



RUYAN GROUP (HOLDINGS) LIMITED

如烟集團(控股)有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 329)

Interim Report

2008

EXECUTIVE DIRECTORS

Mr. Wong Yin Sen
Mr. Hon Lik
Mr. Wong Hei Lin
Mr. Li Kim Hung

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Pang Hong
Mr. Cheung Kwan Hung
Mr. Ding Xun

AUDIT COMMITTEE

Mr. Pang Hong
Mr. Cheung Kwan Hung
Mr. Ding Xun

COMPANY SECRETARY

Mr. Li Kim Hung

SOLICITORS

Tung & Co, Hong Kong
Commerce & Finance Law Office,
The People's Republic of China

AUDITORS

Deloitte Touche Tohmatsu

REGISTERED OFFICE

Cricket Square, Hutchins Drive
P.O. Box 2681
Grand Cayman KY1-1111
Cayman Islands

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS IN THE HONG KONG SPECIAL ADMINISTRATIVE REGION OF THE PEOPLE'S REPUBLIC OF CHINA ("HONG KONG")

Rooms 1010-12, 10th Floor
West Tower
Shun Tak Centre
168-200 Connaught Road Central
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PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
Butterfield House
68 Fort Street, George Town
P.O. Box 705
Grand Cayman, KY1-1107
Cayman Islands

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
Shops 1712-1716, Hopewell Centre
183 Queen's Road East
Hong Kong

PRINCIPAL BANKERS

in Hong Kong:

The Hong Kong and Shanghai Banking Corporation Limited
Bank of China (Hong Kong) Limited

in the PRC:

China Construction Bank
Shenyang Economic and Technology Development Zone Branch

WEBSITE

www.ruyangroup.com

STOCK CODE

329

Management Discussion and Analysis

BUSINESS REVIEW AND MARKET CONDITIONS

The following is the six-month business review ended 30 June 2008 (the “period under review”) presented by the Board.

During the period under review, the Group recorded an unaudited consolidated turnover of approximately HK\$233,168,000, representing an increase of approximately 73.7% when compared with approximately HK\$134,214,000 in the corresponding period in 2007. The unaudited consolidated profits attributable to shareholders was approximately HK\$14,617,000 in the period under review, representing an increase of approximately 31.2% from approximately HK\$11,141,000 in the corresponding period in 2007. On these bases, the earnings per share for the period under review was approximately HK 0.97 cents (corresponding period in 2007: approximately HK 0.79 cents).

As for health care products, competition in the market of health care products was further intensified in 2008. The Group timely responded to market demands and made improvement in our traditional products. We added new products with four specifications, which provide higher add-on value to cater for different needs of consumers. Among which, the sales of three new products, namely the “6-year”, “8-year” and “10-year” increased significantly. Meanwhile, the pre-sale preparation work for new product “參中之寶” is in progress.

As for pharmaceutical business, we have completed tenders in 24 provinces throughout the country, and handled procedures for pricing in 29 provinces and municipalities. End customers in our sales increased to 489 from 402 of 2007. Sales income maintained steady growth when compared with the same period of 2007.

With the lifting of suspension for the pharmaceutical approval in 2007, the State Food and Drug Administration has resumed review and approval procedures. The Company applied for 15 new products, of which 5 passed the Center for Drug Evaluation and entered the next phase for approval.

For sales operation in the first half of 2008, we mainly focused on channel and network construction. We have established 5 offices in key provinces, namely Liaoning, Szechuan, Guangdong, Henan and Shandong, which serve as centers covering the whole country. We also adopted the market development strategy of surrounding the cities with third terminals (the rural area).

Management Discussion and Analysis

As for electronic cigarette business, the Company has applied for a number of patents since April 2003, including invention patents, utility model patents and design patents. Among which two most important invention patents were granted patent certificates by the State Intellectual Property Office on 16 April 2008, and one invention patent was granted patent certificate by the Eurasian Patent Office, European Patent Office and Intellectual Property Office of Singapore respectively.

In April 2008, Ruyan products won two of the six awards presented at the 2008 Tobacco Plus Expo held at the Las Vegas Convention Center on April 24th and 25th. The Company's e-cigarette was named 2008's most innovative product and its Ruyan Vegas e-cigar was named the most marketable product of the year.

For the period under review, the Group achieved sales income of approximately HK\$233,168,000, an increase of 73.7% from the corresponding period in 2007. Of which, the sales income of health care products, pharmaceuticals products and electronic cigarettes was approximately HK\$48,838,000, HK\$20,131,000 and HK\$164,199,000 respectively.

NEW PRODUCT DEVELOPMENT

Beginning in 2nd quarter of 2008, Ruyan's latest products, **RUYAN** e-Gar® and **RUYAN** Vegas® were introduced to the North American, European, Southeast Asian, Middle-Eastern, Russian, Korean, Israeli and other markets. Initial market feedback has been positive, as the products have mostly filled a need for a safe smoking alternative in venues where smoking bans have been implemented – such as bars, pubs, restaurants, hotels and casinos. Both nicotine and non-nicotine versions of the products have been popular.

Looking ahead to the 2nd-half of the fiscal year, Ruyan will place a strong emphasis on product design – whether from a utility or style perspective – to increase consumer appeal and to accommodate international trends. New products will be announced and launched in the coming months.

Management Discussion and Analysis

REGIONAL DEVELOPMENT

In the first half of the fiscal year, further progress was made in market-entry in key markets, and sales were achieved throughout the period. Selecting business partners and developing sales channels continue to be the top priority for international business. In the past few months, existing partnerships were further developed in North America, Korea, Israel, Turkey, the United Kingdom and Ireland. At the same time, serious negotiations occurred with partners in the European Union, the Middle East, Australia, Japan, Russia and other countries and territories.

Ruyan's Progress in China

The Company initially developed the domestic market in the Eastern and Southern China, and gradually extends to inner regions. The Group intends to establish a base in Xian, Shaanxi for the development of markets in the Western China. After acquiring the office, we shall develop our markets in the western provinces such as Shanxi, Szechuan and Yunnan.

Ruyan's Progress in North America

The progress made in North America, and in the United States, in particular, are a top achievement for the Company. After months of intensive efforts by Ruyan America, Inc., the regulatory situation for Ruyan has been established.

Ruyan's Progress in the Republic of Korea

In accordance with agreements made with the Company in September of 2007, the Company's Korean partner paid for its first sizeable order to the Company at the end of December of last year. Working together with the Korean partner, the Korean market has been opened and all significant regulatory hurdles have been overcome, including meeting electronic safety standards and the standards of customs and the relevant health.

Management Discussion and Analysis

Ruyan's Progress in Other Markets

The Company has supported its partners in the United States, Korea, Israel and other countries to provide critical legal support to defend patent and trademark positions in the respective countries. In response, our partners have taken appropriate actions to pursue patent and copyright infringements wherever possible. Additional legal support was driven through government channels to reinforce Ruyan's position as the authentic and original manufacturer of the e-cigarette and related products. As a result of multiple efforts, markets in these countries have been maintained, and sales and marketing activities by both the partners and Ruyan are now able to proceed again normally. In China, strong actions are underway to stop illegal manufacturing and exports of copycat products. Several websites infringing upon the Ruyan trademark have already been shut down or will be shut down by the end of September.

LIQUIDITY AND FINANCIAL ANALYSIS

As at 30 June 2008, bank loans of the Group amounted to HK\$18,181,000, representing a decrease of HK\$5,359,000 as compared to the total outstanding bank loans as at 31 December 2007, all of which were short-term loans due within one year and partial in Renminbi loans. Although Renminbi is under the pressure of potential revaluation, movements of Renminbi were comparatively stable and the Directors do not anticipate to face any major currency exposures, therefore the Group has not arranged any currency hedge. The Group's aggregate finance cost was approximately HK\$13,927,000 (corresponding period in 2007: HK\$3,009,000). The Group did not use any property as security for such banking facilities, nor was there the use of any financial instruments for hedging purposes. Other borrowings in the sum of HK\$20,467,000 (2007: HK\$24,990,000) are secured by legal charges over the certain of building and leasehold land of the Group.

Gearing ratio of the Group reduced from approximately 27.8% as at 31 December 2007 to approximately 25.2% as at 30 June 2008. This calculation is based on net borrowings of approximately HK\$167,559,000 (31 December 2007: HK\$168,270,000) and shareholders fund of approximately HK\$664,374,000 (31 December 2007: HK\$604,817,000).

As at 30 June 2008, the balance of the inventories amounted to HK\$189,939,000, representing a decrease of HK\$18,928,000 when compared with the balance of that as at 31 December 2007.

Management Discussion and Analysis

INTERIM DIVIDEND

The Board resolved not to declare an interim dividend for the six months ended 30 June 2008 (2007: Nil).

DETAILS OF MATERIAL ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND ASSOCIATED COMPANIES

There was no material acquisitions and disposals of subsidiaries and associated companies during the six months ended 30 June 2008.

SIGNIFICANT INVESTMENTS HELD

There was no material change in the significant investments held by the Group during the six months ended 30 June 2008.

CHARGE OF ASSETS

As at 30 June 2008, the Group had no bank deposits pledged to banks (2007: Nil).

CONTINGENT LIABILITIES

As at 30 June 2008, the Group did not provide any form of guarantees for any outside companies and was not liable to any material legal proceedings of which provision for contingent liabilities was required.

SHORT AND LONG TERM BUSINESS PROSPECTS AND DEVELOPMENT PLANS

Electronic Cigarette

The Hospitality Industry

Ruyan America has determined that traditional hospitality outlets, i.e. bars, restaurants and hotels, have suffered significant loss of business, revenue and profitability resulting from smoking bans. The hospitality industry is looking for ways to enhance revenue and deal with the negative ramifications of the smoking bans. Additionally, the distributors to the industry are also looking for ways to add to their product offerings and assist their traditional customers with new, high margin products. The Ruyan products fit the profile that they are looking for. Ruyan America held a major business conference for suppliers to the Atlantic City casino industry in August. Atlantic City casinos will officially ban smoking indoors as of October 2008.

Traditional Tobacco Outlets

The single greatest opportunity for rapid growth and acceptance of products is through distribution and sales through traditional tobacco outlets. Recently, Ruyan America became a member of the National Association of Tobacco Outlets, Inc. (NATO). Meetings with the organization and its reaction to demonstrations of the Ruyan product met with significant excitement and enthusiasm on the part of the association. Additionally, NATO, along with Tobacco Outlet Business, the industry's trade journal, sponsors the annual Tobacco Plus Expo, a trade show where members of NATO, over 400 distributors and 2100 retailers, are able to see and order our new products. Ruyan America participated in major industry conferences and exhibitions in North America throughout the summer.

Other Markets

In the United Kingdom and Ireland, regulatory approvals are in-process, and the Company received its first order in June. Partners' investment in legal and marketing and sales activities in these markets will be significant in the 4th quarter of 2008 and leading into Q1 2009.

Sales from 2nd half year of 2008 came from a variety of markets: the United States (North America), Korea, Israel, Russia, the United Kingdom, Japan, Germany, France, Panama, Malaysia, South Africa, Spain, Italy, the United Arab Emirates, and several other countries. With market-entry of new products proceeding to completion in multiple markets, and with the strong ramp-up in advertising and sales planned in the USA, Korea, Spain, the UK and other EU markets in the coming months, the sales forecast for international sales starting from 2nd half year of 2008 is expected having rapid development.

Management Discussion and Analysis

Approvals of Market-Entry

International product testing for both safety and efficacy is nearing completion under the guidance of respected international experts and laboratories. Major results will be announced by the last quarter of 2008.

Although regulatory obstacles to full market-entry for this new product category are formidable to both Ruyan and other competitors, Ruyan remains pro-active with respect to its positioning and acceptance by governments and the public alike. Ruyan is on-track to continue opening key markets with strong partners and innovative new products throughout the remainder of the fiscal year.

Marketing in China

The Company developed sales through cooperation with main commercial sales channels in middle and large cities of China. These channels include convenient stores, supermarket in shopping malls, TV shopping, pharmaceutical chains and other specialty sales channels.

Development of Pharmaceuticals and health care products

We will continue the unfinished tenders in the second half of 2008, and will mainly handle the procedures for separate pricing of “Azi” with the National Development and Reform Commission. The construction of channels and network will be further developed to penetrate the front lines. We will have target for breakthrough in the sales of single item in 2009, and it is our ultimate goal to establish our own sales team and network.

As the overall market for health care products recovers in China, new products have been launched in the health care products market at a faster rate. With the effort we put into the promotion of the new product “參中之寶” and the enhancement of its market awareness, our sales of health care products will increase further. On the basis of maintaining our existing sales model, the Group plans to expand sales through direct sales on TV and expects sales of our health care products will increase year after year.

EMPLOYEE POLICY, PERFORMANCE AND SALARY PROCEDURES

As at 30 June 2008, the Group employs a total of about one thousand five hundred employees in the PRC and Hong Kong.

The remuneration package of employees is determined by reference to their performance, experience and their positions, duties and responsibilities in the Group. In addition, discretionary bonuses will be paid to staff based on individual and the Group's performance.

Management Discussion and Analysis

DIRECTORS' INTERESTS IN SHARES AND UNDERLYING SHARES

As at 30 June 2008, the interests and short positions of the Directors and their associates in the shares and underlying shares of the Company and its associated corporations, as recorded in the register required to be kept by the Company pursuant to section 352 of the Securities and Futures Ordinance, 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 Listed Companies (the "Model Code") were as follows:

Interests in the ordinary shares of HK\$0.10 each in the Company

Name of director	Capacity	Number of issued ordinary shares of the Company (Note 1)	Number of underlying shares in respect of the options granted under the share option scheme of the Company (Notes 1 & 5)	Approximate Percentage of the issued share capital of the Company
Mr. Wong Yin Sen	Beneficial owner		1,500,000 (L)	0.10%
	Interest of a controlled corporation	825,406,000 (L) (Note 2)		54.54%
		351,200,000 (S) (Note 3)		23.21%
Mr. Hon Lik	Beneficial owner		1,500,000 (L)	0.10%
	Interest of a controlled corporation	825,406,000 (L) (Note 2)		54.54%
		351,200,000 (S) (Note 3)		23.21%
Mr. Wong Hei Lin	Beneficial owner		1,500,000 (L)	0.10%
	Interest of a controlled corporation	825,406,000 (L) (Note 2)		54.54%
		351,200,000 (S) (Note 3)		23.21%
Mr. Li Kim Hung	Beneficial owner (Note 4)	220,000 (L)		0.01%
			15,000,000 (L)	0.99%
Mr. Pang Hong	Beneficial owner	Nil	1,000,000 (L)	0.07%
Mr. Cheung Kwan Hung	Beneficial owner	Nil	1,000,000 (L)	0.07%
Mr. Ding Xun	Beneficial owner	Nil	1,000,000 (L)	0.07%

Management Discussion and Analysis

Notes:

- (1) "L" denotes long position and "S" denotes short position.
- (2) The 825,406,000 shares comprise 437,406,000 shares held by Ability Act Investments Limited and 388,000,000 shares held by Absolute Target Limited. Absolute Target Limited is owned as to 46.25% by Mr. Wong Yin Sen, 42.50% by Mr. Hon Lik and 11.25% by Mr. Wong Hei Lin. Ability Act Investments Limited is owned as to 4.75% by Goldtools Investments Limited which is wholly owned by Mr. Wong Hei Lin and 90.5% by Dragon Concept Investments Limited which is owned as to 52.11% and 47.89% by Mr. Wong Yin Sen and Mr. Hon Lik respectively.
- (3) The 351,200,000 shares are held by Absolute Target Limited, which in turn is owned as to 46.25% by Mr. Wong Yin Sen, 42.50% by Mr. Hon Lik and 11.25% by Mr. Wong Hei Lin.
- (4) Mr. Li Kim Hung is beneficially interested in 4.75% of Ability Act Investments Limited. Ability Act Investments Limited holds 437,406,000 shares in the Company, which represent 28.90% of the entire issued shares in the Company.
- (5) For details of the interests in underlying shares in respect of the options granted under the share option scheme of the Company, please refer to the section "Share Option Scheme" below.

Long positions in the shares of associated corporation of the Company

Name of director	Name of associated corporation	Number of shares held	Approximately percentage of shareholding
Mr. Wong Yin Sen	Dragon Concept Investments Limited	5,211	52.11%
Mr. Hon Lik	Dragon Concept Investments Limited	4,789	47.89%
Mr. Wong Yin Sen	Absolute Target Limited	4,625	46.25%
Mr. Hon Lik	Absolute Target Limited	4,250	42.50%
Mr. Wong Hei Lin	Absolute Target Limited	1,125	11.25%

Save as disclosed above, as at 30 June 2008, none of the Directors nor their associates had any interests or short positions in any shares and underlying shares of the Company or any of its associated corporations as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

SHARE OPTION SCHEME

In accordance with the terms of the share option scheme, the board of directors of the Company is authorized, at its absolute discretion, to grant options to the participants, including executive directors of the Company and its subsidiaries, to subscribe for shares in the Company. Options granted may be exercised at any time during the five-year period commencing on the date on which the option is accepted and expiring on the last day of the five-year period.

Management Discussion and Analysis

During the six months ended 30 June 2008, share options granted under the share option scheme of the Company adopted on 30 May 2003 were as follows:

Category of participants	Date of share options granted	No. of share options outstanding as at 1 January 2008	No. of share options granted during the period	No. of share options outstanding as at 30 June 2008	Exercise period	Exercise price per share option (HK\$)
Directors						
Wong Yin Sen	9 Jan 2008	–	1,500,000	1,500,000	11 Jan 2008 to 10 Jan 2013	0.60
Hon Lik	9 Jan 2008	–	1,500,000	1,500,000	4 Feb 2008 to 3 Feb 2013	0.60
Wong Hei Lin	9 Jan 2008	–	1,500,000	1,500,000	4 Feb 2008 to 3 Feb 2013	0.60
Li Kim Hung	9 Jan 2008	–	15,000,000	15,000,000	24 Jan 2008 to 23 Jan 2013	0.60
Pang Hong	9 Jan 2008	–	1,000,000	1,000,000	14 Jan 2008 to 13 Jan 2013	0.60
Cheung Kwan Hung	9 Jan 2008	–	1,000,000	1,000,000	11 Jan 2008 to 10 Jan 2013	0.60
Ding Xun	9 Jan 2008	–	1,000,000	1,000,000	22 Jan 2008 to 21 Jan 2013	0.60
				22,500,000		
Employees (in aggregate)						
	9 Jan 2008	–	22,600,000	22,600,000	6 Feb 2008 to 5 Feb 2013	0.60
	18 Feb 2008	–	1,000,000	1,000,000	17 March 2008 to 16 March 2013	0.70
	28 Feb 2008	–	6,000,000	6,000,000	27 March 2008 to 26 March 2013	0.70
	5 June 2008	–	2,000,000	2,000,000	3 July 2008 to 2 July 2013	0.62
				31,600,000		
Others						
	6 May 2008	–	2,000,000	2,000,000	3 June 2008 to 2 June 2013	0.61
			Total	56,100,000		

Management Discussion and Analysis

Notes:

1. There is no vesting period for the 34,500,000 share options granted on 9 January 2008, whereas the remaining 21,600,000 share options granted are subject to a vesting period of three stages with 33.33% of such options granted becoming exercisable on the first anniversary, another 33.33% becoming exercisable on the second anniversary and the remaining 33.34% becoming exercisable on the third anniversary of the respective dates on which the options were accepted.
2. No option was exercised or cancelled or lapsed during the period.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

At no time during the period under review was the Company, its holding company, or any of its subsidiaries or fellow subsidiaries a party to any arrangements to enable the Directors of the company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

SUBSTANTIAL SHAREHOLDERS

So far as is known to Directors, as at 30 June 2008, the persons or companies (other than directors or chief executive) who had interests or short positions in the shares or underlying shares of the Company which fall to be disclosed to the Company under Part XV of the SFO, or which were recorded in the register of substantial shareholders required to be kept by the Company under section 336 of the SFO were as follows:

Interests in the ordinary shares of HK\$0.10 each in the Company

Name	Capacity	Number of shares of the Company (Note 1)	Approximate percentage of shareholding
Absolute Target Limited (Note 2)	Beneficial owner	388,000,000 (L) 351,200,000 (S)	25.64% 23.21%
Ability Act Investments Limited (Note 3)	Interest of controlled corporation	437,406,000 (L)	28.90%
Central SAFE Investments Limited (Note 4)	Interest of controlled corporation Person having a security interest in shares	68,926,886 (L) 175,600,000 (L)	4.55% 11.60%
Evolution Capital Management, LLC (Note 5)	Investment Manager Person having a security interest in shares	67,603,773 (L) 175,600,000 (L)	4.47% 11.60%
Evolution Master Fund Ltd. SPC, Segregated Portfolio M (Note 5)	Beneficial owner Person having a security interest in shares	67,603,773 (L) 175,600,000 (L)	4.47% 11.60%

Management Discussion and Analysis

Notes:

- (1) "L" denotes long position and "S" denotes short position.
- (2) Absolute Target Limited is owned as to 46.25%, 42.50% and 11.25% by Mr. Wong Yin Sen, Mr. Hon Lik and Mr. Wong Hei Lin respectively.
- (3) Ability Act Investments Limited is owned as to 4.75% by Goldtools Investments Limited which is wholly owned by Mr. Wong Hei Lin, 4.75% by Success Glory Group Limited which is wholly owned by Mr. Li Kim Hung, and 90.5% by Dragon Concept Investments Limited which is owned as to 52.11% and 47.89% by Mr. Wong Yin Sen and Mr. Hon Lik respectively.
- (4) Pursuant to the corporate substantial shareholder notice filed by Central SAFE Investments Limited on 25 January 2008, the interest in an aggregate of 244,526,886 shares were directly held by BOCI Financial Products Limited which was a wholly owned subsidiary of BOC International Holdings Limited, a wholly owned subsidiary of Bank of China Limited. Central SAFE Investments Limited was interested in 67.5% shareholding of Bank of China Limited.
- (5) As at 30 June 2008, Evolution Capital Management, LLC and Evolution Master Fund Ltd. SPC, Segregated Portfolio M were interested in the same block of an aggregate of 243,203,773 shares.

Other than as disclosed above, the Company has not been notified of any other relevant interests or short positions in the issued share capital of the Company as at 30 June, 2008.

PURCHASE, SALE OR REDEMPTION OF SECURITIES

During the period under review, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's securities.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") as set out in the Appendix 10 to the Listing Rules as its own code of conduct regarding securities transactions by the Directors. Having made specific enquiry of all directors, they all confirmed that they have complied with the required standard set out in the Model Code during the six months ended 30 June 2008.

Management Discussion and Analysis

COMPLIANCE WITH CODE ON CORPORATE GOVERNANCE PRACTICES

The Company has complied with the code provisions of the Code on Corporate Governance Practices (the “Code”) as set out in Appendix 14 to the Listing Rules during the period under review, with the following exception as having been elaborated in our 2007 Annual Report:

Under code provision A.4.1 of the Code, non-executive directors should be appointed for specific term and subject to re-election. The non-executive Directors of the Company are not appointed for a specific term of office. However, the non-executive Directors of the Company are subject to retirement by rotation and re-election at annual general meetings in accordance with the Company’s Articles of Association.

AUDIT COMMITTEE

The audit committee of the Board (comprising three independent non-executive directors of the Company) and the management of the Company have reviewed the accounting principles and practices adopted by the Group and have discussed the matters related to auditing, financial reporting procedures and internal control, including the review of the interim financial report during the period under review.

The interim financial report during the period under review has been reviewed by the audit committee of the Board and the management of the Company as well as Messrs. Deloitte Touche Tohmatsu, the auditors of the Company, in accordance with the Statements of Auditing Standards 700 “Engagements to review interim financial reports” issued by the HKICPA.

REMUNERATION COMMITTEE

The remuneration committee of the board (comprising three independent non-executive directors of the Company) was established in September 2005.

Its duties include making recommendations on the Group’s policy and structure for remuneration package of the directors and senior management, evaluation and making recommendations on other employees’ benefit arrangements.

Management Discussion and Analysis

MEMBERS OF THE BOARD

As at the date hereof, the members of the Board are as follows:

Executive Directors

Wong Yin Sen
Hon Lik
Wong Hei Lin
Li Kim Hung

Independent Non-executive Directors

Pang Hong
Cheung Kwan Hung, Anthony
Ding Xun

On behalf of the Board

Ruyan Group (Holdings) Limited

Wong Yin Sen

Chairman

Hong Kong, 23 September 2008

REPORT ON REVIEW OF INTERIM FINANCIAL INFORMATION

TO THE BOARD OF DIRECTORS OF RUYAN GROUP (HOLDINGS) LIMITED

如烟集團(控股)有限公司

(incorporated in the Cayman Islands with limited liability)

INTRODUCTION

We have reviewed the interim financial information set out on pages 17 to 30 which comprises the condensed consolidated balance sheet of Ruyan Group (Holdings) Limited as of 30 June 2008 and the related condensed consolidated income statement, statement of changes in equity and cash flow statement for the six-month period then ended and certain explanatory notes. The Main Board Listing Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of a report on interim financial information to be in compliance with the relevant provisions thereof and Hong Kong Accounting Standards (“HKAS”) 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants. The directors are responsible for the preparation and presentation of this interim financial information in accordance with HKAS 34. Our responsibility to express a conclusion on this interim financial information based on our review, and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

SCOPE OF REVIEW

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the Hong Kong Institute of Certified Public Accountants. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the interim financial information is not prepared, in all material respects, in accordance with HKAS 34.

Deloitte Touche Tohmatsu

Certified Public Accountants

Hong Kong

23 September 2008

CONDENSED CONSOLIDATED INCOME STATEMENT

For the six months ended 30 June 2008

	NOTES	Six months ended	
		30.6.2008 HK\$'000 (unaudited)	30.6.2007 HK\$'000 (unaudited)
Revenue		233,168	134,214
Cost of sales		(67,545)	(40,274)
Gross profit		165,623	93,940
Other income		1,431	808
Distribution and selling expenses		(68,060)	(44,165)
Administrative expenses		(55,348)	(25,314)
Change in fair value of derivative financial instruments		(1,550)	–
Change in fair value of held-for-trading investments		(3,707)	(127)
Finance costs		(13,927)	(3,009)
Profit before tax		24,462	22,133
Income tax expense	5	(9,845)	(2,869)
Profit for the period	6	14,617	19,264
Attributable to:			
Equity holders of the parent		14,617	11,141
Minority interests		–	8,123
		14,617	19,264
Earnings per share	8		
Basic		HK0.97 cents	HK0.79 cents

CONDENSED CONSOLIDATED BALANCE SHEET

At 30 June 2008

	NOTES	30.6.2008 HK\$'000 (unaudited)	31.12.2007 HK\$'000
Non-current assets			
Property, plant and equipment	9	62,090	61,473
Goodwill		3,934	3,934
Available-for-sale investments	10	–	–
Intangible assets		2,107	2,743
Prepaid lease payments		27,763	26,427
Deposit for acquisition of properties		14,000	–
		109,894	94,577
Current assets			
Inventories		189,939	208,867
Trade receivables	11	217,215	161,736
Deposits and other receivables		37,481	58,194
Prepaid lease payments		606	571
Held-for-trading investments	12	40,244	266
Bank balances and cash		381,499	361,316
		866,984	790,950
Current liabilities			
Trade payables	13	16,324	16,948
Accruals and other payables		79,734	63,554
Borrowings		26,360	30,913
Amount due to a minority shareholder		7,127	–
Derivative financial instruments		31,490	29,940
Taxation payable		10,270	1,998
		171,305	143,353
Net current assets		695,679	647,597
Total assets less current liabilities		805,573	742,174
Non-current liabilities			
Borrowings due after one year		12,288	17,617
Convertible bonds		128,911	119,740
		141,199	137,357
		664,374	604,817
Capital and reserves			
Share capital	14	151,336	151,336
Reserves		513,038	453,481
		664,374	604,817

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 30 June 2008

	Share capital HK\$'000	Share premium account HK\$'000	Shareholders' contribution HK\$'000 (note a)	Issuable shares HK\$'000	Translation reserve HK\$'000	Non-distributable reserves HK\$'000 (note b)	Share option reserve HK\$'000	Merger reserves HK\$'000	Special reserves HK\$'000	Accumulated profits HK\$'000	Attributable to equity holders of the Company HK\$'000	Minority interests HK\$'000	Total HK\$'000
At 1 January 2007, as originally stated	70,080	65,339	-	-	17,519	24,032	-	-	3,142	125,574	305,686	-	305,686
Effect of the Acquisition (note c)	-	-	21,780	-	1,274	705	-	47	-	34,042	57,848	37,768	95,616
At 1 January 2007, as restated	70,080	65,339	21,780	-	18,793	24,737	-	47	3,142	159,616	363,534	37,768	401,302
Exchange difference on translation of functional to presentation currency and net income recognised directly in equity	-	-	-	-	10,466	-	-	-	-	-	10,466	-	10,466
Profit for the period	-	-	-	-	-	-	-	-	-	11,141	11,141	8,123	19,264
Total recognised income for the period	-	-	-	-	10,466	-	-	-	-	11,141	21,607	8,123	29,730
Acquired from minority interests upon the completion of the Acquisition	-	-	-	-	-	-	-	45,891	-	-	45,891	(45,891)	-
Issue of convertible notes	-	-	-	976,433	-	-	-	(1,062,676)	-	-	(86,243)	-	(86,243)
Issue of new shares upon the conversion of convertible notes	54,950	770,338	-	(768,310)	-	-	-	-	-	-	66,978	-	66,978
At 30 June 2007	125,030	835,677	21,780	218,123	29,259	24,737	-	(1,016,738)	3,142	170,757	411,767	-	411,767
At 1 January 2008	151,336	1,182,410	21,780	-	52,418	24,737	-	(1,016,738)	3,142	185,732	604,817	-	604,817
Exchange differences on translation of functional to presentation currency and net income recognised directly in equity	-	-	-	-	35,913	-	-	-	-	-	35,913	-	35,913
Profit for the period	-	-	-	-	-	-	-	-	-	14,617	14,617	-	14,617
Total recognised income for the period	-	-	-	-	35,913	-	-	-	-	14,617	50,530	-	50,530
Recognition of equity-settled share-based payments	-	-	-	-	-	-	9,027	-	-	-	9,027	-	9,027
At 30 June 2008	151,336	1,182,410	21,780	-	88,331	24,737	9,027	(1,016,738)	3,142	200,349	664,374	-	664,374

Notes:

- Shareholders' contribution represents the amounts contributed by shareholders of SBT Investment (Holdings) Limited ("SBT").
- The non-distributable reserve represents statutory reserves appropriated from profit after tax of the Company's PRC subsidiary under the PRC laws and regulations.
- On 14 June 2007, Wealthy Well Investments Limited, a wholly-owned subsidiary of the Company, acquired from Ability Act Investments Limited ("AAI") the entire issued shares of SBT at a total consideration of HK\$1,062,676,000 (the "Acquisition"). As the controlling shareholders of the Company are also the controlling shareholders of AAI, the Company has accounted for the Acquisition in accordance with the Accounting Guideline 5 "Merger Accounting for Common Control Combinations" issued by the Hong Kong Institute of Certified Public Accountants to prepare the condensed consolidated financial statements, assuming that the current group structure had been in existence throughout the periods presented.

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 30 June 2008

	Six months ended	
	30.6.2008 HK\$'000 (unaudited)	30.6.2007 HK\$'000 (unaudited)
Net cash from operating activities	30,008	56,348
Investing activities		
Additions of property, plant and equipment	(799)	(2,960)
Deposit for acquisition of properties	(14,000)	–
Net cash used in Investing activities	(14,799)	(2,960)
Financing activities		
Repayment of bank borrowings	(6,915)	(6,238)
Repayment of other borrowings	(7,335)	(3,112)
Repayment of other loans	–	(10,028)
Interest paid	(1,888)	(1,932)
Increase in amount due to a minority shareholder	7,127	–
Net cash used in financing activities	(9,011)	(21,310)
Net increase in cash and cash equivalents	6,198	32,078
Cash and cash equivalents at beginning of the period	361,316	76,222
Effect of foreign exchange rate changes	13,985	4,416
Cash and cash equivalents at end of the period	381,499	112,716
Analysis of the balances of cash and cash equivalents		
Bank balances and cash	381,499	112,716

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2008

1. GENERAL INFORMATION

Ruyan Group (Holdings) Limited (the "Company") was incorporated in the Cayman Islands as an exempted company with limited liability and its shares are listed on The Stock Exchange of Hong Kong Limited.

The condensed consolidated financial statements are presented in Hong Kong dollars, and the functional currency of the Company is Renminbi. As the Company is listed in Hong Kong, the directors consider that it is appropriate to present its financial information in Hong Kong dollars.

The Company acts as an investment holding company. Its subsidiaries are principally engaged in production and sales of a series of health care products, pharmaceutical products and electronic cigarettes.

2. BASIS OF PREPARATION

The condensed consolidated financial statements have been prepared in accordance with the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and with Hong Kong Accounting Standard 34 "Interim Financial Reporting".

3. PRINCIPAL ACCOUNTING POLICIES

The condensed consolidated financial statements have been prepared under the historical cost basis except for certain financial instruments, which are measured at fair values, as appropriate.

The accounting policies used in the condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual financial statement for the year ended 31 December 2007, except for the accounting policy set out below:

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2008

3. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

Equity-settled share-based payment

Share options granted to employees

The fair value of services received determined by reference to the fair value of share options granted at the grant date is recognised as an expense in full at the grant date when the share options granted vest immediately, with a corresponding increase in equity (share option reserve).

At each balance sheet date, the Group revises its estimates of the number of options that are expected to ultimately vest. The impact of the revision of the estimates during the vesting period, if any, is recognised in profit or loss, with a corresponding adjustment to share option reserve.

At the time when the share options are exercised, the amount previously recognised in share option reserve will be transferred to share premium. When the share options are forfeited after the vesting date or are still not exercised at the expiry date, the amount previously recognised in share option reserve will be transferred to accumulated profits.

In the current interim period, the Group has applied, for the first time, the following new interpretations ("new Interpretations") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which are effective for the Group's financial year beginning on 1 January 2008.

HK(IFRIC)-INT 11	HKFRS 2: Group and treasury share transactions
HK(IFRIC)-INT 12	Service concession arrangements
HK(IFRIC)-INT 14	HKAS 19-The limit on a defined benefit asset, minimum funding requirements and their interaction

The adoption of these new Interpretations had no material effect on the results or financial position of the Group for the current or prior accounting periods. Accordingly, no prior period adjustment has been recognised.

The Group has not early applied the following new or revised standards, amendments and interpretations that have been issued but are not yet effective.

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2008

3. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

Equity-settled share-based payment (Continued)

Share options granted to employees (Continued)

HKAS 1 (Revised)	Presentation of financial statements ¹
HKAS 23 (Revised)	Borrowing costs ¹
HKAS 27 (Revised)	Consolidated and separate financial statements ²
HKAS 32 & 1 (Amendments)	Puttable financial instruments and obligations arising on liquidation ¹
HKFRS 2 (Amendment)	Vesting conditions and cancellations ¹
HKFRS 3 (Revised)	Business combinations ²
HKFRS 8	Operating segments ¹
HK(IFRIC)-INT 13	Customer loyalty programmes ³
HK(IFRIC)-INT 15	Agreements for the construction of real estate ¹
HK(IFRIC)-INT 16	Hedges of a net investment in a foreign operation ⁴

¹ Effective for accounting periods beginning on or after 1 January 2009.

² Effective for accounting periods beginning on or after 1 July 2009.

³ Effective for accounting periods beginning on or after 1 July 2008.

⁴ Effective for accounting periods beginning on or after 1 October 2008.

The adoption of HKFRS 3 (Revised) may affect the accounting for business combination for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. HKAS 27 (Revised) will affect the accounting treatment for changes in a parent's ownership interest in a subsidiary that do not result in a loss of control, which will be accounted for as equity transactions.

The directors of the Company anticipate that the application of the other new or revised standards or interpretation will have no material impact on the results and the financial position of the Group.

4. SEGMENTAL INFORMATION

Business segments

For management purposes, the Group is currently organised into three operating businesses-production and sales of health care products, pharmaceutical products and electronic cigarettes. These businesses are the basis on which the Group reports its primary segment information.

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2008

4. SEGMENTAL INFORMATION (CONTINUED)

Business segments (Continued)

Segment information about these businesses for the six months ended 30 June 2008 and 2007 is presented below.

	Health care products		Pharmaceutical products		Electronic cigarettes products		Total	
	2008 HK\$'000	2007 HK\$'000	2008 HK\$'000	2007 HK\$'000	2008 HK\$'000	2007 HK\$'000	2008 HK\$'000	2007 HK\$'000
Segment turnover	48,838	39,807	20,131	19,669	164,199	74,738	233,168	134,214
Segment result	7,049	3,033	5,823	6,262	66,534	32,100	79,406	41,395
Other income							1,431	808
Unallocated corporate expenses							(42,448)	(17,061)
Finance costs							(13,927)	(3,009)
Profit before tax							24,462	22,133
Income tax expense							(9,845)	(2,869)
Profit for the period							14,617	19,264

5. INCOME TAX EXPENSE

	Six months ended	
	30.6.2008 HK\$'000	30.6.2007 HK\$'000
Enterprise Income Tax in the People's Republic of China (the "PRC")	9,845	2,869

No Hong Kong Profits Tax is payable by the Company or its subsidiaries operating in Hong Kong since they had no assessable profit for both periods.

On 26 June 2008, the Hong Kong Legislative Council passed the Revenue Bill 2008 which includes the reduction in corporate profit tax rate by 1% to 16.5% effective from the year of assessment 2008-2009.

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2008

5. INCOME TAX EXPENSE (CONTINUED)

PRC Enterprise Income Tax is calculated at the rate prevailing in the relevant districts of the PRC taking relevant tax incentives into account.

On 16 March 2007, the PRC promulgated the Law of the PRC on Enterprise Income Tax (the "New Law") by Order No. 63 of the President of the PRC. On 6 December 2007, the State Council of the PRC issued Implementation Regulation of the New Law. The New Law and the Implementation Regulation have changed the tax rate from 33% to 25% for the Group's subsidiaries from 1 January 2008.

6. PROFIT FOR THE PERIOD

	Six months ended	
	30.6.2008	30.6.2007
	HK\$'000	HK\$'000
Profit for the period has been arrived at after charging (crediting):		
Advertising expenses	51,284	32,383
Amortisation of intangible assets (included in cost of sales)	785	720
Amortisation of prepaid lease payments	292	271
Depreciation of property, plant and equipment	3,560	3,838
Staff costs (including directors' emoluments and share-based payment expenses)	19,057	5,553
Interest income	(699)	(876)

7. DIVIDEND

No dividends were paid, declared or proposed during both periods. The directors do not recommend the payment of an interim dividend.

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2008

8. EARNINGS PER SHARE

The calculation of basic earnings per share attributable to the ordinary equity holders of the Company is based on the following data:

	Six months ended	
	30.6.2008 HK\$'000	30.6.2007 HK\$'000
Earnings for the purpose of basic earnings per share attributable to equity holders of the Company	14,617	11,141
	Six months ended	
	30.6.2008 '000	30.6.2007 '000
Weighted average number of ordinary shares for the purpose of basic earnings per share	1,513,360	1,408,360

Diluted earnings per share has not been presented as the conversion of the Company's outstanding convertible notes would result in an increase in profit per share for the six months ended 30 June 2008 and 2007 and the outstanding share options granted during the period were anti-dilutive for the six months ended 30 June 2008.

9. MOVEMENT IN PROPERTY, PLANT AND EQUIPMENT

During the period, additions to the Group's property, plant and equipment amounted to approximately HK\$799,000 (six months ended 30 June 2007: HK\$2,960,000).

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2008

10.AVAILABLE-FOR-SALE INVESTMENTS

	30.6.2008 HK\$'000	31.12.2007 HK\$'000
Available-for-sales investments	1,000	1,000
Less: Impairment loss recognised	(1,000)	(1,000)
	-	-

11.TRADE RECEIVABLES

The Group allows an average credit period from 60 days to 270 days to its trade customers. The following is an aged analysis of trade receivables net of allowance of doubtful debts at the balance sheet date:

	30.6.2008 HK\$'000	31.12.2007 HK\$'000
0-60 days	73,345	40,542
61-90 days	34,404	30,146
91-180 days	78,048	47,721
181-270 days	31,418	42,961
Over 270 days but less than 1 year	-	366
	217,215	161,736

12.HELD-FOR-TRADING INVESTMENTS

	30.6.2008 HK\$'000	31.12.2007 HK\$'000
Listed equity securities in Hong Kong	30,845	266
Unlisted unit trust funds	9,399	-
	40,244	266

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2008

13. TRADE PAYABLES

The following is an aged analysis of trade payables at the balance sheet date:

	30.6.2008	31.12.2007
	HK\$'000	HK\$'000
0-30 days	1,020	3,431
31-60 days	1,094	519
61-90 days	1,042	1,947
Over 90 days but less than 1 year	10,329	9,174
Over 1 year	2,839	1,877
	16,324	16,948

14. SHARE CAPITAL

	Number of shares	Share capital
	'000	HK\$'000
Ordinary shares of HK\$0.10 each		
Authorised:		
At 1 January 2007	1,000,000	100,000
Increase in authorised share capital	1,000,000	100,000
At 31 December 2007 and 30 June 2008	2,000,000	200,000
Issued:		
At 1 January 2007	700,800	70,080
Placing of shares	105,000	10,500
Conversion of convertible notes	707,560	70,756
At 31 December 2007 and 30 June 2008	1,513,360	151,336

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2008

15.SHARE-BASED PAYMENTS

The Company has a share option scheme for eligible employees of the Group. Details of the share options outstanding during the current period are as follows:

	Number of share options
Granted during the period	56,100,000

The closing prices of the Company's shares immediately before 9 January 2008, 18 February 2008, 28 February 2008, 6 May 2008 and 5 June 2008, the dates of grant of the 2008 options, were HK\$0.61, HK\$0.70, HK\$0.70, HK\$0.61 and HK\$0.62 respectively.

In the current period, share options were granted on 9 January 2008, 18 February 2008, 28 February 2008, 6 May 2008 and 5 June 2008. The fair values of the options determined at the dates of grant using the Binominal model approximately were HK\$10,303,000, HK\$248,000, HK\$1,497,000, HK\$453,000 and HK\$460,000 respectively.

34,500,000 share options granted on 9 January 2008 were vested immediately at the date of grant. For the remaining 21,600,000 share options, the right of the grantee to exercise the option shall vest in three stages: 33.3% of share options granted will vest from the expiry of one year from the acceptance date of the option (the "Acceptance Date") up to the day immediately before the fifth anniversary of the Acceptance Date; 33.3% of share options granted will vest from the expiry of two years from the Acceptance Date up to the day immediately before the fifth anniversary of the Acceptance Date; and 33.4% of the share options granted will vest from the expiry of three years from the Acceptance Date up to the day immediately before the fifth anniversary of the Acceptance Date.

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2008

15.SHARE-BASED PAYMENTS (CONTINUED)

The following assumptions were used to calculate the fair values of the share options:

	9.1.2008	18.2.2008	28.2.2008	6.5.2008	5.6.2008
Grant date share price	HK\$0.61	HK\$0.70	HK\$0.70	HK\$0.61	HK\$0.62
Exercise price	HK\$0.60	HK\$0.70	HK\$0.70	HK\$0.61	HK\$0.62
Option life	5 years	5 years	5 years	5 years	5 years
Expected volatility	44.9%	45.5%	45.6%	47.7%	47.2%
Dividend yield	—	—	—	—	—
Risk-free interest rate	2.83%	2.19%	2.33%	2.46%	2.91%

The Binominal model has been used to estimate the fair value of the options. The variables and assumptions used in computing the fair value of the share options are based on the directors' best estimate. The value of an option varies with different variables of certain subjective assumptions.

Expected volatility was determined by using the historical volatility of the Company's share price over the previous 5 years.

At each balance date, the Group revises its estimates of the number of options that are expected to ultimately vest. The impact of the revision of the estimates, if any, is recognised in the profit and loss, with a corresponding adjustment to the share option reserve.

In the current period, share-based payment expenses of HK\$9,027,000 (2007: nil) has been recognised in the condensed consolidated income statement with a corresponding adjustment recognised in the Company's share option reserve.

16.RELATED PARTY TRANSACTIONS

The remuneration of key management during the period was HK\$10,280,000 (six months ended 30 June 2007: HK\$3,050,000).