

## 5. LOSS BEFORE TAX

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

| | Six months ended 30 June | |
|---|---|---|
| | **2006** | 2005 |
| | **(Unaudited)** | (Unaudited) |
| | ***HK$'000*** | *HK$'000* |
| Other revenue: | | |
| Interest income | **(5)** | (2) |
| Other income | **(16)** | – |
| | **(21)** | (2) |
| Finance costs: | | |
| Interest on bank loans, overdrafts and other borrowings wholly repayable within five years | **170** | 765 |
| Amortisation of Chinese medicine intellectual property and knowhow | **2,051** | 1,994 |
| Impairment of goodwill | **12,044** | – |
| Provision against inventories | **–** | 370 |
| Loss on disposal of fixed assets | **181** | 781 |
| Staff costs (excluding directors' remuneration) | **2,037** | 3,037 |
| Depreciation | **703** | 653 |

## 6. TAXATION

No provision has been made as the Group sustained tax losses during the six months ended 30 June 2005 and 2006. 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.

## 7. 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$23,306,000 (Six months ended 30 June 2005: HK$15,531,000) and the weighted average of 734,878,242 (30 June 2005: 619,114,761) ordinary shares in issue during the period.

Diluted loss per share for the six months ended 30 June 2005 and 30 June 2006 have not been shown as they would have an anti-dilutive effect on the basic loss per share for both periods.

## 8. DIVIDENDS

The directors of the Company do not recommend the payment of any interim dividend for the six months ended 30 June 2006 (Six months ended 30 June 2005: Nil).

## 9. FIXED ASSETS

| | **30 June 2006** *HK$'000* | 31 December 2005 *HK$'000* |
|---|---|---|
| Net book value at beginning of period/year | **6,604** | 7,532 |
| Additions | **111** | 1,241 |
| Disposals | **(117)** | (3,414) |
| Depreciation | **(703)** | (1,298) |
| Depreciation write back on disposal | **77** | 2,329 |
| Exchange adjustments | **–** | 214 |
| Net book value at end of period/year | **5,972** | 6,604 |

## 10. INTANGIBLE ASSETS

| | **30 June 2006** *HK$'000* | 31 December 2005 *HK$'000* |
|---|---|---|
| Balance at beginning of period/year | **26,300** | 29,550 |
| Amortisation for the period/year | **(2,052)** | (3,250) |
| Balance at end of period/year | **24,248** | 26,300 |

## 11. GOODWILL

| | **30 June 2006** *HK$'000* | 31 December 2005 *HK$'000* |
|---|---|---|
| Balance at beginning of period/year | **37,024** | 77,974 |
| Impairment loss recognised in the period/year | **(12,044)** | (40,950) |
| Balance at end of period/year | **24,980** | 37,024 |

## 12. ACCOUNTS RECEIVABLE

An aged analysis of accounts receivable based on payment due date and net of provisions is as follows:

| | **30 June 2006** *HK$'000* | 31 December 2005 *HK$'000* |
|---|---|---|
| Within 1 month | **2,131** | 866 |
| 2 to 3 months | **803** | 1,438 |
| 4 to 6 months | **540** | 647 |
| 7 to 12 months | **186** | 1,228 |
| Over 1 year | **594** | 566 |
| | **4,254** | 4,745 |

## 13. ACCOUNTS PAYABLE

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

| | **30 June 2006** | 31 December 2005 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Within 1 month | **1,717** | 288 |
| 2 to 3 months | **684** | – |
| 4 to 6 months | **197** | 115 |
| 7 to 12 months | **18** | 18 |
| Over 1 year | **456** | 895 |
| | **3,072** | 1,316 |

## 14. OTHER BORROWINGS

As at 30 June 2006, the balance of HK$1,414,000 represents an advance by the minority shareholder of the Company's subsidiary. The advance is unsecured, non-interest bearing and had no fixed date of repayment.

As at 31 December 2005, the other borrowings included the unsecured other borrowings which bore interest at Hong Kong dollar prime rate plus 2% per annum. On 8 February 2006, the unsecured other borrowings of approximately HK$20,543,000 were discharged.

## 15. SHARE CAPITAL AND OPTIONS

### Share capital

| | **30 June 2006** | 31 December 2005 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| *Authorised:* | | |
| 50,000,000,000 ordinary shares of HK$0.01 each | **500,000** | 500,000 |
| *Issued and fully paid:* | | |
| 760,980,673 (31 December 2005: 636,650,673) ordinary shares of HK$0.01 each | **7,610** | 6,367 |

### 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 2006, 15,000,000 of the above share options were cancelled and no share options were exercised.

Under the rules of the Scheme, the Company may seek approval of the Shareholders at general meeting to refresh the original scheme limit (the "Refreshed Scheme Limit") provided that the total number of option shares must not exceed 10% of the Shares in issue as at the date of such approval. An ordinary resolution had been proposed to seek the approval of the Shareholders which was granted on 26 May 2006. Accordingly, the Refreshed Scheme Limit was renewed to 76,098,067 Option Shares. (Refer to the note 21(i) – Post Balance Sheet Event regarding further grant of option shares).

## 16. 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 | |
|---|---|---|
| | **2006** | 2005 |
| | ***HK$'000*** | *HK$'000* |
| Purchase of raw materials/herbs from the holding company of a minority interest | **2,580** | 863 |
| Rental expenses paid to related company – Sunview Company Limited | **540** | 540 |
| Rental expenses paid to an associate company of a minority interest | **337** | 294 |
| Share of office services from a related company – WorldVest Capital Limited | **258** | 258 |

## 17. OPERATING LEASE ARRANGEMENTS

| | Six months ended 30 June | |
|---|---|---|
| | **2006** | 2005 |
| | ***HK$'000*** | *HK$'000* |
| Minimum lease payments paid under operating leases | **287** | 474 |

| | **30 June** | 31 December |
|---|---|---|
| | **2006** | 2005 |
| | ***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 | **324** | 2,130 |
| In the second to fifth years, inclusive | **230** | 240 |
| | **554** | 2,370 |

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 was for a period of two years beginning from 1 August 2005. By mutual agreement of the parties, the Lease was terminated on 13 March 2006. As a result, the total minimum lease payments were reduced in the current and future periods.

## 18. CAPITAL COMMITMENTS

(a) As at 30 June 2006, 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 19 in the amount of approximately HK$19,009,000 (31 December 2005: HK$19,009,000).

(b) On 11 June 2006, the Company entered into the sale and purchase agreement (the "Agreement") pursuant to which the Company has conditionally agreed to purchase a 51% interest of the issued share capital of Clear Concept International Limited from the vendor. The total consideration for the purchase of the said share interest is the Hong Kong dollars equivalent of Rmb250,000,000 (approximately HK$242,718,447). Such consideration shall be satisfied by the Company either (a) by the allotment and issue of 385,267,376 consideration shares at a price of HK$0.63 per share; or (b) by the allotment and issue of not less than 280,000,000 consideration shares at a price of HK$0.63 per share and the balance thereof by the issue of non-interest bearing consideration convertible note in the principal amount of up to HK$66,318,447 to mature on the third anniversary of the date of issue at a conversion price of HK$0.63 per share subject to adjustments if applicable.

Clear Concept holds a 49% interest in Vodone Datamedia Technology Co., Ltd (第一視頻數碼媒體技術有限公司) ("TMD1"), a company incorporated in the PRC. TMD1 is the holder of an exclusive advisory service agreement with Vodone Telemedia Co., Ltd (第一視頻通信傳媒有限公司) ("VODONE"), an associated company and an operator in the tele-media/information/entertainment/advertising businesses in the PRC. Conditional upon the completion of the TMD1 acquisition and the placing (refer to note 21(ii)), the Group intends to commit Rmb200,000,000 (approximately HK$194,175,000) to subscribe for equity interests in the related service companies. The funds will contribute to the business development and operation of the tele-media related services. Details of the proposed transactions are described in the Company's circular dated 18 August 2006.

## 19. CONTINGENT LIABILITIES

On 21 March 2003, Huayi entered into an agreement to acquire from an independent third party ("Vendor") minority equity interest in two Sino-foreign joint venture companies and the right of exploitation of wild herbs (collectively referred to as the "Investment") at a total consideration of approximately HK$67,888,000 to develop a Chinese medicinal centre and wild herbs harvesting area. Partial payments for the acquisition were made but since July 2003, a balance of approximately HK$19,009,000 remains outstanding and has been recognised as a capital commitment (refer to note 18(a)).

As at the balance date, the balance of consideration has not yet been paid and no settlement agreement has been reached by Huayi and the Vendor. In accordance with the agreement, the Vendor has the right to cancel 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. Full provision against the amount of deposit paid had been made in the year ended 31 December 2004. No action has been made at present to resolve the matter.

## 20. FINANCIAL RISK MANAGEMENT

### Financial risk factors

The main risks arising from the Group's financial instruments are credit risk, foreign exchange risk, liquidity risk and interest rate risk. The directors of the Company meet periodically to analyse and formulate measures to manage the Group's exposure to these risks. Generally, the Group introduces conservative strategies on its risk management which are summarised as follows. The Group has not used any derivatives and other instruments for hedging purposes.

*(a) Credit risk*

The Group has no significant concentrations of credit risk. The carrying amounts of trade receivables included in the balance sheet represent the Group's maximum exposure to credit risk in relation to its financial assets. 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. No other financial assets carry a significant exposure to credit risk.

*(b) Foreign exchange risk*

The Group mainly operates in the PRC and has no significant exposure to any specific foreign currency other than Renminbi.

*(c) Liquidity risk*

The Group's policy is to regularly monitor current and expected liquidity requirements and where applicable, its compliance with lending covenants, to ensure that it maintains sufficient reserves of cash and adequate committed lines of funding from financial institutions to meet its liquidity requirements in the short and longer term.

*(d) Fair value and cash flow interest rate risk*

The Group has no interest-bearing assets or long term borrowings. Its income and operating cash flows are substantially independent of changes in market interest rates.

### Fair value estimation

The carrying amount of cash and cash equivalents, trade and other receivables and trade and other payables approximate their fair values.

The fair value of interest-bearing borrowing is estimated as the present value of further cash flows, discounted at current market interest rates for similar financial instruments.

## 21. POST BALANCE SHEET EVENT

(i) On 31 July 2006, pursuant to the share option scheme of the Company, a total of 43,760,000 share options were granted to the directors of the Group and eligible participants. 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$0.85 per share. The options may be exercisable during the period from 1 August 2006 to 31 July 2009.

(ii) In connection with the proposed acquisition of Clear Concept as described in note 18(b), the Company entered into the placing agreement with the placing agent on 13 July 2006 to place, on a best efforts basis, up to 342,857,143 new shares at a placing price of HK$0.70 per share for a gross proceed of up to HK$240,000,000.

(iii) On 13 September 2006, the special general meeting of the shareholders of the Company was held. Among others, the resolutions for the acquisition of Clear Concept by the issue of the consideration shares/convertible consideration notes and the special mandate for the placing of new shares (refer to (ii) above) were approved by the shareholders.

## 22. APPROVAL OF THE INTERIM FINANCIAL STATEMENTS

The unaudited condensed consolidated interim financial statements were reviewed by the audit committee and approved and authorised for issue by the board of directors on 20 September 2006.

## MANAGEMENT DISCUSSION AND ANALYSIS

### Business Review

Turnover of the Group for the six months ended June 30, 2006 was HK$7,540,000 (as compared to HK$9,548,000 for the corresponding period of last year). Loss attributable to shareholders for the period amounted to HK$23,306,000 (HK$15,531,000 for the corresponding period of last year.)

### Pharmaceutical Business

During the period, the pharmaceutical business showed little sign of improvement. General price increase on medicine products is restricted by the government to protect the basic needs of consumers and is exerting pressure on the Group's China medicine business. Following the disruptive plant relocation as reported previously, the Group's subsidiary Huayi Pharmaceutical Co., Ltd. ("Huayi") was unable to have any breakthrough in expanding its business after it had resumed production of Chinese medicines.

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$7,540,000, representing a 21% reduction from the same period of last year. The low sales level was impacted in part by Huayi's reduced sales force and the inability to break into and sustain sales in other geographical areas. The lack of funding for product developing, advertising and plant expansion were restricting factors for improving its operations. During the period, rising material costs increased production costs and the less than optimal operating level resulted in reduced profit margin. Net loss for the period was also higher due to the goodwill impairment recognised in the period and unabsorbed fixed costs. Due to the continued poor performance of the Chinese medicine sales, in particular the inability to increase unit sales, management revised its China medicine business outlook and made a provisional goodwill impairment charge of HK$12,044,000 to net income.

To establish a more optimal operation scale, the management is faced with the options of relocating to or by erecting a larger, cost effective new factory; the leasing of a well-equipped manufacturing plant; or the subcontracting or licensing to outside parties to manufacture Huayi's products. These alternatives are being carefully assessed or tried under liquidity constrained conditions but with no immediate success. In the meantime, Huayi continued to operate as a self-sustaining and lean organization. During the period staff costs had been cut by about 40% from that of the corresponding period of the previous year.

### Operating Environment

At the macro level, China continues to out perform all other major economies recording over 10% GDP growth in each of the past quarters of 2006. China's economy is fueled by its huge domestic demand. Growth in the industrial, consumer goods and the service sectors (e.g. entertainment business) are expected to continue to remain strong in the years to come although from time to time, central government control measures may be required. The divergence of the telecommunications and multi-media information/entertainment services has created much attention. New frontier in tele-media with tremendous business potential is just unfolding; the possibilities and the potential can be far reaching. China's transformation into a more open, demand driven economy induces vendors and suppliers to spend astronomical sums on advertising, the most powerful tool to get customer recognition in the vast market. To take advantage of this evolving trend, the Directors focus opportunities in unique market segments that cater to this demand.

### Proposed Acquisition in the Tele-Media Service Industry

Following the termination of the steel acquisition as reported in the Company's 2005 annual report, management continued with its efforts of identifying other worthy opportunities in the PRC with the aim to diversify and improve its business prospects. On 11 June 2006, the Company entered into the conditional sale and purchase agreement with an independent third party proposing to acquire a 51% interest in Clear Concept International Limited ("Clear Concept"). Clear Concept holds an indirect 49% interest in Vodone Datamedia Technology Co., Ltd (第一視頻數碼媒體技術有限公司) ("TMD1"), a company that has exclusive advisory service contracts to support its associated company operating in tele-media business in the PRC. The operator, Vodone Telemedia Co., Ltd. (第一視頻通信傳媒有限公司) ("VODONE"), possesses a portfolio of licenses including TV program production and operation, telecom and information service operation, network culture operation etc. These licenses enable VODONE, or appropriate parties contracted by it to engage in a wide-range of internet broadband contents and services, mobile TV, online and mobile video advertising etc. in the PRC accessing the huge user base in broadband, fixed line and mobile phones. VODONE has established platforms to aggregate and distribute tele-media contents and is positioned to engage in on-line advertising in the PRC through the web-based advertising alliance with the other portals to unleash the power of the more dynamic, alternative form of advertising. Links with banks, debit cards, Telcos etc. have been established making it extremely convenient for users to select their choices and pay their fees. Through exclusive service contracts with VODONE, the Group through TMD1 and the related service companies will provide various technical and business services for sharing of the revenues and to participate in the PRC's info-tainment business that offers vast potential. The acquisition of Clear Concept will be settled by the issue of consideration shares or a combination of consideration shares and convertible consideration notes. Upon completion of the acquisition and the placing (refer to the intended placing in the following section), it is planned that Rmb200,000,000 (approximately HK$194,175,000) from the placing proceeds will be applied to subscribe for equity interests in the service companies to support the roll out of VODONE's tele-media business. Details of the acquisition and the placing are described in the Company's circular dated 18 August 2006.

### Liquidity and financial resources

During the period, the Company placed 124,330,000 new shares to independent third parties at HK$0.235 per share for a gross proceed of HK$29,217,550. Part of the proceeds was utilized to settle an unsecured debt of HK$20,500,000. During the period, there was no cash outlays for investing activity although the Company did enter into the material contract in respect of the Clear Concept acquisition as mentioned in the preceding section.

The Group's cash flow position remained at a low level during the period which restricted its expansion and capital commitment options. As at 30 June 2006, the Group had cash and cash equivalent balance of approximately HK$2,858,000, decreased from the 2005 year-end level primarily due to cash used for normal operating needs and a higher level of fees during the period. At period end, the current ratio (represented by total current assets to total current liabilities) of the Group improved to 0.38 from the 2005 year-end level, primarily due to the reduced unsecured debt during the period. The Company granted 30,000,000 share options under its Share Option Scheme in 2005 at an exercise price of HK$0.86 per share. Subsequent to the period-end and at the date of this report, 3,000,000 of such share options had been exercised contributing additional cash of HK$2,580,000.

In connection with the acquisition and business expansion into the tele-media service industry, the Company proposes to raise gross amount of up to HK$240,000,000 by the issue of up to 342,857,143 placing shares at the price of HK$0.70 per share. Proceeds of the placing shall primarily be used to fund the business expansion of the tele-media business and for general working capital of the Group. Assuming all the consideration shares and the maximum number of placing shares are issued, the consideration shares relating to the Clear Concept acquisition and the placing shares shall, when fully issued, represent approximately 25.8% and 23.0% of the enlarged issue share capital of the Company upon completion of both the acquisition and the placing.

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

### Capital structure and gearing

As at 30 June 2006, there were 760,980,673 shares issued and outstanding and the equity of the group attributable to shareholders amounted to approximately HK$21,504,000. The completion of the proposed acquisition and placing will broaden the equity and the shareholder base of the Company. As at 30 June 2006, the overall gearing ratio (represented by the ratio of total liabilities to shareholders' equity) of the Group was approximately 16.1%, significantly improved from the 2005 year-end level due to the retirement of the unsecured debt.

**Prospects**

With general price control and liquidity constraint, the Group's pharmaceutical business is expected to operate at less than optimal level, a condition requiring continued monitoring.

The Directors consider that the proposed acquisition of Clear Concept is a significant positive development for the Group reflecting continued implementation of its previously adopted growth and diversification strategy. The Group is ready to participate in the high-growth, profitable tele-media and advertising service businesses. With VODONE's experience and the portfolio of licenses obtained, by leveraging on the Group's access to international capital market, VODONE is expected to gain first mover advantage in providing tele-media services. As the convergence of telecommunications and multi-media continues to evolve, and the immense info-tainment needs of the mass population in PRC yet to be fulfilled, the Directors are confident that the Group's partnership with VODONE will exploit further new business opportunities that would be mutually beneficial. As such, the Group will dedicate its efforts to roll out its business development plan in the tele-media business area and, in suitable time in the future, will reassess its options with respect to the Chinese medicine business.

**Employees and remuneration policy**

As at 30 June 2006, the Group has a staff of about 90 in China and Hong Kong, which included management, administrative, production and selling staff. The Group remunerates its Directors and staff primarily based on their contribution, responsibility, qualification and experience. 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 2002, Company has adopted an employee share option scheme a purpose of which is to provide incentive or reward for staff contribution to, and to allow them the opportunity to become a shareholder of, the Group. Housing benefits were provided for certain Hong Kong and PRC employees. 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 AND BOARD COMMITTEES

The Board has established the audit committee in compliance with Rule 3.21 of the Listing Rules. The audit committee was set up 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 2006. The Board has yet to delegate the nomination and the remuneration functions to a committee of the Board as discussed in the Company's 2005 Annual Report.

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

### (a) interests in Share

As at the date of this report, 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"):

| Name of director | Nature of interest | Number of ordinary shares Long position | Number of ordinary shares Short position | % of the issued share capital |
|---|---|---|---|---|
| Guo Duen How, Tom | Personal | 2,300,000 | nil | 0.30% |
| Kao Ying Lun | Personal | 10,500,000 | nil | 1.38% |
| Wu Fred Fong | Personal | 10,500,000 | nil | 1.38% |

### (b) Interests in share option granted

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. The following provides the relevant information and the share options granted to Directors up to the date of this report.

| Name of Director | Shares options granted | Approx. % to issue share capital | Exercise price per share (HK$) | Date of grant | Exercise period |
|---|---|---|---|---|---|
| Guo Duen How, Tom | 1,700,000 | 0.22% | 0.86 | 11/3/2005 | Note A |
| | 6,100,000 | 0.80% | 0.85 | 19/7/2006 | Note B |
| Kao Ying Lun | 1,700,000 | 0.22% | 0.86 | 11/3/2005 | Note A |
| | 3,100,000 | 0.41% | 0.85 | 19/7/2006 | Note B |
| Wang Chun | 7,600,000 | 1.00% | 0.85 | 19/7/2006 | Note B |

| Name of Director | Shares options granted | Approx. % to issue share capital | Exercise price per share (HK$) | Date of grant | Exercise period |
|---|---|---|---|---|---|
| Wu Fred Fong | 1,700,000 | 0.22% | 0.86 | 11/3/2005 | Note A |
| | 3,100,000 | 0.41% | 0.85 | 19/7/2006 | Note B |
| Yu Jianmeng | 1,500,000 | 0.20% | 0.86 | 11/3/2005 | Note A |
| | 1,800,000 | 0.24% | 0.85 | 19/7/2006 | Note B |
| Zhang Lijun | 7,600,000 | 1.00% | 0.85 | 19/7/2006 | Note B |
| Choy Tak Ho | 600,000 | 0.08% | 0.86 | 11/3/2005 | Note A |
| | 760,000 | 0.10% | 0.85 | 19/7/2006 | Note B |
| Loke Yu | 760,000 | 0.10% | 0.85 | 19/7/2006 | Note B |
| Tsui Chun Chung, Arthur | 600,000 | 0.08% | 0.86 | 11/3/2005 | Note A |
| | 760,000 | 0.10% | 0.85 | 19/7/2006 | Note B |

*Note A: the exercise period for the 11/3/2005 grant is 22/3/2005 to 21/3/2007 both days inclusive*
*Note B: the exercise period for the 19/7/2006 grant is 1/8/2006 to 31/7/2009 both days inclusive*

Save as disclosed above, as at 30 June 2006, 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 SHAREHOLDER

As at 30 June 2006, 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 was 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.

| | | Number of shares | | % of the |
|---|---|---|---|---|
| Name of shareholder | Nature of interest | Long position | Short position | issued share capital |
| Mr. Chen Ven Chien *(note 1)* | personal | 48,000,000 | Nil | 6.3% |

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

## CODE OF CORPORATE GOVERNANCE PRACTICES

Save for the deviations as reported and discussed in the Corporate Governance Report as contained in the Company's 2005 Annual Report, 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 2006, in compliance with the Code on Corporate Governance Practices as set out in Appendix 14 of the Listing Rules. The non-executive Directors of the Company are subject to retirement by rotation and re-election at the Company's annual general meeting in accordance with the Bye-Laws of the Company.

## 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 2006. 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 2006.

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

Hong Kong,
20 September 2006