## 1. GENERAL

The Company was incorporated and registered as an exempted company with limited liability in the Cayman Islands under the Companies Law (2001 Second Revision) Chapter 22 of the Cayman Islands on 14 August 2002 and its shares have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). Its parent is Sinovest International Investment Limited, a company incorporated in the British Virgin Islands ("BVI") with limited liability and owned as to approximately 79.4% by Forway Investment Limited, which is considered the ultimate holding company of the Company. The address of the registered office and principal place of business of the Company are disclosed in the "Corporate Information" section to the annual report.

The consolidated financial statements are presented in Renminbi, which is the functional currency of the Company.

The Company acts as an investment holding company. The principal activities of its principal subsidiaries are set out in the note 29 to the consolidated financial statements.

## 2. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

In the current year, the Group has applied, for the first time, a number of new standards, interpretations and amendments issued by the International Accounting Standards Board (the "IASB") and the International Financial Reporting Interpretations Committee ("IFRIC") of the IASB which are either effective for accounting periods beginning on or after 1 December 2005 or 1 January 2006. The adoption of these new standards, interpretations and amendments had no material effect on how the results and the financial position for the current or prior periods have been prepared and presented. Accordingly, no prior year adjustment has been required.

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

## 2. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS *(Continued)*

| | |
|---|---|
| IAS 1 (Amendment) | Capital disclosures[1] |
| IFRS 7 | Financial instruments: Disclosures[1] |
| IFRS 8 | Operating segments[2] |
| IFRIC 7 | Applying the restatement approach under IAS 29 Financial Reporting in Hyperinflationary Economies[3] |
| IFRIC 8 | Scope of IFRS2[4] |
| IFRIC 9 | Reassessment of embedded derivatives[5] |
| IFRIC 10 | Interim financial reporting and impairment[6] |
| IFRIC 11 | IFRS 2 Group and Treasury Share Transactions[7] |
| IFRIC 12 | Service concession arrangements[8] |

1 Effective for annual periods beginning on or after 1 January 2007.
2 Effective for annual periods beginning on or after 1 January 2009.
3 Effective for annual periods beginning on or after 1 March 2006.
4 Effective for annual periods beginning on or after 1 May 2006.
5 Effective for annual periods beginning on or after 1 June 2006.
6 Effective for annual periods beginning on or after 1 November 2006.
7 Effective for annual periods beginning on or after 1 March 2007.
8 Effective for annual periods beginning on or after 1 January 2008.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") and Hong Kong Companies Ordinance.

The consolidated financial statements have been prepared on the historical cost as explained in the principal accounting policies set out below.

**Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefit from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

**Basis of consolidation** *(Continued)*

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Acquisition of additional interests in subsidiaries are recorded at the book value of the net assets attributable to the interests. The excess of the cost of acquisition over the carrying amounts of net assets acquired is recognised as goodwill.

**Business combinations**

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition are recognised at their fair values at the acquisition date.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

**Revenue recognition**

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods provided in the normal course of business, net of discounts and sales related taxes.

Sales of goods are recognised when goods are delivered and title has passed.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

**Property, plant and equipment**

Property, plant and equipment, other than construction in progress, are stated at cost less depreciation and any identified impairment loss as at the balance sheet date.

Construction in progress is stated at cost less any accumulated impairment loss. Cost includes all construction costs and other direct costs attributable to such projects. It is not depreciated until completion of construction. Costs of completed construction works are transferred to the appropriate category of property, plant and equipment.

Depreciation is provided to write off the cost of property, plant and equipment other than construction in progress over their estimated useful lives after taking into account their estimated residual value, if any, using the straight line method.

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the profit or loss.

**Land use rights**

Payments for obtaining land use rights are considered as operating lease payment and charged to income statement over the period of the right using the straight line method.

**Goodwill**

Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment loss.

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently whenever there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the consolidated income statement. An impairment loss for goodwill is not reversed in subsequent periods.

On subsequent disposal of a subsidiary, the attributable amount of goodwill capitalised is included in the determination of the amount of profit or loss on disposal.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

**Research and development expenditure**

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset is recognised only if all of the following conditions are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

When no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

**Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost, which comprises all costs of purchase and, where applicable, costs of conversion and other costs that have been incurred in bringing the inventories to their present location and condition, is calculated using the first-in first-out method. Net realisable value represents the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

**Impairment of assets excluding goodwill**

At each balance sheet date, the Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

**Financial instruments**

Financial assets and financial liabilities are recognised on the consolidated balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

*Financial assets*

*Trade receivables/bills receivables/amounts due from related companies/other receivables/ bank balances*

Trade receivables, bills receivables, amounts due from related companies, other receivables and bank balances are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest rate method. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired. The allowance recognised is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed at initial recognition.

*Financial liabilities and equity*

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. The Group's financial liabilities are generally classified into financial liabilities at fair value through profit or loss and other financial liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

*Trade payables/amounts due to related companies/other payables*

Trade payables, amounts due to related companies and other payables are initially measured at fair value and are subsequently measured at amortised cost using effective interest method.

*Equity instruments*

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

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

**Government grants**

Government grants in the form of incentive payment are recognised as income when there is reasonable assurance that the Group comply with the conditions attaching to the grants.

Government grants are recognised as income over the periods necessary to match them with the related product research costs. Grants related to expense items are recognised in the same period as those expenses are charged in the consolidated income statement and are deducted in reporting the related expenses.

**Taxation**

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income and expense that are taxable or deductible in other years, and it further excludes income statement items that are never taxable and deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on the tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

**Foreign currencies**

Transactions in foreign currencies other than Renminbi ("RMB") are translated at the rates ruling on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies other than RMB are re-translated at the rates ruling on the balance sheet date. Gains and losses arising on exchange are dealt with in the income statement.

On consolidation, the assets and liabilities of the Group's foreign operation which are denominated in currencies other than RMB are translated at the rates ruling on the balance sheet date. Income and expense items are translated at the average exchange rate for the year. Exchange differences arising, if any, are classified as exchange reserve. Such translation differences are recognised as income or as expenses in the period in which the subsidiary is disposed of.

**Leases**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rental payable under operating leases are charged to the income statement on a straight line basis over the period of the leases.

**Retirement benefit costs**

Payments to defined contribution retirement benefit plans are charged as an expense as they fall due.

The pension cost, which represents the amount payable in accordance with the regulations promulgated by the local Municipal Government, is charged to the income statement as incurred.

## 4. KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the entity's accounting policies which are described in note 3, management has made the following key assumptions concerning the future that have significant effect on the amounts recognised in the financial statements.

**Estimated impairment of goodwill**

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. As at 31 December 2006, the carrying amount of goodwill is RMB58,479,000. Details of the recoverable amount calculation are disclosed in note 13.

## 5. TURNOVER AND SEGMENT INFORMATION

Turnover represents the net amount received and receivable from sales of Chinese pharmaceutical products.

The Group's operation is regarded as a single segment, being an enterprise engaged in research and development, manufacture and trading of Chinese pharmaceutical products. Over 90% of the Group's sales are made in the People's Republic of China ("PRC") and over 90% of the Group's assets are situated in the PRC during the year. Accordingly, no segmental analysis of business and geographical segments is presented for the year.

## 6. PROFIT BEFORE TAXATION

| | **2006**<br>**RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| Profit before taxation has been arrived at after charging: | | |
| Auditors' remuneration | **1,706** | 1,761 |
| Cost of inventories recognised as expense | **249,175** | 274,772 |
| Depreciation of property, plant and equipment | **29,733** | 25,792 |
| Operating lease rentals in respect of land use rights | **328** | 328 |
| Staff costs (including directors' remuneration (see note 7)) | **50,680** | 51,007 |
| Pension costs | **3,064** | 2,428 |
| Minimum lease payments under operating lease in respect of rented premises | **1,714** | 1,001 |
| Research and development costs | **3,856** | 10,083 |
| and after crediting: | | |
| Reversal of allowance for bad and doubtful debts | **33** | – |
| Gain on disposal of property, plant and equipment | **28** | 3 |
| Interest income | **44,779** | 17,817 |
| Exchange gain | **756** | 17 |

## 7. DIRECTORS', SUPERVISORS' AND EMPLOYEES' REMUNERATION

Directors' remuneration:

**Year ended 31 December 2006**

| | Fees RMB'000 | Salaries, allowance and other benefits RMB'000 | Pension costs RMB'000 | Performance related incentive payments RMB'000 | Total remuneration RMB'000 |
|---|---|---|---|---|---|
| Name of executive directors | | | | | |
| Li Zhenjiang | 50 | 1,537 | – | – | 1,587 |
| Wang Zhihua | 50 | 673 | – | – | 723 |
| Xin Yunxia | 50 | 673 | – | – | 723 |
| Li Huimin | 50 | 700 | – | – | 750 |
| Hung Randy King Kuen | 50 | 1,382 | 12 | 91 | 1,535 |
| Name of independent non-executive directors | | | | | |
| Ren Dequan | 60 | – | – | – | 60 |
| Li Kung Man | 121 | – | – | – | 121 |
| Cheng Li | 60 | – | – | – | 60 |
| Wang Jianping | 61 | – | – | – | 61 |
| Zhou Chaofan | 61 | – | – | – | 61 |
| | 613 | 4,965 | 12 | 91 | 5,681 |

Year ended 31 December 2005

| | Fees RMB'000 | Salaries, allowance and other benefits RMB'000 | Pension costs RMB'000 | Performance related incentive payments RMB'000 | Total remuneration RMB'000 |
|---|---|---|---|---|---|
| Name of executive directors | | | | | |
| Li Zhenjiang | 50 | 1,407 | – | 875 | 2,332 |
| Wang Zhihua | 50 | 630 | – | 309 | 989 |
| Xin Yunxia | 50 | 630 | – | 309 | 989 |
| Li Huimin | 50 | 332 | – | 139 | 521 |
| Hung Randy King Kuen | 29 | 813 | 6 | 71 | 919 |
| Hou Jiangtao | 20 | 337 | – | – | 357 |
| Name of independent non-executive directors | | | | | |
| Li Kung Man | 124 | – | – | – | 124 |
| Wang Jianping | 117 | – | – | – | 117 |
| Zhou Chaofan | 117 | – | – | – | 117 |
| | 607 | 4,149 | 6 | 1,703 | 6,465 |

## 7. DIRECTORS', SUPERVISORS' AND EMPLOYEES' REMUNERATION *(Continued)*

Employees' remuneration:

The five highest paid individuals of the Group included 5 directors for the year (2005: 4), details of whose remuneration are set out above. The remuneration of the remaining one employee for 2005 is as follows:

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| Salaries, allowance and other benefits | **–** | 839 |
| Pension costs | **–** | 11 |
| | **–** | 850 |

Emoluments of these directors and employees were within the follow bands:

| | **2006 Number of** | | 2005 Number of | |
|---|---|---|---|---|
| | **Directors** | **Employees** | Directors | Employees |
| RMB500,001 – RMB1,000,000 | **3** | **–** | 3 | 1 |
| RMB1,500,001 – RMB2,000,000 | **2** | **–** | – | – |
| RMB2,000,001 – RMB2,500,000 | **–** | **–** | 1 | – |
| | **5** | **–** | 4 | 1 |

During the year, no remuneration was paid by the Group to the directors, supervisors or the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors and supervisors has waived any remuneration during the year.

## 8. INCOME TAX

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Current tax: | | |
| PRC Enterprise Income Tax | **(51,796)** | (7,923) |
| Deferred tax (note 14) | **(2,261)** | 2,477 |
| | **(54,057)** | (5,446) |

The provision for PRC Enterprise Income Tax ("PRC EIT") is calculated based on the estimated taxable income for PRC taxation purposes at the rate of taxation applicable for the year.

The reconciliation of tax charge to the profit before taxation per the income statement for the year is as follows:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | RMB'000 | % | RMB'000 | % |
| Profit before taxation | **387,034** | | 342,452 | |
| Tax at the applicable tax rate of 33% | **(127,722)** | **(33.0)** | (113,009) | (33.0) |
| Tax effect of expenses that are not deductible in determining taxable profit | **(2,649)** | **(0.7)** | (3,367) | (1.0) |
| Tax effect of income that are not taxable in determining taxable profit | **6,814** | **1.8** | 2,683 | 0.8 |
| Tax loss not recognised | **(657)** | **(0.2)** | (1,311) | (0.4) |
| Tax effect on tax holiday | **54,395** | **14.1** | 104,023 | 30.5 |
| Income tax on concessionary rate | **13,460** | **3.5** | 6,281 | 1.8 |
| Effect of different tax rates of subsidiaries operating in other jurisdiction | **2,179** | **0.5** | (598) | (0.2) |
| Others | **123** | **0.0** | (148) | (0.1) |
| Taxation charge and effective tax rate for the year | **(54,057)** | **(14.0)** | (5,446) | (1.6) |

## 8. INCOME TAX *(Continued)*

Pursuant to the relevant law and regulations in the PRC, Shineway Pharmaceutical Co., Ltd. ("Shineway Pharmaceutical") and Hebei Shineway Pharmaceutical Co., Ltd. ("Hebei Shineway") are entitled to a 50% relief from PRC EIT for current year and the following two years. The first profit-making period of Shineway Pharmaceutical and Hebei Shineway commenced on 1 January 2004 and the full exemption from PRC EIT ended on 31 December 2005.

In addition, pursuant to 瓊海國稅發2004第151號, Shineway Pharmaceutical Sales Co. Ltd. ("Shineway Sales") was exempted from the PRC EIT for the year ended 31 December 2003. Pursuant to 國發 1988 第26號, the PRC EIT rate applicable to Shineway Sales is 15% on its assessable profit.

## 9. EARNINGS PER SHARE

The calculations of basic earnings per share is based on the following data:

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Earnings for the purpose of basic earnings per share (profit for the year attributable to equity holders of the Company) | **332,977** | 331,467 |

| | **Number of ordinary shares** | |
|---|---|---|
| | **2006** | 2005 |
| Weighted average number of ordinary shares for the purposes of basic earnings per share | **827,000,000** | 828,550,800 |

No diluted earnings per share is presented, as the Company did not have any potential ordinary shares outstanding.

## 10. DIVIDENDS

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Dividends recognised as distributions during the year: | | |
| Dividends paid during the year: | | |
| 2005 final dividend paid – RMB10 cents (2004: nil) per share | **82,700** | – |
| 2005 special dividend paid – RMB2 cents (2004: nil) per share | **16,540** | – |
| 2006 Interim dividend paid - RMB10 cents (2005: RMB10 cents) per share | **82,700** | 82,700 |
| | **181,940** | 82,700 |

In respect of the current year, the directors propose that a final dividend of RMB10 cents (2005: RMB10 cents) and a special dividend of RMB2 cents (2005: RMB2 cents) per share will be paid to shareholders on 30 April 2007. These dividends are subject to approval by shareholders at the Annual General Meeting and has not been included as liabilities in these financial statements. The 2006 proposed dividends are payable to all shareholders on the Register of Members on 24 April 2007. The total estimated dividends to be paid is RMB99,240,000.

## 11. PROPERTY, PLANT AND EQUIPMENT

| | Buildings RMB'000 | Plant and machinery RMB'000 | Office equipment RMB'000 | Motor vehicles RMB'000 | Construction in progress RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|
| **COST** | | | | | | |
| At 1 January 2005 | 122,050 | 133,391 | 3,143 | 247 | 311 | 259,142 |
| Additions | 27,700 | 32,104 | 3,988 | 1,516 | 18,768 | 84,076 |
| Reclassifications | – | 1,129 | – | – | (1,129) | – |
| Disposals | – | – | – | (174) | – | (174) |
| At 31 December 2005 | 149,750 | 166,624 | 7,131 | 1,589 | 17,950 | 343,044 |
| Additions | – | 4,483 | 1,151 | 822 | 16,763 | 23,219 |
| Reclassifications | 15,722 | 10,304 | 485 | – | (26,511) | – |
| Disposals | – | (326) | (3) | (47) | – | (376) |
| Currency realignment | – | – | (32) | – | – | (32) |
| **At 31 December 2006** | **165,472** | **181,085** | **8,732** | **2,364** | **8,202** | **365,855** |
| **DEPRECIATION** | | | | | | |
| At 1 January 2005 | 23,361 | 61,384 | 1,325 | 56 | – | 86,126 |
| Provided for the year | 7,054 | 17,693 | 916 | 129 | – | 25,792 |
| Eliminated on disposals | – | – | – | (67) | – | (67) |
| At 31 December 2005 | 30,415 | 79,077 | 2,241 | 118 | – | 111,851 |
| Provided for the year | 7,157 | 21,086 | 1,197 | 293 | – | 29,733 |
| Reclassification | – | (2) | 2 | – | – | – |
| Eliminated on disposals | – | (45) | (3) | (42) | – | (90) |
| Currency realignment | – | – | (7) | – | – | (7) |
| **At 31 December 2006** | **37,572** | **100,116** | **3,430** | **369** | **–** | **141,487** |
| **CARRYING VALUES** | | | | | | |
| **At 31 December 2006** | **127,900** | **80,969** | **5,302** | **1,995** | **8,202** | **224,368** |
| At 31 December 2005 | 119,335 | 87,547 | 4,890 | 1,471 | 17,950 | 231,193 |

The following rates per annum are used for the depreciation of property, plant and equipment:

| | |
|---|---|
| Buildings | 5% |
| Plant and machinery | 10% – 33% |
| Office equipment | 20% |
| Motor vehicles | 33% |

## 12. LAND USE RIGHTS

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| **CARRYING VALUE** | | |
| At 1 January | **6,274** | 6,602 |
| Expense for the year | **(328)** | (328) |
| At 31 December | **5,946** | 6,274 |
| Analysed for reporting purposes as: | | |
| Current portion (included in other receivables) | **328** | 328 |
| Non-current portion | **5,618** | 5,946 |
| | **5,946** | 6,274 |

The amount represents the payment for medium term land use rights situated in the PRC, amortise over the periods ranged from 45 to 50 years.

## 13. GOODWILL

| | RMB'000 |
|---|---|
| At 1 January 2005 | – |
| Arising on acquisition of additional interest in a subsidiary | 58,479 |
| **At 31 December 2005 and 31 December 2006** | **58,479** |

Goodwill acquired has been allocated to the cash-generating unit ("CGU") of Shineway Sales.

The recoverable amount of the CGU is determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGU. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow projection derived from the most recent financial budgets approved by management for the next five years based on an estimated constant growth rate of 6%. This rate does not exceed the average long-term growth rate for the relevant markets.

The rate used to discount the forecast cash flows from Shineway Sales is 8%.

At 31 December 2006, no impairment loss is identified.

## 14. DEFERRED TAXATION

The followings are the major deferred tax assets recognised and movement thereon during the year.

| | **Accelerated tax depreciation** RMB'000 | **Others** RMB'000 | **Total** RMB'000 |
|---|---|---|---|
| At 1 January 2005 | 7,520 | 1,462 | 8,982 |
| (Credit to) debit from income for the year | (193) | 2,670 | 2,477 |
| At 31 December 2005 and 1 January 2006 | 7,327 | 4,132 | 11,459 |
| Debit from (credit to) income for the year | 635 | (2,896) | (2,261) |
| **At 31 December 2006** | **7,962** | **1,236** | **9,198** |

At the balance sheet date, the Group has unused tax losses RMB10,820,000 (2005: RMB8,830,000) available for offset against future profits. No deferred tax asset has been recognised due to the unpredictability of future profit streams. The tax loss may be carried forward indefinitely.

## 15. INVENTORIES

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Raw materials | **13,708** | 17,317 |
| Work in progress | **11,434** | 5,224 |
| Finished goods | **13,055** | 12,910 |
| | **38,197** | 35,451 |

All inventories were carried at cost at the respective balance sheet dates.

## 16. OTHER FINANCIAL ASSETS

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Bills receivables and trade receivables: | | |
| Bills receivables | **63,301** | 134,348 |
| Trade receivables | **3,346** | 2,998 |
| | **66,647** | 137,346 |

The Group allows a credit period normally ranging from six months to one year to its trade customers. The bills receivables and trade receivables are of the age within 6 months at the balance sheet dates.

The directors consider that the carrying amounts of bills receivables and trade receivables approximate their fair values.

Bank balances and cash comprises cash held by the Group and short-term bank deposits with an original maturity of three months or less. The carrying amounts of these assets approximate their fair values. The effective interest rate range from 0.75% to 4.86% per annum.

At the balance sheet date, certain bank balances and cash of RMB777,993,000 (2005: RMB713,742,000) were denominated in RMB which is not a freely convertible currency in the international market. The exchange rate of RMB is determined by the Government of the PRC and the remittance of these funds out of the PRC is subject to exchange restrictions imposed by the Government of the PRC.

**Credit risk**

The Group's principal financial assets are bills and trade receivables, other receivables and bank balances. The maximum exposure to credit risk in the event that the counter parties fail to perform their obligations as at end of financial year in relation to each class of recognised financial assets is the carrying amount of those assets.

In order to minimise the credit risk, the management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt and debt investments at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

The credit risk on liquid funds is limited because majority of the counterparties are state-owned banks with good reputation.

The Group's concentration of credit risk by geographical locations is mainly in the PRC.

## 16. OTHER FINANCIAL ASSETS *(Continued)*

**Market risk**

*Fair value interest rate risk*

Interest bearing financial assets are mainly pledged bank deposits and bank balance which are all short-term in nature and carry fixed interest rates. Therefore, the Group is not exposed to significant fair value interest rate risk due to the short maturity of financial assets. The Group currently does not have an interest rate hedging policy and will consider enter into interest rate hedging should the need rises.

*Foreign currency risk*

Foreign currency risk refers to the risk that movement in foreign currency exchange rate which will affect the Group's financial results and its cash flows. The Group has certain bank balances denominated in HKD and USD. Management considers the exchange rate fluctuation between RMB, USD and HKD is not significant, and thus no hedging arrangement of foreign currency risk has been entered into. Furthermore, the Group carries out majority of its transactions in RMB and accordingly, the Group is not exposed to any significant foreign currency risk.

## 17. AMOUNT DUE FROM (TO) A RELATED COMPANY

| | **2006<br>RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| Amount due from a related company: | | |
| Heibei Shineway Chain Drugstores Co., Ltd. | | |
| ("Shineway Drugstores") | **–** | 155 |

Certain directors of the Company have beneficial interests in Shineway Drugstores. The balance with Shineway Drugstores was in trade nature and with the age of less than six months at 31 December 2005. In the opinion of the directors, the carrying amount approximated its fair value.

| | **2006<br>RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| Amount due to a related company: | | |
| Shineway Medical Science & Technology (Lang Fang) | | |
| Co. Ltd. ("Shineway Lang Fang") | **587** | – |

The amount due to Shineway Lang Fang as at 31 December 2006 is unsecured, interest-free and repayable on demand.

The directors considered these amounts approximate to their fair values.

## 18. PLEDGED ASSETS

Pledged assets represents certain bills receivables and bank deposits pledged to bank to secure banking facilities granted to the Group. Bills receivables of RMB1,368,000 (2005: nil) and bank deposits of RMB1,882,000 (2005: nil) were pledged to bank to secure bills payables totalling RMB2,973,000 (2005: nil) issued by the Group and are therefore classified as current assets. The pledged assets will be released upon the settlement of the relevant bills payables.

## 19. SHARE CAPITAL

| | **Number of shares** '000 | Amount RMB'000 |
|---|---|---|
| Ordinary shares of HK$0.10 each | | |
| Authorised: | | |
| Balance at 31 December 2005 and 31 December 2006 | 5,000,000 | 530,000 |
| Issued and fully paid: | | |
| Balance at 1 January 2005 | 830,000 | 87,980 |
| Cancellation upon repurchase of own shares (Note) | (3,000) | (318) |
| Balance at 31 December 2005 and 31 December 2006 | 827,000 | 87,662 |

Note: In 2005, the Company repurchased on the Stock Exchange a total of 3,000,000 shares of HK$0.10 each of the Company at an aggregate consideration of HK$9,874,000, all of these shares were subsequently cancelled. The aggregate consideration was paid out of the accumulated profits.

## 20. SHARE OPTIONS

The Company's share option scheme (the "Scheme"), was adopted pursuant to a resolution passed on 10 November 2004 for the primary purpose of providing incentives to:

(a) director or employee of any members of the Group; and

(b) any discretionary object of a discretionary trust established by any substantial shareholder of the Company or employee of any member of the Group.

The Scheme will expire on 9 November 2014. Under the Scheme, the Board of Directors of the Company may grant options to eligible person to subscribe for shares in the Company.

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Company in issue at any point of time, without prior approval from the Company's shareholders. The number of shares issued and to be issued in respect of which options granted and may be granted to any individual in any one year is not permitted to exceed 1% of the shares of the Company in issue at any point in time, without prior approval from the Company's shareholders. Options granted to substantial shareholders, independent non-executive directors, 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) in excess of 0.1% of the Company's share capital or with a value in excess of HK$5,000,000 must be approved in advance by the Company's shareholders.

Option granted must be taken up within 14 days from the date of offer, upon payment of HK$1 per option. Options may be exercise at any time from the date of grant of the share option to the 10 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 grants; (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.

No option has been granted since adoption.

## 21. RESERVES

Statutory surplus reserve fund, statutory public welfare fund, discretionary surplus reserve fund and merger reserve represented the reserves ("Reserves") of the Group companies.

(a) Basis of appropriations to reserves

The transfers to statutory surplus reserve fund, statutory public welfare fund and discretionary surplus reserve fund are based on the profit in the financial statements prepared under Chinese Accounting Standards.

(b) Statutory surplus reserve fund

Shineway Pharmaceutical, Hebei Shineway and Shineway Sales's Articles of Association ("Articles") require the appropriation of 10% of its profit after taxation each year to the statutory surplus reserve fund until the balance reaches 50% of the registered share capital. According to the provision of the Articles, in normal circumstances, the statutory surplus reserve fund shall only be used for making up losses, capitalisation into share capital and expansion of production and operation. For the capitalisation of statutory surplus reserve fund into share capital, the remaining amount of such reserve fund shall not be less than 25% of the registered share capital.

(c) Statutory public welfare fund

Pursuant to the PRC Company Law, Shineway Pharmaceutical, Hebei Shineway and Shineway Sales shall make allocation from its profit after taxation at the rate of 5% to 10% to the statutory public welfare fund. The statutory public welfare fund can only be utilised on capital items for employees collective welfare. Individual employees only have the right to use these facilities, the titles to which will remain with Shineway Pharmaceutical, Hebei Shineway and Shineway Sales. The statutory public welfare fund forms part of the shareholders' equity but is not distributable other than in liquidation.

During the year ended 31 December 2006, the relevant statutory requirements were amended, and the Group transferred the statutory public welfare fund to statutory surplus reserve fund accordingly.

(d) Discretionary surplus reserve fund

Pursuant to the Articles, Shineway Pharmaceutical, Hebei Shineway and Shineway Sales shall make allocation from its profit after taxation and appropriations to the discretionary surplus reserve fund at the rate decided by the shareholders annually. In normal circumstances, the discretionary surplus reserve fund shall only be used for making up losses, capitalisation into share capital and expansion of Shineway Pharmaceutical, Hebei Shineway and Shineway Sales's production and operation.

(e) Merger reserve of the Group represents the difference between the net asset value of Yuan Da International Limited ("Yuan Da") and Hong Zhan International Limited ("Hong Zhan") and the nominal amount of the Company's shares which were issued as consideration for the acquisition of Yuan Da and Hong Zhan at the time of the group reorganisation in 2004.

## 22. OTHER FINANCIAL LIABILITIES

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Bills payables | **2,973** | – |
| Trade payables | **73,173** | 58,101 |
| Receipt in advance | **26,341** | 27,870 |
| | **102,487** | 85,971 |

An aged analysis of the Group's trade and bills payables at the balance sheet date is as follows:

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Within 6 months | **71,214** | 54,644 |
| Over 6 months but less than 1 year | **3,724** | 2,769 |
| Over 1 year but less than 2 years | **1,198** | 276 |
| Over 2 years | **10** | 412 |
| | **76,146** | 58,101 |

Trade payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchase ranges from two months to six months.

The directors consider that the carrying amounts of trade payables, bills payables and receipt in advance approximate their fair values.

## 23. GOVERNMENT GRANTS RECEIVED

The amounts represent government subsidies received in advance in relation to research and development expenses on certain new products. The amounts are recognised in the same period as the related research and development expenses are incurred and are deducted in reporting the related research and development expenses. The grant is recognised as deferred income because there is an obligation to repay the grant if the related research is not successfully completed.

## 24. OPERATING LEASE

At the balance sheet date, the Group had commitments for future minimum lease payments under non-cancellable operating lease which fall due as follows:

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Within one year | **1,211** | 1,500 |
| In the second to fifth year inclusive | **391** | 1,385 |
| | **1,602** | 2,885 |

Operating lease payments represent rentals payable by the Group for certain of its warehouse, staff quarters and offices. Leases are negotiated for terms ranged from 1 to 3 years with fixed rental.

Included in the operating lease commitment, RMB469,000 (2005: RMB469,000) fall due within one year and RMB352,000 (2005: RMB821,000) fall due in the second to fifth year inclusive are payable to Shineway Medical Science & Technology Co., Ltd ("Shineway Medical").

## 25. RETIREMENT BENEFITS PLANS

The employees of the Group participate in retirement and medicare insurances in accordance with the PRC laws and related regulations. When an employee joins the Group, he is enrolled with the local retirement plan. Contributions to the retirement insurance, borne by the Group and the employee jointly at the proportions stipulated by the local Municipal Government, are paid to the social insurance institutions monthly. When the employee retires, he receives his retirement funds from the insurance company directly and is also entitled to enjoy medical benefits after retirement provided by the insurance company. Other than this, the Group has no obligation for any related retirement benefits.

The total expense recognised in the income statement of RMB3,064,000 (2005: RMB2,428,000) represents contributions payable to this plan by the Group at rates specified in the rules of the plan.

## 26. CAPITAL COMMITMENTS

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Capital expenditure in respect of acquisition of property, plant and equipment contracted for but not provided in the financial statements | **2,545** | 12,056 |

## 27. POST BALANCE SHEET EVENT

On 1 March 2007, a wholly-owned subsidiary entered into a transfer agreement with Shineway Lang Fang for the acquisition of the research and development center and the relevant land use rights for an aggregate consideration of RMB23,960,000.

Mr. Li Zhenjiang, an executive Director, is a controlling shareholder of the Shineway Lang Fang.

## 28. RELATED PARTY TRANSACTIONS

During the year, the Group had the following significant transactions with related parties:

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Trading transactions: | | |
| Service fee to Shineway Medical (note a) | **6,955** | 6,601 |
| Sale of goods to Shineway Drugstores (note a) | **277** | 2,018 |
| Rental expenditure paid to Shineway Medical (note a) | **469** | 117 |
| Purchase of 20% equity interest in Shineway Sales (note b) | **–** | 80,846 |
| Service fee to Shineway Lang Fang | **1,174** | 1,111 |

**Compensation of key management personnel**

Remuneration of directors and other members of key management during the year amounted to RMB6,338,000 (2005: RMB6,465,000).

The remuneration of directors and key executives is determined by the remuneration committee having regard to the performance of individuals and market trends.

Notes:

(a) Shineway Medical, which is owned by the beneficial shareholder of the Company, holds 80% equity interest in Shineway Drugstores.

(b) Pursuant to the equity interest transfer agreement dated 30 March 2005 entered into between Shineway Lang Fang, a 70% subsidiary of Shineway Medical, and Yuan Da, a wholly-owned subsidiary of the Company, Yuan Da acquired 20% equity interest in Shineway Sales from Shineway Lang Fang at a consideration of RMB80.8 million. The consideration was determined with reference to the net profit of Shineway Sales for the year ended 31 December 2004 and the price earnings ratio of the Group. The goodwill arisen from the acquisition of minority interests of a subsidiary amounted to RMB58.5 million. The details of the determination of the consideration was set out in the circular of the Company dated 19 April 2005.

## 29. SUBSIDIARIES

Details of the subsidiaries at 31 December 2006 are as follows:

| Name of company | Place and date of incorporation/ establishment | Issued and fully paid/ registered capital | Percentage of equity interest held by the Company Directly | Indirectly | Principal activities |
|---|---|---|---|---|---|
| Yuan Da 遠大國際有限公司 | British Virgin Islands ("BVI") 20 November 2002 | Share – US$10,000 | 100% | – | Investment holding |
| Hong Zhan 宏展國際有限公司 | BVI 20 November 2002 | Share – US$10,000 | 100% | – | Investment holding |
| 神威藥業營銷有限公司 Shineway Sales (Note a) | People's Republic of China (the "PRC") 3 March 2003 for a term of 30 years | Registered capital – RMB98,533,542 | – | 100% | Trading of Chinese pharmaceutical products |
| 神威藥業有限公司 Shineway Pharmaceutical (Note b) | PRC 30 December 2003 for a term of 30 years | Registered capital – US$25,000,000 | – | 100% | Research and development, manufacture and trading of Chinese pharmaceutical products |
| 河北神威藥業有限公司 Hebei Shineway (Note b) | PRC 30 December 2003 for a term of 30 years | Registered capital – US$12,000,000 | – | 100% | Manufacture and trading of Chinese pharmaceutical products |
| China Shineway Pharmaceutical (Hong Kong) Limited 中國神威藥業(香港)有限公司 | Hong Kong 21 April 2004 | Share – HK$1 | – | 100% | Trading of Chinese pharmaceutical products |

Notes:

(a) With effect from 30 March 2005, Shineway Sales has become a foreign wholly-owned enterprise after the equity interest transfer as disclosed in Note 28.

(b) Shineway Pharmaceutical and Hebei Shineway are foreign wholly-owned enterprises.