SELECTED FINANCIAL DATA

Selected Historical Consolidated Financial Information

The following tables present our selected historical consolidated financial information for the periods indicated.

	Year ended 31 December			Five months ended 31 May	
	2006	2007	2008	2008	2009
				(unaudited)	
	(RMB in millions, except per share information)				
Consolidated Income Statement Data:					
Revenue	**23,736.6**	**31,110.2**	**38,187.4**	**15,007.2**	**18,048.0**
Cost of sales	(21,747.1)	(28,560.0)	(35,152.5)	(13,794.6)	(16,610.0)
Gross profit	**1,989.5**	**2,550.2**	**3,034.9**	**1,212.6**	**1,438.0**
Other income	17.3	24.0	69.9	16.2	19.7
Distribution and selling expenses	(779.0)	(945.3)	(966.0)	(365.0)	(408.6)
General and administrative expenses	(747.6)	(839.6)	(966.7)	(354.4)	(346.5)
Operating profit	**480.3**	**789.3**	**1,172.1**	**509.4**	**702.6**
Other gains/loss – net	(45.6)	124.1	92.7	79.4	104.0
Finance income	11.7	17.8	24.3	7.3	9.0
Finance costs	(101.5)	(150.9)	(266.0)	(98.1)	(93.9)
Finance costs – net	(89.8)	(133.1)	(241.7)	(90.8)	(84.9)
Share of results from associates	19.2	40.0	54.2	22.8	25.1
Profit before income tax	**364.0**	**820.4**	**1,077.4**	**520.8**	**746.8**
Income tax expense	(181.5)	(284.5)	(259.3)	(119.0)	(193.8)
Profit for the year/period	**182.4**	**535.9**	**818.1**	**401.8**	**552.9**
Attributable to:					
Equity holders of the Company	101.3	380.9	585.7	297.0	421.5
Minority interests	81.1	155.0	232.4	104.8	131.4
	182.4	535.9	818.1	401.8	552.9
Dividends per share[1]	0.10	0.18	0.06	-	0.17
Basic and fully diluted earnings per share attributable to equity holders of the Company during the year/period[2]	0.06	0.23	0.36	0.18	0.26

(1) The calculation of dividends per share is based on dividends declared by the Company to its equity holders for each period presented on the assumption that 1,637,037,451 Shares, representing the number of Shares of the Company issued and outstanding as of 6 October 2008 upon conversion of the Company into a joint stock limited company, as if such Shares had been outstanding for all periods presented.

(2) Basic and fully diluted earnings per share for each period presented have been calculated by dividing the profit attributable to equity holders of the Company for each period presented by 1,637,037,451 Shares issued and outstanding as of 6 October 2008 upon conversion of the Company into a joint stock limited company, as if such shares had been outstanding for all periods presented.

	Year ended 31 December			Five months ended 31 May	
	2006	2007	2008	2008	2009
				(unaudited)	
	(RMB in millions)				
Consolidated Segment Financial Data:					
External segment revenue[(1)(2)]:					
Pharmaceutical distribution	21,927.2	28,997.3	35,745.1	14,017.7	16,845.7
Retail pharmacy	823.1	835.6	952.2	389.0	463.2
Other business operations[(3)]	986.3	1,277.3	1,490.2	600.5	739.1
Total revenue	23,736.6	31,110.2	38,187.4	15,007.2	18,048.0
Cost of sales					
Pharmaceutical distribution	20,548.5	27,106.8	33,370.7	13,074.5	15,735.4
Retail pharmacy	615.5	620.1	708.3	293.4	337.2
Other business operations[(3)]	583.1	833.1	1,073.5	426.7	537.4
Total cost of sales	21,747.1	28,560.0	35,152.5	13,794.6	16,610.0
Gross profit					
Pharmaceutical distribution	1,378.7	1,890.5	2,374.3	943.2	1,110.3
Retail pharmacy	207.7	215.5	243.9	95.6	126.0
Other business operations[(3)]	403.2	444.2	416.7	173.8	201.7
Total gross profit	1,989.5	2,550.2	3,034.9	1,212.6	1,438.0
Operating profit					
Pharmaceutical distribution	394.2	680.6	1,053.7	448.2	629.8
Retail pharmacy	12.3	24.2	11.9	5.0	4.2
Other business operations[(3)]	73.8	84.5	106.5	56.2	68.6
Total profit from operations	480.3	789.3	1,172.1	509.4	702.6
Depreciation and amortization					
Pharmaceutical distribution	81.7	88.4	114.2	48.8	46.6
Retail pharmacy	12.5	12.5	14.4	3.8	5.9
Other business operations[(3)]	32.5	34.0	44.2	17.2	24.4
Total depreciation and amortization	126.7	134.9	172.7	69.8	77.0

(1) External segment revenue refers to segment revenue after inter-segment elimination.

(2) The inter-segment revenues for the years ended 31 December 2006, 2007 and 2008 were RMB177.6 million, RMB225.9 million and RMB311.2 million, respectively. The inter-segment revenues for the five months ended 31 May 2008 and 2009 were RMB140.9 million and RMB147.6 million, respectively.

(3) Other business operations consist of the (i) distribution and selling of laboratory supplies; (ii) manufacturing and distribution of chemical reagents; and (iii) production and sale of pharmaceutical products.

	As of 31 December			As of 31 May
	2006	2007	2008	2009
	(RMB in millions)			
Consolidated Balance Sheet Data:				
Non-current assets	2,192.7	2,332.0	2,433.4	2,645.1
Current assets				
Cash and cash equivalents	1,838.8	1,955.6	1,712.1	2,602.1
Other current assets	7,558.8	9,999.7	11,969.4	13,781.1
Total current assets	9,397.6	11,955.3	13,681.5	16,383.2
Total assets	**11,590.3**	**14,287.3**	**16,114.9**	**19,028.3**
Non-current liabilities				
Long-term borrowings	177.7	157.7	130.0	60.0
Other non-current liabilities	552.6	564.3	696.5	722.8
Total non-current liabilities	730.3	722.0	826.5	782.8
Current liabilities				
Short-term borrowings (including current portion of long-term borrowings)	1,704.4	1,521.6	1,504.2	2,464.9
Other current liabilities	6,565.4	9,425.3	10,373.6	11,903.1
Total current liabilities	8,269.7	10,946.9	11,877.8	14,368.0
Total liabilities	**9,000.0**	**11,668.9**	**12,704.3**	**15,150.8**
Equity				
Equity attributable to equity holders of the Company	1,759.7	1,683.7	2,264.2	2,584.5
Minority interests	830.6	934.6	1,146.4	1,293.1
Total equity	**2,590.3**	**2,618.3**	**3,410.6**	**3,877.6**
Total equity and liabilities	**11,590.3**	**14,287.3**	**16,114.9**	**19,028.3**

	Year ended 31 December			Five months ended 31 May	
	2006	2007	2008	2008	2009
				(unaudited)	
	(RMB in millions)				
Consolidated Cash Flow Data:					
Net cash from operating activities	638.4	441.2	653.8	(474.0)	264.1
Net cash (used in) investing activities	(270.9)	(14.4)	(148.0)	(2.2)	(37.3)
Net cash from/(used in) financing activities	119.8	(310.0)	(749.4)	(16.0)	663.1
Net increase/(decrease) in cash and cash equivalents	487.4	116.8	(243.5)	(492.2)	890.0

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are the largest distributor and a leading supply chain service provider of pharmaceutical and healthcare products in China with integrated operations in the following business segments:

- *Pharmaceutical distribution.* We provide pharmaceutical supply chain management for the distribution of domestic and imported prescription and over-the-counter medicines from manufacturers and suppliers to hospitals, other distributors, retail drug stores and other customers. In the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2009, external revenue generated from our pharmaceutical distribution operations accounted for 92.4%, 93.2%, 93.6% and 93.3% of our total revenue, respectively.

- *Retail pharmacy operations.* We have a network of retail pharmacies that we directly operate or franchise in major cities throughout China. In the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2009, external revenue generated from our retail pharmacy operations accounted for 3.5%, 2.7%, 2.5% and 2.6% of our total revenue, respectively.

- *Other business operations.* In our other business operations, we engage in the manufacturing or selling of pharmaceutical products, chemical reagents and laboratory supplies. In the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2009, external revenue generated from our other business operations accounted for 4.2%, 4.1%, 3.9% and 4.1% of our total revenue, respectively.

We have experienced significant growth in our business in recent years. Our revenues increased from RMB23,736.6 million in 2006 to RMB31,110.2 million in 2007 and to RMB38,187.4 million in 2008, representing a CAGR, of 26.8% from 2006 to 2008. Our net profit, defined as after tax profit attributable to our equity holders, increased from RMB101.3 million in 2006 to RMB380.9 million in 2007 and to RMB585.7 million in 2008, representing a CAGR of 140.4% from 2006 to 2008. In the five months ended 31 May 2009, our revenue amounted to RMB18,048.0 million, representing an increase of 20.3% over the same period in 2008, and in the five months ended 31 May 2009, our net profit amounted to RMB421.5 million, representing an increase of 41.9% over the same period in 2008.

In 2008, triggered by the liquidity crisis in the capital markets, global economic conditions deteriorated. The PRC continued to have positive GDP growth in the year; however, the rate of growth in the PRC slowed down significantly compared to the preceding year, and major economic indicators, including employment rates, levels of consumer spending and exports, declined. More recently, the PRC Government has announced and implemented fiscal stimulus measures to combat the effects of the economic downturn, including spending an additional RMB850 billion from 2009 to 2011 on a healthcare reform plan and measures to encourage lending by PRC banking institutions, which have in recent months exhibited some signs of success. Pharmaceutical consumption has traditionally been relatively unaffected by economic downturns, and, likewise, our results of operations and financial condition in the Track Record Period were not materially adversely affected by the deterioration in global economic and liquidity conditions. Notwithstanding that we are not able to currently predict when worldwide economic and liquidity conditions will improve, we believe that China's economic growth and its announced fiscal stimulus measures should continue to create opportunities for our business.

Basis of Presentation

Our Company was established in the PRC on 8 January 2003 by CNPGC and Fosun Investment, two leading companies dedicated to the pharmaceutical industry in China, as a limited liability company under the PRC Company Law and commenced operations in the same year. On 6 October 2008, our Company became a joint stock company with limited liability under the PRC Company Law by converting its registered capital and reserves as of 30 September 2007 at a ratio of 1:0.8699 into 1,637,037,451 shares with a par value of RMB1.00 each. Pursuant to the Restructuring undertaken by the equity holders of our Company, Sinopharm Investment and CNPGC currently hold 96% and 4%, respectively, of the equity interest in the Company.

During the Track Record Period, we acquired approximately 58.67% of the outstanding shares of National Medicines from CNPGC, our parent company and acquired a 100% equity interest in Guangxi Guoda Pharmacy Chainstore Co., Ltd. from a wholly-owned subsidiary of CNPGC. The consolidated financial statements include the financial position, results and cash flows of National Medicines and Guangxi Guoda Pharmacy Chainstore Co., Ltd. as if the structure of our Company had been in existence since 1 January 2006. In addition, companies acquired from or disposed to third parties during the Track Record Period are included in or excluded from the consolidated financial statements from the date of that acquisition or disposal, respectively.

Inter-company transactions and unrealized gains on transactions between members of our Company have been eliminated on consolidation of our financial statements. Unrealized losses are also eliminated unless the transaction provides evidence of the impairment of asset transferred. For the purpose of preparing the consolidated financial statements, the accounting policies of the Company's subsidiaries have been changed where necessary to ensure consistency with the policies adopted by our Company.

Our Listed Subsidiaries

Two of our major subsidiaries, National Medicines and Accord Pharma, are listed in the PRC. The A shares of National Medicines are listed on the Shanghai Stock Exchange and the A shares and B shares of Accord Pharma are listed on the Shenzhen Stock Exchange. As of 31 May 2009, we had an effective equity interest of 44.03% in National Medicines and 38.33% in Accord Pharma. The operating and financial results of National Medicines and Accord Pharma are consolidated with our financial statements contained in the Accountant's Report on our financial information included in Appendix I to this document.

National Medicines primarily engages in the pharmaceutical distribution logistics services and pharmaceutical manufacturing business segments. National Medicines operates directly and through two subsidiaries, Guorui Pharmaceutical and China National Pharmaceutical Logistics Co., Ltd. National Medicines' customers are predominately located in the Huainan region and Beijing in China. The board of directors of National Medicines consists of nine directors, of whom Ms. Fu Mingzhong, Mr. Fan Banghan and Mr. Wei Yulin are also directors of the Company.

Accord Pharma primarily engages in the pharmaceutical distribution, pharmaceutical manufacturing and retail pharmacy business segments. Accord Pharma operates directly and through 21 subsidiaries, including Zhijun Pharmaceutical, Sinopharm Holding Guangzhou Co. Ltd. and Guangdong Accord Drugstore Co., Ltd. Accord Pharma's customers are predominately located in Guangdong and Guangxi provinces in China. The board of directors of Accord Pharma consists of nine directors, of whom Ms. Fu Mingzhong and Mr. Wei Yulin are also directors of the Company.

The following table sets forth certain financial information of our two listed subsidiaries, as well as the percentages that these amounts represented of the respective totals of these amounts in our consolidated financial information. The amounts and percentages are based on audited PRC GAAP financial statements of the listed subsidiaries, which are not included in this document and audited HKFRS financial statements of our Company, as contained in the Accountant's Report on our financial information included in Appendix I to this document. The percentage contributions of the two listed subsidiaries may have been materially different if we had based the comparison to our financial information prepared in accordance with PRC GAAP.

	As of and year ended 31 December					
	2006		2007		2008	
	RMB	%	RMB	%	RMB	%
	(in millions, except for percentages)					
National Medicines:						
Revenue	2,810.8	11.8	3,573.8	11.5	4,385.5	11.5
Accord Pharma:						
Revenue	5,708.7	24.1	6,878.3	22.1	8,360.4	21.9

In the opinion of the Company's directors and our management, the transactions between the Company or its subsidiaries and National Medicines or Accord Pharma are in the ordinary course of our business and on normal commercial terms, except for the sales of medical products to specific related parties under major disaster, epidemic and other emergencies which are priced at cost and relevant trade receivables which will be offset with medical reserve funds upon approval from CNPGC and the relevant PRC government authorities.

Factors Affecting Our Results of Operations

The following are the key factors that affect our results of operations.

Business environment

Our performance and profitability depend on the growth of the PRC pharmaceutical industry and healthcare market. The growth of the PRC pharmaceutical industry is supported by the size of China's population, representing approximately one-fifth of the world's population, the growth of the percentage of the population in China over the age of 60 as a percentage of total population, and that China has had one of the fastest growing economies in the world with rising levels of disposable income. Rising income levels have the additional effect of increasing the prevalence of lifestyle-related illnesses, further contributing to the demand for pharmaceutical and personal care products. In addition, the PRC Government has implemented a series of measures to reform the healthcare system in China, including the enhancement of primary care systems, community healthcare services and rural cooperative medical services, to provide adequate healthcare resources to its immense population that is spread over a vast area. Toward that goal, the PRC government has recently announced to spend RMB850 billion in addition to the regular healthcare budget from 2009 to 2011 for increasing medical insurance coverage, expanding infrastructure and other initiatives. These healthcare reform measures are expected to facilitate patients' access to healthcare services and expand the growth of the PRC healthcare market. We expect China's aging population, growing affluence and healthcare reform measures to increase the market demand for pharmaceutical products and improve our results of operations.

Our results of operations are also expected to be affected by the growing consolidation of the PRC pharmaceutical distribution market. Currently, the PRC pharmaceutical industry is highly fragmented, with over 9,500 distributors, resulting in a complex distribution system with inefficient logistics. We expect that the competitive pressures and PRC Governmental policies to standardize industry quality standards will foster consolidation in the industry. We believe that we are well-positioned to benefit from industry consolidation because of our well-developed national distribution network, scale of operations and our past success in completing and benefiting from acquisitions of pharmaceutical companies. Accordingly, we continue to be interested in participating in the consolidation of our industry on terms that are consistent with these benefits, which include improved cost structure efficiencies, greater scale of business operations and increased market share.

Policies and regulations of the PRC pharmaceutical industry

We operate in a highly-regulated industry. Policies and regulations promulgated by the PRC Government may significantly affect the pricing, marketing, production and consumption of pharmaceutical products and therefore, affect our results of operations.

In addition, the PRC Government has instituted national urban medical insurance programs to provide medical insurance coverage for urban residents in the PRC and to provide guidance on which prescription and over-the-counter medicines are included in the program and to what extent the purchases of these medicines are reimbursable. See "Industry Overview — Overview of the PRC Healthcare Market — Primary Growth Drivers of the Healthcare Industry — Increasing coverage of social medical insurance in China". To overhaul the rural healthcare system, the PRC Government has also implemented the rural cooperative medical insurance system, which provides medical resources in rural areas and reduces healthcare costs for poor rural residents. Such medical insurance reforms are expected to foster the growth of the PRC healthcare market and in particular, the consumption of pharmaceutical and healthcare products. To capture opportunities arising from such developments, we have enhanced our penetration into urban hospitals and community clinics at the provincial and municipal levels, as well as customers in rural areas.

In addition, the pricing and volume of the products that we distribute may be affected by pharmaceutical distribution market reforms implemented by the PRC Government. These include increasing anti-corruption measures, implementing mandated collective tendering processes for the purchase of medicines by hospitals and imposing industry-wide standards and requirements. The increased anti-corruption measures are expected to result in more growth opportunities for compliant enterprises. Further, a substantial portion of the products that we distribute are to hospitals that are owned or controlled by PRC Governmental authorities at the county or provincial levels. These hospitals must implement collective tender processes for the purchase of medicines listed in the Medical Insurance Catalog. Such hospitals will assess, among other things, the quality and price of the medicine and reputation of the manufacturer as well as the breadth of the product offerings and scale of the distributor. In our experience, hospitals prefer to cooperate with larger distributors, establishing relationships which afford them a broad range of products and services and efficiency in the tendering process. Pharmaceutical products included in the Medical Insurance Catalog are subject to price controls in the form of retail price ceilings, and are subject to periodic downward price adjustments by the relevant regulatory authorities. The PRC Government has also adopted measures aimed at raising the operating standards of pharmaceutical companies and promoting the quality of distribution of pharmaceutical products in China, in order to ensure a stable supply of safe, effective medicines. For example, the PRC Government has adopted GSP certification requirements and strengthened its enforcement of these requirements. We expect that the imposition of these more stringent standards for the distribution of pharmaceutical products will also drive industry consolidation. With our large-scale pharmaceutical distribution operations and strict quality control, we believe that we are well-positioned to benefit from the changes in PRC regulatory requirements.

Distribution network, product offerings and scale of operations

Our ability to increase revenue in our pharmaceutical distribution segment is directly affected by our distribution network. In recent years, we have expanded our distribution network rapidly. As of 31 May 2009, our distribution network of 25 distribution centers spanned 19 provinces, municipalities and autonomous regions in China. Because of our geographically diverse network, we are able to effectively provide our products and services to our customers in all of China. In addition, we have a stable and diverse customer base, comprising hospitals, distributors, retail drug stores and other healthcare institutions located throughout China. As of 31 May 2009, our customers included 4,723 hospitals, including 670 class-three hospitals, and 2,545 distributors, over 22,000 retail drug stores and other customers. We plan to expand the geographic coverage of our distribution network and to enhance our penetration into new customer categories and demographics. For example, we intend to continue to improve our relationships with community clinics at the provincial and municipal levels, as well as customers in rural areas. At the same time, we also intend to bolster our direct selling efforts to hospitals and clinics, to increase our control over product pricing and build stronger relationships with these significant customers.

We currently distribute over 22,000 different types of pharmaceutical and healthcare products, including prescription medicines and over-the-counter medicines, consisting of branded and generic Western and Chinese medicines, as well as personal care products and medical supplies. Our ability to optimize and diversify our product offerings and product mix for distribution is also an important factor affecting our results of operations. We continuously review and refine our product offerings and product pricing (where allowed under applicable PRC rules and regulations) to respond to changing demographics, lifestyles, habits and customer preferences. Going forward, we will also seek to optimize our product mix by including more products with higher margins.

Our large-scale operations offer us enhanced operational and cost efficiencies and position us favorably against other distributors in China's fragmented pharmaceutical distribution market. Because of our industry expertise, distribution infrastructure and large-scale operations, we have experienced significant growth in our business in the past three years. We believe that our extensive distribution network, product offerings and our large scale of operations are important factors in driving our revenue growth.

Cost of purchasing merchandise, pricing and gross margins

The cost of purchasing merchandise for our pharmaceutical distribution and retail pharmacy operations is the largest component of our cost of sales. Our products comprise a broad range of branded and generic prescription and over-the-counter medicines and other personal care products. We use certain measures to control our cost of purchasing merchandise, including consolidating procurement through careful supplier selection, centralized purchases from suppliers and leveraging our nationwide distribution network.

We source the majority of our products from international and regional manufacturers of pharmaceutical and healthcare products. In principle, we set the distribution price of our products as agreed by our suppliers and customers during the negotiation process, after taking into account various factors, including our procurement costs and gross margin levels, our extensive distribution network and bargaining power, government policies and regulations, competition, customer preferences and market considerations. These factors, in turn, affect the distribution pricing range for different customers. For our hospital customers, we establish a pricing range aligned with our suppliers through the PRC Government-mandated collective tender process. For our pharmaceutical distribution customers, customary with market practice, our pricing range is generally achieved through a three-party negotiation involving our Company, the distributor customer and the supplier. The factors listed above generally determine pricing policy and price ranges of products distributed to retail drug stores and other customers.

Substantially all of the revenue of our pharmaceutical distribution, retail pharmacy and pharmaceutical manufacturing operations were generated from our sales of pharmaceutical products that are subject to price controls in the form of fixed prices or price ceilings during the Track Record Period. In this period, the PRC Government implemented seven rounds of reductions in the retail prices of various pharmaceutical products, which affected substantially all the pharmaceutical products in our pharmaceutical distribution and retail pharmacy segments and the products we manufacture in our other business operations segment. See "Regulation — Price Controls". The following table sets forth certain information relating to the seven rounds of price reductions implemented during the Track Record Period:

Date of price reduction	Title of government notice	Type of product affected	Average reduction of retail price
1 June 2006	Notice of NDRC on the Imposition of the Maximum Retail Prices of Antineoplastic Drugs, including Doxorubcin	68	23%
1 August 2006	Notice of NDRC on the Imposition of the Maximum Retail Prices of 99 Types of Antimicrobial Agents, including Penicillins	99	30%
1 October 2006	Notice of the Imposition of the Maximum Retail Prices of 32 Types of Anti-tumor Chinese Patent Medicines, including Cinobutacini Injection	32	14.5%
1 December 2006 (effective from 26 January 2007)	Notice of the NDRC concerning Maximum Retail Prices of 354 Types of Medicines, including Arginine	354	20%
1 February 2007	Adjustment of Retail Prices of 278 Types of Chinese Patent Medicines by the NDRC	278	15%
1 April 2007	Adjustment of the Retail Prices of 188 Types of Chinese Patent Medicines by the NDRC	188	16%
1 May 2007	Adjustment of the Maximum Retail Prices of 260 Types of Western Medicines by the NDRC	260	19%

In our pharmaceutical distribution operations, we have not been significantly affected by the PRC Government price controls because of the relative stability in the margin between our costs of purchasing pharmaceutical products from our suppliers and our prices of pharmaceutical products sold to our hospital, pharmaceutical distributor and other customers, determined in accordance with the PRC Government-mandated collective tender process, our arrangements with our suppliers, our three-party negotiation with distributors and suppliers and the purchase orders from our customers. In these various arrangements, we seek to pass the pressure of retail price controls instituted by the PRC Government to our suppliers and maintain our gross margins, which were relatively stable in our pharmaceutical distribution business segment during the Track Record Period.

We generally set the retail price of our products for our retail pharmacy operations based on the cost-plus method, including the cost of purchasing merchandise plus a standard mark-up for our operating costs. From time to time, the PRC Government will include new medicines in the Medical Insurance Catalog and adjust prices or set ceilings for the retail prices of such medicines to end-users. In our retail pharmacy business segment, retail prices of pharmaceutical products are frequently lower than the price ceilings imposed by the PRC Government, due to the intensive competition in the retail pharmacy industry. We seek to mitigate these pricing pressures by selling more private label products that carry higher margins than non-private label products sourced from third parties. As a result, we have not been significantly affected by price controls in our retail pharmacy operations, as reflected in our gross margins, which were relatively stable in this business segment during the Track Record Period.

However, there are limitations on our flexibility to raise or set prices and pass along our cost increases in our manufacturing operations, in which we may be subject to pricing pressures as a result of retail price controls instituted by the PRC Government. In order to maintain a competitive gross margin for our pharmaceutical manufacturing operations, we seek to continue to increase our sales volumes and manage our manufacturing costs, enhance our product portfolio by introducing new products with higher margins and control our selling and distribution expenses by integrating the sales channels of our pharmaceutical manufacturing operations.

The gross margins for our pharmaceutical distribution and retail pharmacy operations are determined by the prices of our products sold and our cost of purchasing merchandise and generally depend on our bargaining powers with our suppliers. Due to the competitive distribution market in which we operate, we experience competitive gross margin pressures. However, we have been able to mitigate the impact of these pressures on our gross margins through our ability to manage our costs of purchasing merchandise. Our gross margins were approximately 8.0% for each of the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2009. We have been able to maintain our gross margins, despite falling retail prices of pharmaceutical products, by enhancing our bargaining power to control the cost of purchasing merchandise. We are the largest pharmaceutical distributor in the PRC, and our geographically-diverse network, full-range of product offerings and value-added services, efficient working capital management and well-known brand and reputation, enhance our bargaining position with our suppliers and allows us to secure more favorable sales terms. During the Track Record Period, we also implemented internal gross margin targets for the products that we sell and concentrated on procuring products that permitted us to achieve our gross margin targets upon sale. We expect to maintain our targeted gross margins by controlling our costs of sales and optimizing our product mix and including more products with higher margins. However, any difficulty that we may encounter in connection with controlling our cost of purchasing merchandise, as well as future regulatory measures that may be taken by the PRC Government, may have a material effect on our gross margins, which in turn may adversely affect our business operations, financial condition and profitability.

Critical Accounting Estimates and Assumptions

Our results of operations and financial condition are sensitive to accounting policies, assumptions and estimates that underlie the preparation of our consolidated financial information. Some of our accounting policies require the application of significant judgment of management in selecting the appropriate assumptions for calculating financial estimates. By nature, these judgments are subject to an inherent degree of uncertainty and are based on our historical experiences, terms of existing contracts, management's view on trends in our industry and information from outside sources.

We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial information.

Useful lives and residual values of property, plant and equipment

We determine the estimated useful lives and residual values and consequently the related depreciation charges for our property, plant and equipment. This estimate is based on the historical experience of the actual useful lives of property, plant and equipment of similar nature and functions. Our management will increase the depreciation charge where useful lives are less than previously estimated lives, and it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold. Actual economic lives may differ from estimated useful lives; actual residual values may differ from estimated residual values. Periodic review could result in a change in depreciable lives and residual values and therefore depreciation expense in future periods.

Impairment of property, plant and equipment and land use rights

Property, plant and equipment and land use rights are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability is determined based on value-in-use calculations or market valuations. These calculations require the use of judgments and estimates.

Management judgment is required in the area of asset impairment particularly in assessing: (i) whether an event has occurred that may indicate that the related asset value may not be recoverable; (ii) whether the carrying value of an asset can be supported by the recoverable amount, being the higher of the fair value less the cost to sell the asset and the net present value of future cash flows the assets are expected to generate; and (iii) the appropriate key assumptions to be applied in preparing cash flow projections including whether these cash flow projections are discounted using an appropriate rate. Changing the assumptions selected by management in assessing impairment, including the discount rates or the growth rate assumptions in the cash flow projections, could materially affect the net present value in the impairment test and, as a result, affect our financial condition and results of operations. If there is a significant adverse change in the projected performance and resulting future cash flow projections, it may be necessary to take an impairment charge to the consolidated income statement.

Impairment of receivables

Trade receivables and prepayment and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for trade and other receivables is established when there is objective evidence that we will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor and default or delinquency in payments are indicators that a trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted by the original effective interest rate.

In determining the appropriate provision for impairment, which includes portfolio and specific reserves, we review the aging of the trade and other receivables and consider factors such as industry trends, customer financial strength and any financial difficulties of the customer, credit standing, historical write-off trends, payment history, probability that the customer will file for bankruptcy or be subject to financial reorganization and the possibility of default or delinquency in payments to assess the probability of collection. We continuously monitor the collectibility of our receivable portfolio by analyzing the aging of the trade and other receivables, assessing creditworthiness of our customers and evaluating the changes in economic conditions that may impact credit risks. If the frequency or severity of customer default changes due to developments in customers' financial conditions or general economic conditions, our provision for impairment may require adjustment.

The carrying amount of trade receivables and prepayment and other receivables is reduced through the use of an allowance account, and the amount of the loss is recognized in the income statement as "general and administrative expenses". When a trade receivable becomes uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against "general and administrative expenses" in the income statement.

Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprise raw materials, direct labor, other direct costs and related production overhead, which is based on normal operating capacity. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. These estimates are based on current market conditions and our historical experience in manufacturing and selling similar products. These factors could change significantly as a result of technical innovations, changes in customer taste and competitor actions in response to severe industry cycles. Management reassesses these estimates at each balance sheet date.

A substantial part of the inventories (approximately 86.6%, 91.9%, 88.4% and 86.5% as of 31 December 2006, 2007 and 2008 and 31 May 2009, respectively) for our pharmaceutical distribution operations, comprise merchandise that we hold for resale. We believe that the weighted average cost method of inventory valuation provides a reasonable approximation of the current cost of replacing inventory within our pharmaceutical distribution operations.

Income taxes and deferred income tax

We are subject to PRC income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. We recognize liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

Deferred income tax assets relating to certain temporary differences and tax losses are recognized when management considers it is likely that future taxable profits will be available against which the temporary differences or tax losses can be utilized. When the expectations are different from the original estimates, such differences will impact the recognition of deferred tax assets and income tax charges in the period in which such estimates are changed.

Post-employment benefit obligations

We provide certain post-employment pension and medical benefits to our current, retired and early retired employees. The employee's entitlement to these benefits is usually conditional on the employee remaining in service with us up to retirement age and completing a minimum service period. The expected costs of these benefits are accrued over the period of employment using an accounting methodology similar to that of a defined benefit plan. Actual gains and losses arising from adjustments and changes in actuarial assumptions are recognized in the income statement. Such post-employment obligations are assessed annually by qualified independent actuaries.

The valuation of the present value of post-employment benefit obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions, such as discount rates, future pension increases, medical cost trend rates, inflation rates and other factors.

Actual results that differ from the assumption are recognized immediately and, therefore, affect recognized expenses in the period in which such differences arise. Any differences in actual experience and changes in these assumptions will affect the carrying amount of benefit obligations.

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of our share of the net identifiable assets of the subsidiary/associate we acquired at the date of acquisition. Goodwill on acquisitions of our subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates and is tested annually for impairment as part of the overall investments in associates balance. Separately-recognized goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Our goodwill, included in our intangible assets and our investments in associates, as of 31 December 2006, 2007 and 2008 and 31 May 2009 was RMB49.3 million, RMB48.0 million, RMB47.9 million and RMB92.3 million, respectively. The changes in the amount of goodwill was primarily due to our acquisition of Suzhou Zhijun Wanqing in March 2009. There had been no impairment charge recognized for goodwill during the Track Record Period.

Goodwill is allocated to cash-generating units identified according to the relevant operating segment for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units according to our business segments that are expected to benefit from the business combination in which the goodwill arose. Our determination of the recoverable amount of a cash-generating unit is determined based on value-in-use calculations. These calculations use pre-tax cash flow projections based on financial budgets covering a five-year period, and are approved by our management. Cash flows beyond the five-year period are extrapolated using estimated growth rates, which do not exceed the long-term average growth rate for the respective business segment in which the cash-generating unit operates.

De facto control over Accord Pharma and National Medicines

Our directors and management are of the view that we had the power to govern the financial and operating policies of Accord Pharma although we held less than 50% of Accord Pharma's equity interests during the Track Record Period. In taking this view, the directors and management considered the following factors: (1) the Company was the single largest shareholder of Accord Pharma during the period; (2) the shareholding in Accord Pharma was dispersed among many public and institutional shareholders; (3) the participation of the other shareholders at the shareholders' meetings was relatively low and passive; and (4) the majority of the executive directors of Accord Pharma also held management positions with the Company.

Our directors and management are also of the view that we had the power to govern the financial and operating policies of National Medicines during the Track Record Period although our equity interests in this company decreased to below 50% following the completion of the share reform in August 2006 (see Note 27 of Appendix I). In taking this view, the directors and management considered the following factors: (1) the Company was the single largest shareholder of National Medicines during the period; (2) the shareholding in National Medicines were dispersed among many public and institutional shareholders; (3) the participation of other shareholders at the shareholders' meetings was relatively low and passive; and (4) the majority of the executive directors of National Medicines also held management positions with the Company.

Description of Selected Components of Results of Operations

Revenue

We generate our revenue from pharmaceutical distribution, retail pharmacy and other business operations. The table below sets forth a breakdown of our external segment revenue after elimination of inter-segment sales, and each segment revenue item as a percentage of our total revenue, as well as our inter-segment sales, for the periods indicated:

	Year ended 31 December						Five months ended 31 May			
	2006		2007		2008		2008		2009	
	RMB	%	RMB	%	RMB	%	RMB (unaudited)	%	RMB	%
	(in millions, except for percentages)									
External Segment Revenue:[(1)]										
Pharmaceutical distribution	21,927.2	92.4	28,997.3	93.2	35,745.1	93.6	14,017.7	93.4	16,845.7	93.3
Retail pharmacy	823.1	3.5	835.6	2.7	952.2	2.5	389.0	2.6	463.2	2.6
Other business operations	986.3	4.2	1,277.3	4.1	1,490.2	3.9	600.5	4.0	739.1	4.1
Total external revenue	**23,736.6**	**100.0**	**31,110.2**	**100.0**	**38,187.4**	**100.0**	**15,007.2**	**100.0**	**18,048.0**	**100.0**
Inter-segment revenue	**177.6**	**N/A**	**225.9**	**N/A**	**311.2**	**N/A**	**140.9**	**N/A**	**147.6**	**N/A**

(1) External segment revenue refers to segment revenue after inter-segment elimination.

We derive the majority of our revenue from our pharmaceutical distribution operations, through which we receive revenue from sales of products distributed to customers. We distribute a comprehensive offering of pharmaceutical and healthcare products, including branded and generic prescription medicines, over-the-counter medicines, Western and Chinese medicines, as well as personal care products and medical supplies through a geographically diverse distribution network. To a lesser extent, pharmaceutical distribution revenues also include import and export agency income and consulting income generated from our pharmaceutical distribution operations. The following table sets forth our external revenue of pharmaceutical distribution operations, after inter-segment elimination, generated from sales to hospitals, other distributors for distribution to end-customers and retail drug stores and other customers for the periods indicated:

	Year ended 31 December						Five months ended 31 May			
	2006		2007		2008		2008		2009	
	RMB	%	RMB	%	RMB	%	RMB (unaudited)	%	RMB	%
	(in millions, except for percentages)									
Hospitals	9,642.2	44.0	13,216.7	45.6	16,719.0	46.8	6,563.4	46.8	8,129.7	48.3
Other distributors	10,927.3	49.8	13,753.8	47.4	16,263.6	45.5	6,372.0	45.5	7,134.2	42.3
Retail drug stores and other customers	1,357.7	6.2	2,026.8	7.0	2,762.5	7.7	1,082.3	7.7	1,581.8	9.4
Total	**21,927.2**	**100.0**	**28,997.3**	**100.0**	**35,745.1**	**100.0**	**14,017.7**	**100.0**	**16,845.7**	**100.0**

Revenue from our retail pharmacy operations are generated from selling prescription medicines, over-the-counter medicines, other pharmaceutical products and healthcare products through our retail and specialty pharmacy stores. In addition, retail pharmacy revenues also include advertising fee income and franchise fee income from our retail pharmacy operations.

We also generate revenue from other business operations, consisting of the sales of pharmaceutical products, chemical reagents and laboratory supplies.

As medicines included in the national and provincial medicine catalogs are subject to government-administered retail price controls and, in the case of hospital sales, a mandatory tendering process, the growth of our revenues is primarily driven by increases in sales volumes of our products. Especially in the case of our pharmaceutical distribution segment, any increase in the sales volume of our products is largely affected by increases in the number of our hospital, retail pharmacy and distributor customers, as well as the level of sales volumes to our existing hospital, retail pharmacy and distributor customers.

For the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, inter-segment sales amounted to RMB177.6 million, RMB225.9 million, RMB311.2 million and RMB140.9 million and RMB147.6 million, respectively. Our inter-segment revenue was mainly derived from sales of pharmaceutical distribution products to our retail pharmacy business segment and sales of self-manufactured medicines to our pharmaceutical distribution and retail pharmacy business segments.

Cost of sales

Our cost of sales consists of cost of merchandise and raw materials and other costs. Other costs include direct labor, depreciation and other costs.

Our cost of sales in pharmaceutical distribution and retail pharmacy segments, which predominantly consist of cost of purchasing merchandise, is affected by changes in inventory levels, product mix and manufacturer pricing practices, which may be influenced by market conditions and other external influences. During the Track Record Period, our cost of purchasing merchandise increased steadily, which is consistent with the increase of revenue generated by our pharmaceutical distribution and retail pharmacy segments.

Our cost of sales in other business operations segment, which mainly consist of manufacturing overhead, raw material costs, direct labor costs, depreciation costs and sales tax, remained relatively stable during the Track Record Period. However, most of the raw materials that we use for the production of pharmaceutical products and chemical reagents are commodities, and their availability and price depends on market supply and demand conditions.

The following table sets forth the breakdown of our cost of sales for the periods indicated:

	Year ended 31 December						Five months ended 31 May			
	2006		2007		2008		2008		2009	
	RMB	%	RMB	%	RMB	%	RMB (unaudited)	%	RMB	%
	(in millions, except for percentages)									
Cost of Sales:										
Cost of merchandise and raw material	21,700.1	99.8	28,500.6	99.8	35,076.2	99.8	13,764.9	99.8	16,573.3	99.8
Other costs	47.0	0.2	59.4	0.2	76.3	0.2	29.7	0.2	36.7	0.2
Total cost of sales	**21,747.1**	**100.0**	**28,560.0**	**100.0**	**35,152.5**	**100.0**	**13,794.6**	**100.0**	**16,610.0**	**100.0**

Other income

The primary source of our other income is government grants we receive from various government organizations from time to time. During the Track Record Period, we received grants from government organizations in an aggregate amount of approximately RMB16.7 million, RMB23.9 million, RMB69.9 million and RMB16.2 million and RMB19.7 million in the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, respectively. These government grants primarily consist of (1) subsidies from municipal governments made to encourage PRC enterprises to expand their operations and increase their investment in new products and services; (2) compensation from the PRC Ministry of Finance for our distribution of iodine below cost; (3) subsidies from local governments to encourage spending on pharmaceutical research and development activities; and (4) compensation from local governments paid to us for relocation. The government grants were provided in accordance with prevailing laws, regulations and rules in the PRC, and generally were made without conditions. Certain grants require the use of funds for specified purposes, such as those to support expansion of operations or for research and development. One of the government grants, for the distribution of iodine, is specific to our Company and not available to other companies. However, the other grants are either available generally to companies in China, or available to those in the pharmaceutical industry, such as government grants for research and development. The increase in the amount of government grants during the Track Record Period was consistent with the expansion of our business operations. The significant increase in government grants from the year ended 31 December 2007 to the year ended 31 December 2008 was primarily because iodine distribution compensation in both 2007 and 2008 was received and recorded in 2008 alone. We expect to continue to receive government grants from various government organizations in the future.

In addition, other income also consists of dividends we receive from our available-for-sale financial assets. For the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, our other income was RMB17.3 million, RMB24.0 million, RMB69.9 million and RMB16.2 million and RMB19.7 million.

Distribution and selling expenses

Our distribution and selling expenses primarily consist of salaries and related expenses for personnel engaged in sales, marketing and distribution activities, sales promotion expenses, travel and office expenses, transportation expenses, rental payments for operating leases and other costs in connection with sales, marketing and distribution activities.

For the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, our distribution and selling expenses were RMB779.0 million, RMB945.3 million, RMB966.0 million and RMB365.0 million and RMB408.6 million, respectively. During these periods, our distribution and selling expenses increased primarily as a result of additional sales, marketing and distribution activities carried out by an increased number of personnel, in support of our growth of revenues, and our increased product offerings. However, during the same periods, the percentage of our distribution and selling expenses to our total revenue gradually decreased from 3.3% in 2006, to 3.0% in 2007, to 2.5% in 2008 and to 2.3% in the five months ended 31 May 2009, primarily due to our efforts to integrate our business operations and our increased economies of scale. In the near term, we expect our distribution and selling expenses to increase to support our sales growth, but for the increase to be at a slower rate relative to our sales growth due to our increased operating efficiency and our enhanced economies of scale.

The following table sets forth the breakdown of the major components of our distribution and selling expenses for the periods indicated:

	Year ended 31 December									Five months ended 31 May					
	2006			2007			2008			2008			2009		
	RMB	% of total distribution and selling expenses	% of total revenue	RMB	% of total distribution and selling expenses	% of total revenue	RMB	% of total distribution and selling expenses	% of total revenue	RMB	% of total distribution and selling expenses	% of total revenue	RMB	% of total distribution and selling expenses	% of total revenue
	(in millions, except for percentages)														
Employee benefit expenses	262.7	33.7	1.11	287.8	30.4	0.93	367.0	38.0	0.96	149.8	41.0	1.00	153.8	37.6	0.85
Sales promotion expenses	163.2	20.9	0.69	191.6	20.3	0.62	164.9	17.1	0.43	54.7	15.0	0.36	59.4	14.5	0.33
Transportation expenses	115.5	14.8	0.49	124.1	13.1	0.40	134.7	13.9	0.35	54.9	15.1	0.37	59.4	14.5	0.33
Travel and office expenses	80.4	10.3	0.34	92.3	9.8	0.30	100.0	10.4	0.26	26.8	7.3	0.18	28.4	7.0	0.16
Rental expenses	79.9	10.3	0.34	99.8	10.6	0.32	109.6	11.3	0.29	43.7	12.0	0.29	61.1	15.0	0.34
Others[(1)]	77.3	10.0	0.33	149.7	15.8	0.48	89.8	9.3	0.24	35.1	9.6	0.23	46.5	11.4	0.26
Total	**779.0**	**100.0**	**3.28**	**945.3**	**100.0**	**3.05**	**966.0**	**100.0**	**2.53**	**365.0**	**100.0**	**2.43**	**408.6**	**100.0**	**2.26**

(1) Others include bidding fees, utilities costs, depreciation of property, plant and equipment, amortization of intangible assets, repair and maintenance and others.

General and administrative expenses

Our general and administrative expenses include salaries and benefits for our administrative, finance and human resources personnel, travel and office expenses, depreciation and amortization expenses, post-employment benefit, research and development expenses, provision for doubtful receivables and other expenses associated with our administrative offices. We make a provision for doubtful receivables when we will not be able to collect the total amount due in accordance with the original terms of the receivables. The amount of the provision is reduced from the carrying amount of our trade receivables and prepayment and other receivables.

For the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, our general and administrative expenses were RMB747.6 million, RMB839.6 million, RMB966.7 million and RMB354.4 million and RMB346.5 million, respectively. However, during the Track Record Period, the percentage of our general and administrative expenses to our total revenue decreased from 3.1% in 2006, to 2.7% in 2007, to 2.5% in 2008 and to 1.9% in the five months ended 31 May 2009, primarily due to our efforts to integrate our business operations and our economies of scale. We expect our general and administrative expenses to increase as we hire additional staff and incur additional costs related to the growth of our business.

The following table sets forth the breakdown of the major components of our general and administrative expenses for the periods indicated:

	Year ended 31 December									Five months ended 31 May					
	2006			2007			2008			2008			2009		
	RMB	% of total general and adminis-trative expenses	% of total revenue	RMB	% of total general and adminis-trative expenses	% of total revenue	RMB	% of total general and adminis-trative expenses	% of total revenue	RMB	% of total general and adminis-trative expenses	% of total revenue	RMB	% of total general and adminis-trative expenses	% of total revenue
	(in millions, except for percentages)														
Employee benefit expenses	262.3	35.1	1.11	318.3	37.9	1.02	404.9	41.9	1.06	143.5	40.5	0.96	152.8	44.1	0.85
Travel and office expenses	104.0	13.9	0.44	123.8	14.7	0.40	146.1	15.1	0.38	52.0	14.7	0.35	42.1	12.2	0.23
Depreciation and amortization expenses	75.8	10.1	0.32	77.1	9.2	0.25	93.1	9.6	0.25	35.4	10	0.24	40.3	11.6	0.22
Post-employment benefit expenses	15.2	2.0	0.06	23.8	2.8	0.08	80.6	8.3	0.21	23.0	6.5	0.15	8.0	2.3	0.04
Research and development	18.2	2.4	0.08	24.6	2.9	0.08	34.9	3.6	0.09	9.8	2.8	0.07	11.8	3.4	0.07
Provision for doubtful trade receivables	25.0	3.3	0.11	22.4	2.7	0.07	10.9	1.1	0.03	11.3	3.2	0.08	17.7	5.1	0.10
Provision for doubtful other receivables	23.1	3.1	0.10	20.9	2.5	0.07	(14.5)	(1.5)	(0.04)	(0.5)	(0.1)	(0.003)	(9.2)	(2.7)	(0.05)
Others(1)	224.0	30.1	0.94	228.7	27.3	0.74	210.7	21.9	0.55	79.9	22.6	0.53	83	24	0.46
Total	**747.6**	**100.0**	**3.15**	**839.6**	**100.0**	**2.70**	**966.7**	**100.0**	**2.53**	**354.4**	**100.0**	**2.36**	**346.5**	**100.0**	**1.92**

(1) Others primarily includes auditors' remuneration and consulting fees, transaction tax, rental for operating leases, repair and maintenance expenses, utilities expenses, provision for inventory and others.

Other gains/losses, net

Other gains/losses, net comprises primarily gains and losses which do not arise from the normal operations of our Company. Our other gains primarily consist of gains on disposal of leasehold land and land use rights and property, plant and equipment, gains on settlement of borrowings, foreign exchange gains and gains or losses on disposal of subsidiaries. The transactions we entered into for the disposal of leasehold land and land use rights and property, plant and equipment were primarily one-off transactions conducted by our subsidiaries. Our gain on settlement of bank borrowings primarily resulted from our settlements with creditors at a discount for the overdue bank borrowings of two of our subsidiaries, which were treated as non-performing loans by the lending banks and then transferred to other asset management companies. Our foreign exchange gains mainly resulted from the appreciation of the Renminbi against the U.S. dollar in connection with our purchases from foreign suppliers.

Our other losses primarily consist of losses on transfers of formerly non-tradable shares held by us in Accord Pharma and National Medicines, equivalent to 4% of the equity interests of Accord Pharma and 12% of the equity interests of National Medicines, to the public holders of the tradable A shares in these companies. Prior to the transfers, Accord Pharma and National Medicines held tradable shares issued in the PRC, or A shares, which are listed on the Shenzhen Stock Exchange and Shanghai Stock Exchange, respectively, as well as non-tradable shares held by us as major shareholder. The share transfers were made pursuant to relevant PRC share reform regulations, under which Accord Pharma and National Medicines on our behalf developed share reform plans, which were approved by the shareholders of each of Accord Pharma and National Medicines, to convert all non-tradable domestic shares held by us in these companies to tradable A shares (subject to certain restrictions under PRC laws and regulations). Under the share reform plan for Accord Pharma, we paid, as consideration for the share reform plan, three non-tradable shares for every 10 A shares held by any holder of Accord Pharma's A shares. Under the share reform plan for National Medicines, we paid, as consideration for the share reform plan, three non-tradable shares for every 10 A shares held by any holder of National Medicines' A shares. Following the implementation of the share reform plans, which were implemented on 28 April 2006 for Accord Pharma and 23 August 2006 for National Medicines, we hold 39.14% and 47.60% of the equity interests in Accord Pharma and National Medicines, respectively.

In the years ended 31 December 2007 and 2008, we disposed of 1.58% and 0.99%, respectively, of our equity interest in National Medicines and realized gains from such disposals of approximately RMB91.4 million and RMB76.0 million, respectively. In the five months ended 31 May 2009, we disposed of 1.00% of our equity interest in National Medicine and 0.81% of our equity interest in Accord Pharma, respectively, and realized gains from such disposals of approximately RMB100.0 million. We used the funds obtained from these disposals to finance our business expansion and investment in new logistics facilities. The sales transactions were made in the stock market after taking into consideration prevailing market conditions, the share price of National Medicines and Accord Pharma and our financing requirements for business development.

For the year ended 31 December 2006, our other loss, net was RMB45.6 million. For the years ended 31 December 2007 and 2008 and the five months ended 31 May 2008 and 2009, our other gains, net were RMB124.1 million, RMB92.7 million and RMB79.4 million and RMB104.0 million, respectively.

Finance income

Our finance income mainly consists of bank interest income. For the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, our finance income was RMB11.7 million, RMB17.8 million, RMB24.3 million and RMB7.3 million and RMB9.0 million, respectively.

Finance costs

Our finance costs consist of interest payments on bank loans and for discounted notes and account receivables factoring transactions. For the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, our finance costs amounted to RMB101.5 million, RMB150.9 million, RMB266.0 million and RMB98.1 million and RMB93.9 million, respectively. From time to time, we enter into notes receivables discount and accounts receivables factoring transactions with banks to supplement our working capital and to facilitate the liquidity of our trade receivables and prepayment and other receivables. We generally enter into such transactions for our accounts receivables from hospitals, for which we often grant longer credit terms because of their reliability.

Share of results from associates

Our share of results from associates is the profits attributable to us from our associates, net of the losses attributable to us from our associates, pursuant to our equity interests in associates. Associates are entities which we generally hold no less than 20% of the equity voting rights and over which we are in the position to exercise significant influence but not control or jointly control.

For the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, our share of results from associates was RMB19.2 million, RMB40.0 million, RMB54.2 million and RMB22.8 million and RMB25.1 million, respectively.

Income tax expense

The following table sets forth the components of income taxes for the periods indicated:

	Year ended 31 December						Five months ended 31 May			
	2006		2007		2008		2008		2009	
	RMB	%	RMB	%	RMB	%	RMB	%	RMB	%
							(unaudited)			
	(in millions, except for percentages)									
Corporate income tax	180.0	99.2	286.4	100.7	271.0	104.5	121.5	102.1	194.0	100.1
Deferred income tax	1.5	0.8	(1.9)	(0.7)	(11.7)	(4.5)	(2.5)	(2.1)	(0.2)	(0.1)
Total income tax	**181.5**	**100.0**	**284.5**	**100.0**	**259.3**	**100.0**	**119.0**	**100.0**	**193.8**	**100.0**

Corporate income tax

Taxation represents the corporate income tax at the statutory rates prevailing in the PRC levied on our taxable income as determined in accordance with PRC GAAP. We also consider "expenses not deductible for tax" in determining our income tax expenses. "Expenses not deductible for tax" refers primarily to expenses such as salaries expenses that exceeded the statutory ceiling in 2006 and 2007 prior to the effective date of the EIT Law discussed below, certain other expenses in excess of prescribed caps and donations that are not deductible under current tax regulations applicable to us.

We and our subsidiaries are incorporated in the PRC and are subject to taxation in the PRC. As of 31 May 2009, we had 86 subsidiaries incorporated in the PRC that were subject to taxation in the PRC. See Note 40 to our Accountant's Report in Appendix I to this document for a description of these subsidiaries. On 16 March 2007, the National People's Congress of the PRC adopted the Enterprise Income Tax Law, or EIT Law, which became effective 1 January 2008. The EIT Law reduced the statutory tax rate from 33% to 25% of taxable income as determined in relevant PRC tax laws and regulations. However, for enterprises which were established before the publication of the new EIT Law and were entitled to preferential tax rates, specifically those enterprises whose preferential tax rates were 15% in 2007, granted by relevant authorities, the new income tax rate will be gradually increased to 25% within five years after the effective date of the new EIT Law. These rates will be 18% in 2008, 20% in 2009, 22% in 2010, 24% in 2011 and 25% in 2012. Enterprises that are currently entitled to exemptions or deductions from the standard income tax rate for a fixed term may continue to enjoy such treatment until the fixed term expires. Some of our subsidiaries enjoyed preferential income tax rates during the Track Record Period in accordance with the EIT Law and a number of circulars, statutes and regulations implemented by the PRC Ministry of Finance, State Administration of Taxation, State Counsel and local tax authorities. See Note 32(a) of Appendix I to this document for more information on the preferential tax treatments or tax exemptions we enjoyed under PRC law. Other than (i) Guangxi Accord Pharmacy Chain Store Co., Ltd., whose fixed term for preferential tax treatment extends to 2010, (ii) Sinopharm Nanning, whose 60% tax exemption was extended to 2008 and (iii) Zhijun Pharmaceutical, who enjoys preferential tax rate for technically advanced enterprise at 15% from January 2008, the preferential tax rates for our other subsidiaries expired in 2007 and the applicable income tax rates for such subsidiaries will gradually increase to 25% in 2012.

In the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, we had income tax expenses of RMB181.5 million, RMB284.5 million, RMB259.3 million and RMB119.0 million and RMB193.8 million, respectively. Our effective tax rates were 49.9%, 34.7%, 24.1% and 22.8% and 26.0% for the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, respectively. Our effective tax rates were higher than the prevailing statutory tax rate during the two-year period ended 31 December 2007 and the five months ended 31 May 2009 primarily because our actual income taxes paid, after making a number of adjustments pursuant to relevant laws and regulations, exceeded our consolidated profit before income tax multiplied by the statutory tax rate. Such positive adjustments primarily reflected the following: (i) certain of our losses on transfers of equity interests in our subsidiaries were not deductible for tax purposes; (ii) certain employee compensation expenses exceeded the statutory deduction limits for tax purposes, which caused our actual taxable income to increase; (iii) certain of our subsidiaries incurred losses for which no deferred income tax was recognized and (iv) a portion of our eliminated income, which was derived from share transfer transactions among our subsidiaries on consolidation of our financial statements, was treated as taxable income for tax purposes.

No provision for Hong Kong income tax was made as we did not have any tax-assessable profit arising in Hong Kong during the Track Record Period.

The following table sets forth the enterprise income tax rates of our significant subsidiaries which enjoyed preferential tax rates for a fixed term during the Track Record Period:

	Year ended 31 December			
	2006	**2007**	**2008**	**2009**
Shanghai Sinopharm Waigaoqiao Co., Ltd.(1)	15%	15%	18%	20%
Shenzhen Zhijun Pharmaceutical Co., Ltd.(2)	15%	15%	15%	15%
Shenzhen Accord Pharmacy Chain Store Co., Ltd.(1)	15%	15%	18%	20%
Shenzhen Accord Pharmaceutical Co., Ltd.(1)	15%	15%	18%	20%
Sinopharm Holding Nanning Co., Ltd.(3)	exempted	13.2%	10%	25%
Sinopharm Holding Hubei Co., Ltd.(4)	15%	15%	25%	25%

(1) The exemptions or deductions from the standard income tax rate enjoyed by these subsidiaries for a fixed term expired in 2007 and the applicable income tax rates for such subsidiaries will be 18% in 2008, 20% in 2009, 22% in 2010, 24% in 2011 and 25% in 2012.

(2) Shenzhen Zhijun Pharmaceutical Co., Ltd qualifies for a 15% income tax rate for a three-year period as a technically advanced enterprise from 2008.

(3) Sinopharm Holding Nanning Co., Ltd. was entitled to a 60% corporate income tax exemption, calculated on the then applicable statutory income tax rate for 2007 and 2008. The preferential tax treatment of Sinopharm Holding Nanning Co., Ltd. expired in the end of 2008.

(4) The preferential tax treatment of Sinopharm Holding Hubei Co., Ltd. expired in the end of 2007.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of tax assets and tax liabilities in the financial statements and the corresponding tax basis and is accounted for using the balance sheet method. Aside from certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits and unused tax losses, to the extent that future taxable profits will be available against which the asset can be recognized. Deferred tax assets and liabilities are determined at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates and regulations that have been enacted or substantively enacted at the balance sheet date. The following table sets forth a reconciliation of deferred tax liabilities and tax assets for the periods indicated:

	Year ended 31 December			Five months ended 31 May
	2006	2007	2008	2009
	(RMB in millions)			
Deferred taxation[1]	1.57	(1.97)	(11.67)	(0.19)
Charged/(credited) in the income statement in respect of :				
Deferred tax assets	1.61	11.97	(4.50)	5.17
Deferred tax liabilities	(0.04)	(13.94)	(7.17)	(5.36)
	1.57	(1.97)	(11.67)	(0.19)

(1) For more information, see Note 13 and 32 to the Accountant's Report on our financial information included in Appendix I to this document.

Minority interests

Minority interests represent the interests not held by us in the results and net assets of the subsidiaries of the Company. We characterize transactions with minority interests as transactions with parties external to our Company. Disposals of minority interests result in gains and losses for our Company and are recorded in our consolidated income statement. Acquisitions of minority interests result in goodwill, being the difference between any consideration paid and the relevant shares acquired of the carrying value of the net assets of the subsidiary. In the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, our profit attributable to minority interests amounted to RMB81.1 million, RMB155.0 million, RMB232.4 million and RMB104.8 million and RMB131.4 million, respectively. Our equity attributable to minority interests as of 31 December 2006, 2007 and 2008 and 31 May 2009 amounted to RMB830.6 million, RMB934.6 million, RMB1,146.4 million and RMB1,293.1 million, respectively.

Significant related party transactions

Related parties are those parties that have the ability to control the other party or exercise significant influence in making financial and operating decisions. Parties are also considered to be related if they are subject to common control.

Our Company is under the control of the PRC Government. Other state-owned enterprises and their subsidiaries, which are not controlled by CNPGC, but directly or indirectly controlled by the PRC Government, are regarded as related parties.

See Note 39 of Appendix I to this document for more information on the significant related party transactions entered between us and our related parties, including other state-owned enterprises during the Track Record Period.

In the opinion of the Company's directors and our management, these significant related party transactions are in the ordinary course of business of our Company and on normal commercial terms, except for the sales of medical products to specific related parties under major disaster, epidemic and other emergencies which are priced at cost and relevant trade receivables which will be offset with medical reserve funds upon approval from CNPGC and the relevant PRC government authorities.

Consolidated Results of Operations

The following table sets forth selected financial information and that information as a percentage of revenues for the periods indicated:

	Year ended 31 December						Five months ended 31 May			
	2006		2007		2008		2008		2009	
	RMB	%	RMB	%	RMB	%	RMB (unaudited)	%	RMB	%
	(in millions, except for percentages)									
Revenue	**23,736.6**	**100.0**	**31,110.2**	**100.0**	**38,187.4**	**100.0**	**15,007.2**	**100.0**	**18,048.0**	**100.0**
Cost of sales	(21,747.1)	(91.6)	(28,560.0)	(91.8)	(35,152.5)	(92.1)	(13,794.6)	(91.9)	(16,610.0)	(92.0)
Gross profit	**1,989.5**	**8.4**	**2,550.2**	**8.2**	**3,034.9**	**7.9**	**1,212.6**	**8.1**	**1,438.0**	**8.0**
Other income	17.3	0.07	24.0	0.08	69.9	0.2	16.2	0.1	19.7	0.1
Distribution and selling expenses	(779.0)	(3.3)	(945.3)	(3.0)	(966.0)	(2.5)	(365.0)	(2.4)	(408.6)	(2.3)
General and administrative expenses	(747.6)	(3.1)	(839.6)	(2.7)	(966.7)	(2.5)	(354.4)	(2.4)	(346.5)	(1.9)
Operating profit	**480.3**	**2.0**	**789.3**	**2.5**	**1,172.1**	**3.1**	**509.4**	**3.4**	**702.6**	**3.9**
Other gains/(loss) – net	(45.6)	(0.2)	124.1	0.4	92.7	0.2	79.4	0.5	104.0	0.6
Finance income	11.7	0.05	17.8	0.06	24.3	0.06	7.3	0.05	9.0	0.05
Finance costs	(101.5)	(0.4)	(150.9)	(0.5)	(266.0)	(0.7)	(98.1)	(0.7)	(93.9)	(0.5)
Finance costs – net	(89.8)	(0.4)	(133.1)	(0.4)	(241.7)	(0.6)	(90.8)	(0.6)	(84.9)	(0.5)
Share of results from associates	19.2	0.08	40.0	0.1	54.2	0.1	22.8	0.2	25.1	0.1
Profit before income tax	**364.0**	**1.5**	**820.4**	**2.6**	**1,077.4**	**2.8**	**520.8**	**3.5**	**746.8**	**4.1**
Income tax expense	(181.5)	(0.8)	(284.5)	(0.9)	(259.3)	(0.7)	(119.0)	(0.8)	(193.8)	(1.1)
Profit for the year/period	**182.4**	**0.8**	**535.9**	**1.7**	**818.1**	**2.1**	**401.8**	**2.7**	**552.9**	**3.1**
Attributable to:										
Equity holders of the Company	101.3	0.4	380.9	1.2	585.7	1.5	297.0	2.0	421.5	2.3
Minority interests	81.1	0.3	155.0	0.5	232.4	0.6	104.8	0.7	131.4	0.7

Unless otherwise indicated, the following discussion includes only the results from external sales. All inter-segment transactions have been eliminated from the financial data discussed in this section. For additional data and information regarding our business segments and segmental presentation, see Note 5 to our consolidated financial statements in the Accountant's Report in Appendix I to this document.

Five months ended 31 May 2009 compared with five months ended 31 May 2008

Revenue

The following table sets forth our external segment revenue and inter-segment sales by each segment for the five months ended 31 May 2008 and 2009:

	Five months ended 31 May					
	2008			2009		
	External revenue[(1)]	Inter-segment revenue	Total	External revenue[(1)]	Inter-segment revenue	Total
	(unaudited)					
	(RMB in millions)					
Segment Revenue:[(1)]						
Pharmaceutical distribution	14,017.7	102.7	14,120.4	16,845.7	99.2	16,944.9
Retail pharmacy	389.0	-	389.0	463.2	-	463.2
Other business operations	600.5	38.2	638.7	739.1	48.4	787.5
Elimination	-	-	(140.9)	-	-	(147.6)
Total	**15,007.2**	**140.9**	**15,007.2**	**18,048.0**	**147.6**	**18,048.0**

(1) External segment revenue refers to segment revenue after inter-segment elimination.

Our total revenue after elimination of inter-segment sales increased by RMB3,040.8 million, or 20.3%, from RMB15,007.2 million in the five months ended 31 May 2008 to RMB18,048.0 million in the five months ended 31 May 2009. The increase was mainly attributable to an increase of RMB2,828 million in revenue from our pharmaceutical distribution operations. In addition, an increase of RMB138.6 million in revenue from our other business operations also contributed to the changes in our total revenue during the period. The increase in our revenues was in line with our market share growth and the development of the PRC pharmaceutical market.

Pharmaceutical distribution segment. Our external revenue from our pharmaceutical distribution operations increased by 20.2%, from RMB14,017.7 million in the five months ended 31 May 2008 to RMB16,845.7 million in the five months ended 31 May 2009. The increase was primarily due to an increase in the number of new hospital customers and an increase in the range and quantity of products sold to existing hospital customers. To a lesser extent, the penetration of our distribution network into community clinics and other healthcare institutes also contributed to the increase in our revenues.

Retail pharmacy segment. Our external revenue from retail pharmacy operations increased by 19.1%, from RMB389.0 million in the five months ended 31 May 2008 to RMB463.2 million in the five months ended 31 May 2009. The increase was primarily due to an increase in the number of our directly owned stores as a result of our acquisition of 93 stores from the State-owned Assets Supervision and Administrative Commission of Ningxia Autonomous Region as well as the opening of new directly owned stores. The growth of revenue from the retail pharmacy stores which we acquired from Shengyang Tianyitang and Zhejiang Intmedic in May and June 2008, which began to exhibit stronger growth in 2009, also contributed to the increase in revenue from our retail pharmacy operations in the five months ended 31 May 2009. Our average daily revenue per directly owned store remained relatively stable in the five months ended 31 May 2009.

Other business operations segment. Our external revenue from our other business operations increased by 23.1%, from RMB600.5 million for the five months ended 31 May 2008 to RMB739.1 million for the five months ended 31 May 2009. The increase was primarily due to our acquisition of Suzhou Zhijun Wanqing in March 2009 as well as the growth of our pharmaceutical manufacturing operations, in terms of quantity of products sold, especially cephalosporin antibiotics products. To a lesser extent, the growth of our chemical reagent operations also contributed to the increase in our revenues.

Our inter-segment sales were RMB140.9 million and RMB147.6 million in the five months ended 31 May 2008 and 2009, respectively. Our inter-segment sales represent the sales by our pharmaceutical distribution segment to our retail pharmacy segment and medicines sold by our pharmaceutical manufacturing operations to our pharmaceutical distribution and retail pharmacy operations.

Cost of sales

Our cost of sales increased by 20.4%, from RMB13,794.6 million in the five months ended 31 May 2008 to RMB16,610.0 million in the five months ended 31 May 2009. The increase was primarily due to an increase in the costs of purchasing merchandise for our pharmaceutical distribution segment. The increase was consistent with the increase in our total revenues in the five months ended 31 May 2009 as compared to the same period in 2008.

Gross profit

As a result of the foregoing, our gross profit increased by 18.6%, from RMB1,212.6 million in the five months ended 31 May 2008 to RMB1,438.0 million in the five months ended 31 May 2009. Our gross profit margin was 8.1% and 8.0% for the five months ended 31 May 2008 and 2009, respectively.

Pharmaceutical distribution segment. Our gross profit in our pharmaceutical distribution operations increased by 17.7%, from RMB943.2 million in the five months ended 31 May 2008 to RMB1,110.3 million in the five months ended 31 May 2009. The gross profit margin for our pharmaceutical distribution segment was 6.7% and 6.6% for the five months ended 31 May 2008 and 2009, respectively.

Retail pharmacy segment. Our gross profit in our retail pharmacy operations increased by 31.8%, from RMB95.6 million in the five months ended 31 May 2008 to RMB126.0 million in the five months ended 31 May 2009. The gross profit margin for our retail pharmacy segment increased to 27.2% for the five months ended 31 May 2009 from 24.6% for the same period in 2008. The increase was primarily due to an increase in our sales of higher-margin private label products.

Other business operations. Our gross profit in our other business operations increased by 16.1%, from RMB173.8 million in the five months ended 31 May 2008 to RMB201.7 million in the five months ended 31 May 2009. The gross profit margin for our other business operations decreased to 27.3% for the five months ended 31 May 2009 from 28.9% for the same period in 2008. Such decrease was primarily due to the decrease of profit margin of our chemical reagent operations as well as our acquisition of Zhijun Suzhou Wanqing, whose product portfolio contained lower-margin products, such as chemical intermediate and APIs.

Other income

Our other income increased by 21.6%, from RMB16.2 million in the five months ended 31 May 2008 to RMB19.7 million in the five months ended 31 May 2009. The increase was primarily due to an increase of government grants that we received from central and local government authorities.

Distribution and selling expenses

Our distribution and selling expenses increased by 11.9%, from RMB365.0 million in the five months ended 31 May 2008 to RMB408.6 million in the five months ended 31 May 2009. The increase in distribution and selling expenses was primarily due to (i) an increase in our rental expenses with respect to our newly opened retail pharmacies and (ii) increases in total personnel and levels of salaries and wages for our sales and marketing staff, transportation expense and travel and office expenses in connection with our sales and marketing activities. Our distribution and selling expenses as a percentage of our total revenue decreased from 2.4% in the five months ended 31 May 2008 to 2.3% for the same period in 2009, primarily due to our increased operating efficiency and enhanced economies of scale.

General and administrative expenses

Our general and administrative expenses decreased by 2.2%, from RMB354.4 million in the five months ended 31 May 2008 to RMB346.5 million in the five months ended 31 May 2009. The decrease in general and administrative expenses was primarily due to (i) a decrease in travel and office expenses as a result of our cost control measures; (ii) a decrease in post-employment benefit expenses due to actuarial gains resulting from changes in interest rates and (iii) our recovery of certain other receivables in 2009, for which we had previously made provisions. The decrease was partially offset by (i) an increase in our employee benefit expenses as a result of increased personnel and salaries and wages of our administrative staff and (ii) an increase in our provisions for impaired account receivables corresponding to the increase in our accounts receivables in the five months ended 31 May 2009.

Our general and administrative expenses as a percentage of our total revenues decreased from 2.4% for the five months ended 31 May 2008 to 1.9% for the same period in 2009, primarily due to our increased operating efficiency and enhanced economies of scale.

Operating profit

As a result of the foregoing, our operating profit was RMB702.6 million in the five months ended 31 May 2009, representing an increase of 37.9% from RMB509.4 million in the five months ended 31 May 2008.

Pharmaceutical distribution segment. Our operating profit in our pharmaceutical distribution operations increased by 40.5%, from RMB448.2 million in the five months ended 31 May 2008 to RMB629.8 million in the five months ended 31 May 2009. Our operating profit margin for our pharmaceutical distribution segment increased to 3.7% for the five months ended 31 May 2009 from 3.2% for the same period in 2008.

Retail pharmacy segment. Our operating profit in our retail pharmacy operations decreased by 16%, from RMB5.0 million in the five months ended 31 May 2008 to RMB4.2 million in the five months ended 31 May 2009. The operating profit margin for our retail pharmacy segment decreased to 0.9% for the five months ended 31 May 2009 from 1.3% for the same period in 2008. The decrease was primarily due to the increase in expenses in connection with opening new directly owned stores for our retail pharmacy operations.

Other business operations segment. Our operating profit in our other business operations increased by 22.1%, from RMB56.2 million in the five months ended 31 May 2008 to RMB68.6 million in the five months ended 31 May 2009. The operating profit margin for our other business operations decreased to 9.3% for the five months ended 31 May 2009 from 9.4% for the same period in 2008.

Other gains, net

Our other gains less other losses increased by 31.0%, from RMB79.4 million in the five months ended 31 May 2008 to RMB104.0 million in the five months ended 31 May 2009. The increase was primarily due to the increase in our gain on disposals of the tradable shares of National Medicines and Accord Pharma during the five months ended 31 May 2009 as compared to the same period in 2008. The increase was partially offset by the decrease of our foreign exchange gains during the five months ended 31 May 2009.

Finance income

Our finance income increased by 23.3%, from RMB7.3 million in the five months ended 31 May 2008 to RMB9.0 million in the five months ended 31 May 2009. The increase was primarily due to increases in the average balance of our bank deposits in interest bearing savings accounts.

Finance costs

Our finance costs decreased by 4.3%, from RMB98.1 million in the five months ended 31 May 2008 to RMB93.9 million in the five months ended 31 May 2009, primarily due to the decrease in interest rates as compared to the same period in 2008. Such decrease was partially offset by an increase in interest expenses resulted from the increase in average amount of outstanding borrowings.

Share of results from associates

Share of results from associates increased by 10.1%, from RMB22.8 million in the five months ended 31 May 2008 to RMB25.1 million in the five months ended 31 May 2009, representing the increase in the profit of our associates described in Note 38 of the Accountants' Report in Appendix I to this document.

Income tax expenses

Our income tax expenses increased by 62.9%, from RMB119.0 million in the five months ended 31 May 2008 to RMB193.8 million in the five months ended 31 May 2009, primarily due to (i) the gradual increases in applicable income tax rates of certain of our subsidiaries whose preferential tax treatments expired after the effectiveness of new EIT Law; (ii) increases in expenses not deductible for tax purposes and (iii) certain of our subsidiaries incurred losses for which no deferred income tax was recognized. As a result, our effective income tax rate increased from 22.8% in the five months ended 31 May 2008 to 26.0% in the five months ended 31 May 2009.

Profit for the period

As a result of the foregoing, our profit increased by 37.6%, or RMB151.1 million, from RMB401.8 million in the five months ended 31 May 2008 to RMB552.9 million for the same period ended 31 May 2009.

Profit attributable to equity holders of the Company

Our profit attributable to equity holders, or net profit, increased by RMB124.5 million or 41.9%, from RMB297.0 million in the five months ended 31 May 2008 to RMB421.5 million in the five months ended 31 May 2009. Our net margin increased from 2.0% in the five months ended 31 May 2008 to 2.3% for the same period ended 31 May 2009.

Minority Interests

Minority interests increased by RMB26.6 million or 25.4%, from RMB104.8 million in the five months ended 31 May 2008 to RMB131.4 million in the five months ended 31 May 2009.

Year ended 31 December 2008 compared with year ended 31 December 2007

Revenue

The following table sets forth our external segment revenue and inter-segment sales by each segment in 2007 and 2008:

	Year ended 31 December					
	2007			2008		
	External revenue(1)	Inter-segment revenue	Total	External revenue(1)	Inter-segment revenue	Total
	(RMB in millions)					
Segment Revenue:(1)						
Pharmaceutical distribution	28,997.3	128.0	29,125.3	35,745.1	213.1	35,958.2
Retail pharmacy	835.6	-	835.6	952.2	-	952.2
Other business operations	1,277.3	97.9	1,375.2	1,490.2	98.1	1,588.3
Elimination	-	-	(225.9)	-	-	(311.2)
Total	**31,110.2**	**225.9**	**31,110.2**	**38,187.4**	**311.2**	**38,187.4**

(1) External segment revenue refers to segment revenue after inter-segment elimination.

Our total revenue after elimination of inter-segment sales increased by RMB7,077.2 million, or 22.7%, from RMB31,110.2 million in the year ended 31 December 2007 to RMB38,187.4 million in the year ended 31 December 2008. The increase was mainly attributable to an increase of RMB6,747.8 million in revenue from our pharmaceutical distribution operations. In addition, an increase of RMB212.9 million in revenue from our other business operations also contributed to the changes in our total revenue during the period. The increase in our revenues was in line with our market share growth and the development of the PRC pharmaceutical market.

Pharmaceutical distribution segment. Our external revenue from our pharmaceutical distribution operations increased by RMB6,747.8 million, or 23.3%, from RMB28,997.3 million in the year ended 31 December 2007 to RMB35,745.1 million in the year ended 31 December 2008. The increase was primarily due to an increase in the number of new hospital customers and an increase in the range and quantity of products sold to existing hospital customers. To a lesser extent, the penetration of our distribution network into community clinics and other healthcare institutions and the inclusion of revenue of Sinopharm Henan which we acquired in May 2008 also contributed to the increase in our revenues.

Retail pharmacy segment. Our external revenue from retail pharmacy operations increased by RMB116.6 million, or 14.0%, from RMB835.6 million in the year ended 31 December 2007 to RMB952.2 million in the year ended 31 December 2008. The increase was primarily due to an increase in the number of our directly owned stores from 446 in 2007 to 468 in 2008, as a result of our acquisition in May and June 2008, respectively, of the retail pharmacy stores of Shenyang Tianyitang and Zhejiang Intmedic, which are independent third-party pharmaceutical companies. The growth of revenue from our directly owned new stores opened in 2007, and which began to exhibit stronger revenues in 2008 as the new stores became more mature, also contributed to the increase in revenue in 2008 from our retail pharmacy operations. It generally takes about one to two years for sales growth of a new store to approach maturity. Our average daily revenue per directly owned store remained relatively stable from 2007 to 2008.

Other business operations segment. Our external revenue from our other business operations increased by RMB212.9 million, or 16.7%, from RMB1,277.3 million in the year ended 31 December 2007 to RMB1,490.2 million in the year ended 31 December 2008. The increase was primarily due to the growth of our pharmaceutical manufacturing operations, in terms of the quantity of products sold, especially cephalosporin antibiotics products. The growth of our chemical reagent and laboratory supplies operations also contributed to the increase in our revenues. The increase in revenue from our other business operations was partly offset by a decrease in sales of our cough syrup products.

Inter-segment sales. Our inter-segment sales were RMB225.9 million and RMB311.2 million in the years ended 31 December 2007 and 2008, respectively. Our inter-segment sales represent the sales by our pharmaceutical distribution segment to our retail pharmacy segment and medicines sold by our pharmaceutical manufacturing operations to our pharmaceutical distribution and retail pharmacy operations.

Cost of sales

Our cost of sales increased by RMB6,592.5 million, or 23.1%, from RMB28,560.0 million in the year ended 31 December 2007 to RMB35,152.5 million in the year ended 31 December 2008. The increase was primarily due to an increase in the costs of purchasing merchandise for our pharmaceutical distribution segment. The increase was consistent with the increase in our total revenues during 2008.

Gross profit

As a result of the foregoing, our gross profit increased by RMB484.7 million, or 19.0%, from RMB2,550.2 million in the year ended 31 December 2007 to RMB3,034.9 million in the year ended 31 December 2008. Our gross profit margin decreased from 8.2% for the year ended 31 December 2007 to 7.9% for the year ended 31 December 2008. The decrease was primarily due to decreased gross profit margin in our other business operations.

Pharmaceutical distribution segment. Our gross profit in our pharmaceutical distribution operations increased by RMB483.8 million, or 25.6%, from RMB1,890.5 million in the year ended 31 December 2007 to RMB2,374.3 million in the year ended 31 December 2008. Our gross profit margin for our pharmaceutical distribution segment increased to 6.6% for the year ended 31 December 2008 from 6.5% for the same period in 2007.

Retail pharmacy segment. Our gross profit in our retail pharmacy operations increased by RMB28.4 million, or 13.2%, from RMB215.5 million in the year ended 31 December 2007 to RMB243.9 million in the year ended 31 December 2008. The gross profit margin for our retail pharmacy segment slightly decreased to 25.6% for the year ended 31 December 2008 from 25.8% for the same period in 2007.

Other business operations. Our gross profit in our other business operations decreased RMB27.5 million, or by 6.2%, from RMB444.2 million in the year ended 31 December 2007 to RMB416.7 million in the year ended 31 December 2008. The gross profit margin for our other business operations decreased to 28.0% for the year ended 31 December 2008 from 34.8% for the same period in 2007. The gross profit margin was negatively impacted by changes in the product portfolio of the pharmaceutical manufacturing operations, resulting from an increase in sales of lower-margin over-the-counter drugs and a decrease in sales of higher-margin products, such as cough syrup products.

Other income

Our other income increased by RMB45.9 million, or 191.3%, from RMB24.0 million in the year ended 31 December 2007 to RMB69.9 million in the year ended 31 December 2008. The increase was mainly attributable to an increase of government grants that we received from central and local government authorities.

Distribution and selling expenses

Our distribution and selling expenses increased by RMB20.7 million, or 2.2%, from RMB945.3 million in the year ended 31 December 2007 to RMB966.0 million in the year ended 31 December 2008. The increase in distribution and selling expenses was mainly attributable to increases in total personnel and levels of salaries and wages for our sales and marketing staff, transportation expense and travel and office expenses in connection with our sales and marketing activities. Our distribution and selling expenses as a percentage of our total revenue decreased from 3.0% in 2007 to 2.5% in 2008, primarily due to our increased operating efficiency and enhanced economies of scale.

General and administrative expenses

Our general and administrative expenses increased by RMB127.1 million, or 15.1%, from RMB839.6 million in the year ended 31 December 2007 to RMB966.7 million in the year ended 31 December 2008. The increase in general and administrative expenses was primarily due to (i) the increase in employee benefit expenses as a result of increased personnel and salaries and wages of our administrative staff and travel and office expenses due to the expansion of our business operations and (ii) an increase in post-employment benefit expenses due to actuarial losses resulting from the decline of interest rates during the period. The increase was partially offset by the decrease of our provisions for doubtful accounts receivables and prepayment and other receivables from the previous year, which was primarily due to (i) a one-off provision for impaired accounts receivables of our subsidiary, China National Pharmaceutical Group Northwest Medicine Co., Ltd, in 2007 that did not recur in 2008 and (ii) our recovery of certain other receivables in 2008, for which we had previously made provisions. Our general and administrative expenses as a percentage of our total revenues decreased from 2.7% in 2007 to 2.5% in 2008, primarily due to our increased operating efficiency and enhanced economies of scale and decrease in provisions.

Operating profit

As a result of the foregoing, our operating profit was RMB1,172.1 million in the year ended 31 December 2008, representing an increase of RMB382.8 million, or 48.5% from RMB789.3 million in the year ended 31 December 2007.

Pharmaceutical distribution segment. Our operating profit in our pharmaceutical distribution operations increased by RMB373.1 million, or 54.8%, from RMB680.6 million in the year ended 31 December 2007 to RMB1,053.7 million in the year ended 31 December 2008. Our operating profit margin for our pharmaceutical distribution segment increased to 2.9% for the year ended 31 December 2008 from 2.3% for the same period in 2007.

Retail pharmacy segment. Our operating profit in our retail pharmacy operations decreased by RMB12.3 million, or 50.8%, from RMB24.2 million in the year ended 31 December 2007 to

RMB11.9 million in the year ended 31 December 2008. The operating profit margin for our retail pharmacy segment decreased to 1.2% for the year ended 31 December 2008 from 2.9% for the same period in 2007. The decrease was primarily due to the integration expenses for our acquisition of the retail pharmacy stores of Zhejiang Intmedic and Shenyang Tianyitang in 2008.

Other business operations segment. Our operating profit in our other business operations increased by RMB22.0 million, or 26.0%, from RMB84.5 million in the year ended 31 December 2007 to RMB106.5 million in the year ended 31 December 2008. The operating profit margin for our other business operations increased to 7.1% for the year ended 31 December 2008 from 6.6% for the same period in 2007.

Other gains, net

Our other gains less other losses decreased by RMB31.4 million, or 25.3%, from RMB124.1 million in the year ended 31 December 2007 to RMB92.7 million in the year ended 31 December 2008. The decrease was primarily due to: (i) the decrease in our gain on disposal of National Medicines' tradable shares as a result of a decrease in the number of shares we sold in 2008 compared to 2007; and (ii) our losses on disposal of our subsidiaries, particularly Sichuan Antibiotic Institute in 2008.

Finance income

Our finance income increased by RMB6.5 million, or 36.5%, from RMB17.8 million in the year ended 31 December 2007 to RMB24.3 million in the year ended 31 December 2008. The increase was mainly due to increases in the average balance of our bank deposits in interest bearing savings accounts.

Finance costs

Our finance costs increased by RMB115.1 million, or 76.3%, from RMB150.9 million in the year ended 31 December 2007 to RMB266.0 million in the year ended 31 December 2008, primarily due to an increase in the amount of interest paid as a result of an increase in (i) interest rates, which increased from January to September 2008, before falling as worldwide economic conditions worsened and (ii) the average amount of outstanding borrowings, as well as the amount of notes discount transactions we entered into.

Share of results from associates

Share of results from associates increased by RMB14.2 million, or 35.5%, from RMB40.0 million in the year ended 31 December 2007 to RMB54.2 million in the year ended 31 December 2008, representing the increase in the profit of our associates described in Note 40 of the Accountant's Report in Appendix I to this document.

Income tax expenses

Our income tax expenses decreased by RMB25.2 million, or 8.9%, from RMB284.5 million in the year ended 31 December 2007 to RMB259.3 million in the year ended 31 December 2008, primarily due to the change in the statutory income tax rate in the PRC. As a result, our effective income tax rate decreased from 34.7% in year ended 31 December 2007 to 24.1% in the year ended 31 December 2008.

Profit for the year

As a result of the foregoing, our profit increased by RMB282.2 million, or 52.7%, from RMB535.9 million in the year ended 31 December 2007 to RMB818.1 million in the year ended 31 December 2008.

Profit attributable to equity holders of the Company

Our profit attributable to equity holders, or net profit, increased by RMB204.8 million or 53.8%, from RMB380.9 million in the year ended 31 December 2007 to RMB585.7 million in the year ended 31 December 2008. Our net margin increased from 1.2% in the year ended 31 December 2007 to 1.5% in the year ended 31 December 2008.

Minority Interests

Minority interests increased by RMB77.4 million or 49.9%, from RMB155.0 million in the year ended 31 December 2007 to RMB232.4 million in the year ended 2008.

Year ended 31 December 2007 compared with year ended 31 December 2006

Revenue

The following table sets forth both our external segment revenue and inter-segment sales by each segment in 2007 and 2006:

	Year ended 31 December					
	2006			2007		
	External revenue[1]	Inter-segment revenue	Total	External revenue[1]	Inter-segment revenue	Total
	(RMB in millions)					
Segment Revenue:[1]						
Pharmaceutical distribution	21,927.2	87.2	22,014.4	28,997.3	128.0	29,125.3
Retail pharmacy	823.1	-	823.1	835.6	-	835.6
Other business operations	986.3	90.4	1,076.7	1,277.3	97.9	1,375.2
Elimination	-	-	(177.6)	-	-	(225.9)
Total	**23,736.6**	**177.6**	**23,736.6**	**31,110.2**	**225.9**	**31,110.2**

(1) External segment revenue refers to segment revenue after inter-segment elimination.

Our total revenue after elimination of inter-segment sales increased by RMB7,373.6 million, or 31.1%, from RMB23,736.6 million in the year ended 31 December 2006 to RMB31,110.2 million in the year ended 31 December 2007. The increase was mainly attributable to an increase of RMB7,070.1 million in revenue from our pharmaceutical distribution operations. In addition, an increase of RMB291.0 million in revenue from our other business operations also contributed to the changes in our total revenue during the period.

Pharmaceutical distribution segment. Our external revenue from our pharmaceutical distribution operations increased by RMB7,070.1 million, or 32.2%, from RMB21,927.2 million in the year ended 31 December 2006 to RMB28,997.3 million in the year ended 31 December 2007. The increase was due primarily to an increase in the number of our new hospital customers and an increase in terms of the range and quantity of products sold to existing customers. To a lesser extent, the penetration of our distribution network into community clinics and other healthcare institutions also contributed to the increase in revenue.

Retail pharmacy segment. Our external revenue from retail pharmacy operations slightly increased by RMB12.5 million, or 1.5%, from RMB823.1 million in the year ended 31 December 2006 to RMB835.6 million in the year ended 31 December 2007. Although the number of our directly owned stores increased from 425 in 2006 to 446 in 2007, the newly opened stores did not make a significant contribution to revenues in 2007 as the stores were still in the developing stage and it generally takes about one to two years for the sales growth of a new store to approach maturity.

Other business operations segment. Our external revenue from our other business operations increased by RMB291.0 million, or 29.5%, from RMB986.3 million in the year ended 31 December 2006 to RMB1,277.3 million in the year ended 31 December 2007. The increase was primarily due to the growth of our pharmaceutical manufacturing operations, in terms of the quantity of products sold, in particular, cephalosporin antibiotics products. To a lesser extent, the increase was also due to the growth of our chemical reagent and laboratory supplies operations.

Inter-segment sales. Our inter-segment sales were RMB177.6 million and RMB225.9 million in the years ended 31 December 2006 and 2007, respectively. Our inter-segment sales represent the sales by our pharmaceutical distribution segment to our retail pharmacy segment and medicines sold by our pharmaceutical manufacturing operations to our pharmaceutical distribution and retail pharmacy operations.

Cost of sales

Our cost of sales increased by RMB6,812.9 million, or 31.3%, from RMB21,747.1 million in the year ended 31 December 2006 to RMB28,560.0 million in the year ended 31 December 2007. The increase was primarily due to an increase in the costs of purchasing merchandise for our pharmaceutical distribution segment. The increase was consistent with the increase in our total revenues during 2007.

Gross profit

As a result of the foregoing, our gross profit increased by RMB560.7 million, or 28.2%, from RMB1,989.5 million in the year ended 31 December 2006 to RMB2,550.2 million in the year ended 31 December 2007. Our gross profit margin was 8.4% and 8.2% for the year ended 31 December 2006 and 2007, respectively.

Pharmaceutical distribution segment. Our gross profit in our pharmaceutical distribution operations increased by RMB511.8 million, or 37.1%, from RMB1,378.7 million in the year ended 31 December 2006 to RMB1,890.5 million in the year ended 31 December 2007. Our gross profit margin for our pharmaceutical distribution segment increased to 6.5% for the year ended 31 December 2007 from 6.3% for the same period in 2006.

Retail pharmacy segment. Our gross profit in our retail pharmacy operations increased by RMB7.8 million, or 3.8%, from RMB207.7 million in the year ended 31 December 2006 to RMB215.5 million in the year ended 31 December 2007. The gross profit margin for our retail pharmacy segment increased to 25.8% for the year ended 31 December 2007 from 25.2% for the same period in 2006.

Other business operations. Our gross profit in our other business operations increased by RMB41.0 million, or 10.2%, from RMB403.2 million in the year ended 31 December 2006 to RMB444.2 million in the year ended 31 December 2007. The gross profit margin for our other business operations decreased to 34.8% for the year ended 31 December 2007 from 40.9% for the same period in 2006. The gross profit margin was negatively impacted by changes in the product portfolio of the pharmaceutical manufacturing operations, resulting in an increase in sales of lower-margin over-the-counter drugs and a decrease in sales of higher-margin products, such as cough syrup products.

Other income

Our other income increased by RMB6.7 million, or 38.7%, from RMB17.3 million in the year ended 31 December 2006 to RMB24.0 million in the year ended 31 December 2007. This increase was mainly attributable to an increase in government grants that we received from central and local government authorities.

Distribution and selling expenses

Our distribution and selling expenses increased by RMB166.3 million, or 21.3%, from RMB779.0 million in the year ended 31 December 2006 to RMB945.3 million in the year ended 31 December 2007. The increase in distribution and selling expenses was mainly attributable to increases in total personnel and levels of salaries and wages for our sales and marketing staff, sales promotion expenses, rental payments, travel and office expenses and transport expenses in connection with our sales and marketing activities. Our distribution and selling expenses as a percentage of our total revenue decreased from 3.3% in 2006 to 3.0% in 2007, primarily due to our increased operating efficiency and enhanced economies of scale.

General and administrative expenses

Our general and administrative expenses increased by RMB92.0 million, or 12.3%, from RMB747.6 million in the year ended 31 December 2006 to RMB839.6 million in the year ended 31 December 2007. The increase in general and administrative expenses was primarily due to increases in employee benefit expenses due to increased personnel and salaries and wages of our administrative staff, as well as travel and office expenses due to the expansion of our business operations. Our general and administrative expenses as a percentage of our total revenue decreased from 3.1% in 2006 to 2.7% in 2007, primarily due to our increased operating efficiency and enhanced economies of scale.

Operating profit

As a result of the foregoing, our operating profit was RMB789.4 million in the year ended 31 December 2007, an increase of RMB309.1 million, or 64.4% from RMB480.3 million in the year ended 31 December 2006.

Pharmaceutical distribution segment. Our operating profit in our pharmaceutical distribution operations increased by RMB286.4 million, or 72.7%, from RMB394.2 million in the year ended 31 December 2006 to RMB680.6 million in the year ended 31 December 2007. Our operating profit margin for our pharmaceutical distribution segment increased to 2.3% for the year ended 31 December 2007 from 1.8% for the same period in 2006.

Retail pharmacy segment. Our operating profit in our retail pharmacy operations increased by RMB11.9 million, or 96.7%, from RMB12.3 million in the year ended 31 December 2006 to RMB24.2 million in the year ended 31 December 2007. The operating profit margin for our retail pharmacy segment increased to 2.9% for the year ended 31 December 2007 from 1.5% for the same period in 2006.

Other business operations segment. Our operating profit in our other business operations increased by RMB10.7 million, or 14.5%, from RMB73.8 million in the year ended 31 December 2006 to RMB84.5 million in the year ended 31 December 2007. The operating profit margin for our other business operations decreased to 6.6% for the year ended 31 December 2007 from 7.5% for the same period in 2006.

Other gains/losses, net

We incurred other losses, net in the amount of RMB45.6 million in the year ended 31 December 2006. We have other gains, net in the amount of RMB124.1 million in the year ended 31 December 2007. The change was mainly attributable to our losses on transfer for no consideration of equity interests in Accord Pharma and National Medicines under the respective share reform schemes in 2006 and the increases of: (i) gain on disposal of National Medicines' tradable shares in 2007; (ii) net gain on foreign exchange transactions due to the appreciation of the Renminbi against the U.S. dollar; and (iii) gains on the disposal of leasehold land and land use rights and property, plant and equipment by Sinopharm Holding Liuzhou Co., Ltd.

Finance income

Our finance income increased by RMB6.1 million, or 52.1%, from RMB11.7 million in the year ended 31 December 2006 to RMB17.8 million in the year ended 31 December 2007. The increase was mainly due to increases in the average balance of our bank deposits in interest bearing savings accounts.

Finance costs

Our finance costs increased by RMB49.4 million, or 48.7%, from RMB101.5 million in the year ended 31 December 2006 to RMB150.9 million in the year ended 31 December 2007, primarily due to an increase in the amount of interest paid as a result of an increase in (i) interest rates and (ii) the amount of our notes receivables discount transactions, as well as the average amount of outstanding borrowings.

Share of results from associates

Share of results from associates increased by RMB20.8 million, or 108.3%, from RMB19.2 million in the year ended 31 December 2006 to RMB40.0 million in the year ended 31 December 2007, representing the increase in profit of our associates described in Note 40 of the Accountant's Report in Appendix I to this document.

Income tax expenses

Our income tax expenses increased by RMB103.0 million, or 56.7%, from RMB181.5 million in the year ended 31 December 2006 to RMB284.5 million in the year ended 31 December 2007, primarily due to an increase in our taxable profit and the movement of deferred tax. However, our effective income tax rate decreased from 49.9% in year ended 31 December 2006 to 34.7% in year ended 31 December 2007. The decrease was primarily due to non-tax deductible losses we recognized on transfers of equity interests in Accord Pharma and National Medicines in 2006, the change in deferred tax calculation that resulted from the application of other statutory income tax rates, an increase in income not subject to tax, a decrease in eliminated income subject to tax and a decrease in non-tax deductible employee compensation expenses.

Profit for the year

As a result of the foregoing, our profit for the year ended 31 December 2007 increased by RMB353.5 million, or 193.8%, from RMB182.4 million in the year ended 31 December 2006 to RMB535.9 million in the year ended 31 December 2007.

Profit attributable to equity holders of the Company

Our profit attributable to equity holders, or net profit, increased by RMB279.6 million or 276.0%, from RMB101.3 million in the year ended 31 December 2006 to RMB380.9 million in the year ended 31 December 2007. Our net margin increased significantly from 0.4% in the year ended 31 December 2006 to 1.2% in the year ended 31 December 2007, primarily due to our losses incurred on transfer for no consideration of equity interests in Accord Pharma and National Medicine under the respective share reform scheme in 2006 which did not recur in 2007.

Minority Interests

Minority interests increased by RMB73.9 million or 91.1%, from RMB81.1 million in the year ended 31 December 2006 to RMB155.0 million in the year ended 2007.

Liquidity and Capital Resources

Our principal sources of funds are cash generated from our operations and various short-term and long-term bank borrowings and lines of credit, as well as equity contributions from shareholders. Our primary liquidity requirements are to finance working capital, fund the payment of interest and principal due on our indebtedness, finance acquisitions and fund capital expenditures and growth and expansion of our facilities and operations.

We have historically met our working capital and other liquidity requirements principally from cash generated by our operations, while financing the remainder primarily through bank borrowings. Going forward, we expect to continue relying principally on our internally-generated cash flows for our working capital and other liquidity requirements, and will also use bank borrowings as capital resources to finance a portion of our operations. We have historically relied primarily on short-term debt, rather than long-term debt, in order to take advantage of the significantly lower interest rates on short-term debt, which in turn lowers our financing costs, and this is also consistent with our historical approach to finance working capital. Should we increase the amount of our long-term capital expenditures and other capital commitments in the future, we may finance these long-term expenditures with long-term debt, if necessary.

Taking into account our cash and cash equivalents on hand, our available credit facilities, cash generated from our future operations, our Directors are of the opinion that we have sufficient working capital to meet our financial requirements for at least the next 12 months from the date of this document. As of 31 May 2009, we had RMB12,920.5 million of banking facilities available to us from commercial banks, of which approximately RMB6,602.1 million was not utilized, and cash and cash equivalents of RMB2,602.1 million.

We conduct our operations directly and through our operating subsidiaries, some of which we do not wholly own, are joint ventures or are public companies. Therefore, we may not be able in all circumstances to allocate our free cash flow as we would like among our subsidiaries. In addition, PRC law restricts the ability of our subsidiaries to transfer funds to us in the form of cash dividends, loans or advances. PRC regulations currently permit payment of dividends only out of accumulated profits as determined in accordance with PRC accounting standards and regulations. In addition, under current PRC laws, regulations and accounting standards, each subsidiary is required to allocate at least 10% of its after-tax profit based on PRC accounting standards to its statutory common reserve fund each year until the cumulative amount of these reserves reaches 50% of its registered capital. These reserves are not distributable as cash dividends. As of 31 May 2009, the required deductions attributable to these statutory common reserve funds amounted to approximately RMB311.8 million.

Furthermore, under regulations of the State Administration of Foreign Exchange, the Renminbi is not convertible into foreign currencies for capital account items, such as loans, repatriation of investments and investments outside of China, unless the prior approval of the State Administration of Foreign Exchange is obtained and prior registration with the State Administration of Foreign Exchange is made. These restrictions have not historically had, and are not expected in the future to have, a material impact on our ability to meet our financial requirements.

We focus on improving the profitability of our business to improve our operating cash flow. We closely monitor and manage: (i) the level of our trade payables and accrual and other payables and receivables; (ii) our inventory levels; and (iii) our ability to obtain external financing by implementing various internal guidelines and mechanisms, including:

- establishing approval procedures for our contract terms governing collection and payment, maintaining strict compliance with contractual terms, performing regular reviews of the collection and payment of trade payables and trade receivables, allocating responsibility for trade receivables and making adequate provisions for doubtful accounts;

- maintaining centralized procurement, budget management, inventory management and an acceptance and return system, which will control our raw materials procurement and enhance our inventory management; and

- increasing our credit facilities.

We intend to further improve our management of receivables and our control of inventories. We will maintain a policy of making capital expenditures only when required to develop our business and when we have adequate cash flows from operations.

Cash flows

The following table sets forth a summary of our cash flows for the periods indicated:

	Year ended 31 December			Five months ended 31 May	
	2006	**2007**	**2008**	**2008**	**2009**
				(unaudited)	
	(RMB in millions)				
Cash and cash equivalents at beginning of year	1,351.4	1,838.8	1,955.6	1,955.6	1,712.1
Net cash generated from operating activities	638.4	441.2	653.8	(474.0)	264.1
Net cash used in investing activities	(270.9)	(14.4)	(148.0)	(2.2)	(37.3)
Net cash generated from/(used in) financing activities	119.8	(310.0)	(749.4)	(16.0)	663.1
Net increase/(decrease) in cash and cash equivalents	487.4	116.8	(243.5)	(492.2)	890.0
Cash and cash equivalents at end of year	1,838.8	1,955.6	1,712.1	1,463.4	2,602.1

Net cash generated from operating activities

We primarily derive our cash inflow from operations from payments for the sale of our products and services in our pharmaceutical distribution, retail pharmacy and other business operations segments. Our cash outflow from operations is primarily used for purchases of merchandise and raw materials in our business segments, distribution and selling expenses and general and administrative expenses. Cash generated from our operations consists of cash flow from operating activities before adjustments for changes in working capital and cash inflows or outflows from changes in working capital. Cash flows from operating activities can be significantly affected by factors such as the timing of accounts receivables from customers and payments of accounts payables to suppliers during the regular course of business.

For the five months ended 31 May 2009, our net cash generated from operating activities was RMB264.1 million, consisting of cash generated from operations of RMB447.1 million, subtracted by income tax paid of RMB183.0 million. Our cash generated from operations consisted of cash flow from operating activities before adjustments for changes in working capital of RMB791.2 million and net negative adjustments for changes in working capital of RMB344.0 million. Net negative adjustments for changes in working capital reflected primarily: (i) an increase in trade receivables of RMB1,251.2 million in line with the growth of our sales, particularly our direct sales to hospitals; and (ii) an increase in inventories of RMB377.7 million, primarily due to the expansion of our pharmaceutical distribution operations. These negative adjustments were partially offset by an increase in trade payables of RMB1,138.7 million resulting from the increased use of notes to make payments for trade payables, as well as the continued growth of our operations.

For the year ended 31 December 2008, our net cash generated from operating activities was RMB653.8 million, consisting of cash generated from operations of RMB955.2 million, subtracted by income tax paid of RMB301.4 million. Our cash generated from operations consisted of cash flow from operating activities before adjustments for changes in working capital of RMB1,344.7 million and net negative adjustments for changes in working capital of RMB389.4 million. Net negative adjustments for changes in working capital reflected primarily: (i) an increases in trade receivables of RMB1,747.3 million in line with the growth of our sales, particularly our direct sales to hospitals; and (ii) an increase in inventories of RMB453.4 million, primarily due to the expansion of our pharmaceutical distribution operations. These negative adjustments were partially offset by an increase in trade payables of RMB1,917.8 million resulting from the increased use of notes to make payments for trade payables, as well as the continued growth of our operations.

For the year ended 31 December 2007, our net cash generated from operating activities was RMB441.2 million, consisting of cash generated from operations of RMB671.8 million, subtracted by income tax paid of RMB230.6 million. Our cash generated from operations consisted of cash flow from operating activities before adjustments for changes in working capital of RMB975.8 million and net negative adjustments for changes in working capital of RMB304.0 million. Net negative adjustments for changes in working capital consisted primarily of: (i) increases of RMB1,280.4 million in trade receivables that corresponded to the growth of our sales in our pharmaceutical distribution operations; and (ii) an increase in inventories of RMB586.0 million, primarily due to the expansion of our pharmaceutical distribution operations, including the carrying of more types of products. These negative adjustments were partially offset by an increase in trade payables of RMB1,594.0 million resulting from the increased use of notes to make payments for trade payables, as well as the continued growth of our operations.

For the year ended 31 December 2006, our net cash generated from operating activities was RMB638.4 million, consisting of cash generated from operations of RMB787.5 million, subtracted by income tax paid of RMB149.1 million. Our cash generated from operations consisted of cash flow from operating activities before adjustments for changes in working capital of RMB684.9 million and net adjustments for positive changes in working capital of RMB102.6 million. Net adjustments for positive changes in working capital consisted primarily of an increase in trade payables of RMB1,155.3 million resulting from expansion of our business operations and the use of notes to make payments. Such positive adjustments were partially offset by: (i) an increases in trade receivables of RMB1,043.7 million in line with the growth of our sales in our pharmaceutical distribution operations; and (ii) an increase in inventories of RMB111.6 million, primarily due to the expansion of our pharmaceutical distribution operations and the carrying of more types of products.

Net cash used in investing activities

Our cash inflow from investing activities primarily consists of interest income, dividends received from subsidiaries and associates, and proceeds from disposals of leasehold land and land use rights, property, plant and equipment and investments in financial assets, subsidiaries and associates. Our cash outflow from investing activities primarily consists of purchases of property, plant and equipment, leasehold land and land use rights, purchases of intangible assets, purchases of investments, and acquisitions of interests in subsidiaries and associates.

For the five months ended 31 May 2009, our net cash used in investing activities was RMB37.3 million. Our cash outflow for investing activities primarily consisted of: (i) cash used in the acquisition of subsidiaries, net of cash acquired, in the amount of RMB92.1 million; (ii) cash used in the purchase of property, plant and equipment, primarily for logistics facilities that support our pharmaceutical distribution and chemical reagent operations and for production facilities used in our manufacturing operations, in the amount of RMB64.0 million. Our cash inflow from investing activities primarily consisted of: (i) proceeds from disposal of tradable shares of National Medicines and Accord Pharma in the amount of RMB111.2 million and (ii) proceeds from the disposal of property, plant and equipment in the amount of RMB14.1 million.

For year ended 31 December 2008, our net cash used in investing activities was RMB148.0 million. Our cash outflow for investing activities primarily consisted of: (i) cash used in the purchase of property, plant and equipment, primarily for logistics facilities that support our pharmaceutical distribution and chemical reagent operations and for production facilities used in our manufacturing operations, in the amount of RMB269.3 million; (ii) cash used in the acquisition of a regional distributor, Sinopharm Henan, and retail pharmacy stores from Zhejiang Intmedic and Shenyang Tianyitang, net of cash acquired, in the amount of RMB24.9 million and (iii) cash used in the purchase of leasehold land and land use rights, in the amount of RMB29.3 million. Our cash inflow from investing activities primarily consisted of: (i) proceeds from disposal of tradable shares of National Medicines in the amount of RMB83.2 million; (ii) proceeds from the disposal of leasehold and land use rights and property, plant and equipment in the amount of RMB43.2 million; and (iii) proceeds from disposal of interests in our associates in the amount of RMB26.2 million.

For the year ended 31 December 2007, our net cash used in investing activities was RMB14.4 million. Our cash outflow for investing activities primarily consisted of: (i) cash used in the purchase of property, plant and equipment primarily for our logistic facilities and retail pharmacy and manufacturing operations in the amount of RMB236.0 million; and (ii) cash used in the disposal of subsidiaries, net of cash disposed of, in the amount of RMB49.1 million. Our cash inflow from investing activities primarily consisted of: (i) proceeds from the disposal of leasehold land and land use rights and property, plant and equipment in the amount of RMB104.0 million; and (ii) proceeds from disposal of tradable shares of National Medicines in the amount of RMB103.7 million.

For the year ended 31 December 2006, our net cash used in investing activities was RMB270.9 million. Our cash outflow for investing activities primarily consisted of: (i) cash used in the purchase of property, plant and equipment primarily for our logistic facilities and manufacturing operations in the amount of RMB180.5 million; and (ii) cash used in the purchase of leasehold land and land use rights in the amount of RMB68.3 million. Our cash inflow from investing activities primarily consisted of: (i) proceeds from the disposal of leasehold land and land use rights and property, plant and equipment in the amount of RMB46.7 million; and (ii) dividends received from our associates, mainly Qinghai Pharmaceutical (Group) Co., Ltd., Yichang Humanwell Pharmaceutical Co., Ltd. and Shenzhen Main Luck Pharmaceutical Co., Ltd., in the amount of RMB15.4 million.

Net cash used in/generated from financing activities

Our cash inflow from financing activities primarily consists of proceeds from borrowings and capital injections from shareholders. Our cash outflow from financing activities primarily consists of repayment of bank borrowings, dividends paid to shareholders, interest payments and increase in pledged bank deposits.

For the five months ended 31 May 2009, our net cash flows from financing activities was RMB663.1 million. Our cash inflow from financing activities primarily consisted of proceeds from borrowings in the amount of RMB4,146.5 million. Our cash outflow from financing activities primarily consisted of: (i) repayment of borrowings in the amount of RMB3,295.9 million and (ii) interest paid in the amount of RMB82.6 million.

For the year ended 31 December 2008, our net cash used in financing activities was RMB749.4 million. Our cash outflow for financing activities primarily consisted of: (i) repayment of borrowings in the amount of RMB3,816.6 million; and (ii) interest paid in the amount of RMB244.2 million. Our cash inflow from financing activities primarily consisted of proceeds from borrowings in the amount of RMB3,096.5 million.

For the year ended 31 December 2007, our net cash used in financing activities was RMB310.0 million. Our cash outflow for financing activities primarily consisted of: (i) cash used in repayment of borrowings in the amount of RMB1,691.0 million; and (ii) an increase in pledged bank deposits used as security for bank borrowings in the amount of RMB524.7 million. Our cash inflow from financing activities primarily consisted of proceeds from borrowings in the amount of RMB2,075.8 million.

For the year ended 31 December 2006, our net cash generated from financing activities was RMB119.8 million. Our cash inflow from financing activities primarily consisted of: (i) proceeds from borrowings in the amount of RMB1,774.2 million and (ii) capital injections from equity holders in the amount of RMB309.6 million. Our cash outflow for financing activities primarily consisted of: (i) cash used in repayment of borrowings in the amount of RMB1,732.8 million; and (ii) cash used in the payment of dividends in the amount of RMB127.4 million.

Capital expenditures

In the past, our capital expenditures consisted primarily of purchases of property, plant and equipment, the cost of leasing land and obtaining land use rights and purchases of intangible assets primarily through business combination or acquisition activities. All of our capital expenditures during the Track Record Period were incurred with respect to activities in China. Our capital expenditures were RMB278.2 million, RMB314.1 million, RMB281.4 million and RMB76.7 million and RMB274.7 million for the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009, respectively.

During the Track Record Period, our capital expenditures in our other business operations constituted a relatively high portion of our total capital expenditures, primarily due to (i) upgrades to and expansion of our pharmaceutical manufacturing facilities and equipment during the Track Record Period and (ii) the nature of pharmaceutical manufacturing operations, which require significant capital investments. Our capital expenditures in our other business operations for the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2008 and 2009 were RMB109.6 million, RMB64.0 million, RMB139.6 million, RMB25.7 million and RMB149.8 million, respectively. The changes in the amount of our capital expenditures during the Track Record Period were primarily due to (i) expansion of the research and development center and upgrades to the manufacturing facilities and equipment of Accord Pharma and the construction of logistics facilities for our chemical reagent operations in 2008 and (ii) our acquisition of Zhijun Suzhou Wangqing in 2009.

The following table sets forth our capital expenditures by segment for the periods indicated:

	Year ended 31 December			Five months ended 31 May	
	2006	2007	2008	2008	2009
				(unaudited)	
	(RMB in millions)				
Pharmaceutical distribution operations	150.7	232.3	132.3	48.3	121.5
Retail pharmacy operations	17.8	17.9	9.5	2.7	3.4
Other business operations	109.6	64.0	139.6	25.7	149.8
Total	**278.2**	**314.1**	**281.4**	**76.7**	**274.7**

We anticipate that our capital expenditures for the year ending 31 December 2009 will be approximately RMB532.6 million, which will be used mainly for the expansion of our distribution network (including through mergers and acquisitions, as well as through organic growth), construction of our logistics infrastructure, upgrading our information system, purchase of equipment and vehicles, opening new directly owned retail pharmacies and the expansion and upgrade of our pharmaceutical manufacturing facilities. The investments for these planned capital expenditures will also be made in China. These capital expenditures will be financed by cash flow generated from operating activities and bank borrowings. We may also issue equity securities from time to time. However, we cannot assure you that we will be able to raise additional capital, if necessary, on terms acceptable to us, or at all.

Although, these are our current plans with respect to our capital expenditures, such plans may change as a result of a change of circumstances and the actual amount of expenditures set out above may vary from the estimated amount of expenditures for a variety of reasons, including changes in market conditions, competition and other factors. As we continue to expand, we may incur additional capital expenditures. Our ability to obtain additional funding for our future capital expenditures is subject to a variety of uncertainties, including our future results of operations, financial condition and cash flows, economic, political and other conditions in the PRC and Hong Kong, and the PRC Government's policies relating to foreign currency borrowings.

Working capital

Our working capital is critical to our financial performance. We must maintain sufficient liquidity and financial flexibility to continue our daily operations. Our sales practices with hospitals in our pharmaceutical distribution segment, as discussed below in "— Trade receivables", has resulted in a significant working capital demand for the operation of our pharmaceutical distribution business. We fund our working capital requirements primarily from cash generated from operations and bank loans, and supplement these sources by the sale of accounts receivable. These comprise note discount or accounts receivable factoring transactions entered into to facilitate the liquidity of our trade receivables and prepayments and other receivables. We manage our working capital by utilizing inventory control measures, periodically assessing our trade receivables and prepayments and other receivables and trade payables and accruals and other payables and adhering to our internal accounting procedures, as well as maximizing the financial control features of our information management systems.

Net current assets

Our current assets primarily consist of trade receivables, inventories, cash and cash equivalents and prepayment and other receivables. Our current liabilities primarily consist of trade payables, bank borrowings and accruals and other payables. We had net current assets of RMB1,127.9 million, RMB1,008.4 million, RMB1,803.7 million, RMB2,015.3 million and RMB2,202.9 million as of 31 December 2006, 2007 and 2008, 31 May 2009 and 31 July 2009, respectively. The table below sets forth our current assets, current liabilities and net current assets as of the date indicated:

	As of 31 December			As of 31 May	As of 31 July
	2006	**2007**	**2008**	**2009**	**2009**
					(unaudited)
	(RMB in millions)				
Current assets					
Inventories	2,043.4	2,634.4	3,154.8	3,613.0	3,719.8
Trade receivables	4,871.5	6,110.5	7,911.8	9,347.9	9,965.0
Prepayments and other receivables	519.2	605.5	616.9	572.3	736.1
Available-for-sale financial assets	0.02	0.02	0.02	0.02	0.02
Pledged bank deposits	124.7	649.3	285.8	247.8	327.7
Cash and cash equivalents	1,838.8	1,955.6	1,712.1	2,602.1	1,661.0
Total current assets	9,397.6	11,955.3	13,681.5	16,383.2	16,409.8
Current liabilities					
Trade payables	5,629.8	7,209.6	9,053.1	10,404.2	10,203.6
Accruals and other payables	872.5	996.9	860.5	1,028.0	1,085.2
Dividends payable	-	464.0	364.0	364.0	336.0
Current income tax liabilities	63.0	114.9	96.0	106.9	75.1
Bank borrowings	1,704.4	1,521.6	1,504.2	2,464.9	2,507.0
Loans from parent company	-	640.0	-	-	-
Total current liabilities	8,269.7	10,946.9	11,877.8	14,368.0	14,206.9
Net current assets	1,127.9	1,008.4	1,803.7	2,015.3	2,202.9

The changes of the balance of net current assets as of the respective dates were consistent with the expansion of our business operations during the Track Record Period.

Pledged bank deposits, cash and cash equivalents

Our pledged bank deposits primarily consist of collateral we provided for bank acceptances, bank borrowings and letters of credit. As of 31 December 2006, 2007 and 2008 and 31 May 2009, the balance of our pledged bank deposits was approximately RMB124.7 million, RMB649.3 million, RMB285.8 million and RMB247.8 million, respectively. As of 31 December 2006, 2007 and 2008 and 31 May 2009, we also had cash in banks and on hand of RMB1,838.8 million, RMB1,955.6 million, RMB1,712.1 million and RMB2,602.1 million, respectively.

Inventories

The following table sets forth the components of our inventories as of the dates indicated:

	As of 31 December			As of 31 May
	2006	2007	2008	2009
	(RMB in millions)			
Raw materials	62.4	167.4	76.9	154.4
Work in progress	0.9	3.5	0.1	29.1
Finished goods and trading merchandise	2,006.9	2,493.4	3,098.8	3,452.5
Less: Provision for impairment	(26.8)	(29.9)	(21.0)	(23.0)
Total(1)	**2,043.4**	**2,634.4**	**3,154.8**	**3,613.0**

(1) The cost of inventories recognized as expenses and included in cost of sales amounted to approximately RMB21,700.1 million, RMB28,500.6 million, RMB35,076.2 million and RMB16,573.3 million for each of the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2009, respectively.

We actively monitor our inventory levels and seek to maintain a low level of raw materials, work in progress and finished goods and commodities. We have sufficient storage area to meet increases in supplies of raw materials, work in progress and finished goods and commodities. Inventories are stated at cost, which is calculated using the weighted average method, or net realizable value, whichever is lower. The cost of finished goods and work in progress comprises raw materials, direct labor, other direct costs and related production overhead, based on normal operating capacity. Net realizable value is the estimated selling price in the ordinary course of business, less applicable selling expenses. We make provisions for impairment of inventories when the carrying value of inventories declines below the net realizable value. We review the carrying value of our inventories from time to time and make write-downs charges or write-backs based on conditions of goods, including aging and expiry, and estimated net realizable value of our inventories, which are recorded in our general and administrative expenses. As of 31 December 2006, 2007 and 2008 and 31 May 2009, our provisions for impairment of inventories were RMB26.8 million, RMB29.9 million, RMB21.0 million and RMB23.0 million, respectively. Net write-downs of inventories to their net realizable values amounted to approximately RMB4.2 million, RMB7.9 million, RMB4.5 million and RMB4.6 million for the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2009.

As of 31 July 2009, approximately RMB3,297.2 million, or 90.7%, of our inventories as of 31 May 2009 (in the amount of approximately RMB3,636.0 million) were subsequently consumed or sold.

We manage our inventories for our pharmaceutical distribution operations with a focus on controlling our inventory holding costs, maintaining the variety of products available for our customers and ensuring the prompt delivery of our products to customers. We monitor the inventory levels of our operating subsidiaries by implementing a budgeted inventory turnover day and reviewing our inventory analysis reports. Our inventory balances as of 31 December 2006, 2007 and 2008 and 31 May 2009 have been increasing, primarily due to increased purchases of merchandise to support the expansion of our pharmaceutical distribution operations. In addition, our inventory balances of raw materials increased as of 31 December 2007 compared to 31 December 2006 primarily as a result of the increase in inventories of raw materials of Accord Pharma corresponding to the increase of its designed production capacity in the end of 2007. Our inventory balances of raw materials increased as of 31 May 2009 compared to 31 December 2008 primarily as a result of our acquisition of Zhijun Suzhou Wangqing, a pharmaceutical manufacturer in Jiangsu Province.

The following table sets forth the turnover days of our inventories for the periods indicated:

	Year ended 31 December			Five months ended 31 May
	2006	2007	2008	2009
Turnover days of inventory[1]	33.6	29.9	30.1	30.6

(1) Turnover days of inventories is derived by dividing the average of the opening and closing balances of inventory for the relevant period by cost of sales and multiplying this figure by 365 days with respect to turnover days of inventories for a year or multiplying this figure by 150 days with respect to turnover days of inventories for a five-month period.

The stability of our turnover days of inventory during the Track Record Period was primarily due to our implementation of, and consistent efforts to maintain, inventory control measures.

Trade receivables

Our trade receivables mainly represent the credit sales of our products to be paid by our customers and consist of accounts receivables and notes receivables. The following table sets forth a breakdown of our trade receivables as of the dates indicated:

	As of 31 December			As of 31 May
	2006	2007	2008	2009
		(RMB in millions)		
Accounts receivables	4,710.2	5,785.9	7,435.4	8,871.8
Notes receivables	264.2	455.4	606.5	623.6
Total trade receivables	4,974.4	6,241.3	8,041.9	9,495.4
Less: Provision for impairment	(102.9)	(130.8)	(130.1)	(147.4)
Trade receivables – net	4,871.5	6,110.5	7,911.8	9,347.9

Our management closely monitors the recoverability of our overdue trade receivables on a regular basis and when appropriate, provides for impairment of these trade receivables. We recognize provisions for impairment of trade receivables as general and administrative expenses in our consolidated income statement. As of 31 December 2006, 2007 and 2008 and 31 May 2009, we had a provision for impairment of trade receivables of approximately RMB102.9 million, RMB130.8 million, RMB130.1 million and RMB147.4 million, respectively, which accounted for 2.1%, 2.1%, 1.6% and 1.6%, respectively, of our total trade receivables. The additions to provision for impairment of trade receivables as a percentage of our total revenues for the years ended 31 December 2006, 2007 and 2008 and the five months ended 31 May 2009 were 0.11%, 0.07%, 0.03% and 0.10%, respectively. The provision for impairment of our trade receivables was reduced by RMB26.7 million, RMB1.2 million, RMB11.6 million and RMB0.4 million in 2006, 2007 and 2008 and the five months ended 31 May 2009, respectively, for write-offs of trade receivables as uncollectible and was increased by additional provisions of RMB25.0 million, RMB22.4 million, RMB10.9 million and RMB17.7 million in 2006, 2007 and 2008 and the five months ended 31 May 2009, respectively. The changes in the amount of our provisions for impairment of trade receivables was primarily due to a one-off provision for the impaired accounts receivables of our subsidiary, China National Pharmaceutical Group Northwest Medicine Co., Ltd, in 2007 (which did not recur in 2008) and our efforts to control and monitor our accounts receivables. Such one-off provision, in the amount of approximately RMB20.4 million, was made for accounts receivables from various customers of the particular subsidiary, which were overdue for more than three years. Our Directors believe that the provision for impairment of our trade receivables is adequate to continue our normal business operations.

The following table sets forth an aging analysis of trade receivables, before provision for impairment, as of the dates indicated:

	As of 31 December						**As of 31 May**	
	2006		**2007**		**2008**		**2009**	
	RMB	(%)	**RMB**	(%)	**RMB**	(%)	**RMB**	(%)
	(in millions, except for percentages)							
Current to three months	4,104.8	82.5	5,318.0	85.3	6,806.9	84.7	8,289.1	87.2
Three to six months	588.3	11.8	668.4	10.7	886.8	11.0	1,021.5	10.8
Six months to one year	189.1	3.8	196.3	3.1	316.9	3.9	148.1	1.6
One to two years	43.2	0.9	26.9	0.4	8.9	0.1	5.3	0.1
Over two years	49.0	1.0	31.7	0.5	22.6	0.3	31.4	0.3
Total	**4,974.4**	**100.0**	**6,241.3**	**100.0**	**8,041.9**	**100.0**	**9,495.4**	**100.0**

In our pharmaceutical distribution segment, we typically grant a credit period of 30 to 120 days to customers. A portion of our customers make payments by notes, with maturities that are generally under 180 days. For customers with good credit history, in particular hospitals, we usually grant a longer credit period. Because our hospital customers are generally reliable, under the payment terms of our contracts with them, and as a customary practice of the pharmaceutical distribution market in China, we grant our hospital customers credit terms that range from 90 days to 180 days. To the extent revenue recognized under a sales contract is not yet paid, we record it as an accounts receivable. As a result of the extended credit periods for our hospital customers, we enter into note discount or factor programs with PRC domestic banks in China for our receivables from hospitals. We expect to continue to sell our accounts receivable in the future at terms acceptable to us to meet our working capital needs and to enhance our liquidity.

We generally do not grant credit terms to our customers for our retail sales in our retail pharmacy operations. We generally receive payments in cash from our customers upon the completion of the retail sales in our retail pharmacy operations. In our other business operations segment, we typically grant a credit period of 30 to 90 days.

We have adopted a series of policies and procedures to achieve prompt recoveries of our overdue trade receivables, such as stringent credit standards for credit analysis of our clients, and close monitoring of the recoverability of our overdue trade receivables. Historically, we have not experienced any significant losses on trade receivables.

As of 31 July 2009, approximately RMB6,316.7 million, or 66.5%, of our trade receivables as of 31 May 2009 (in the amount of approximately RMB9,495.4 million) were subsequently settled.

The following table sets forth the turnover days of our trade receivables for the periods indicated:

	Year ended 31 December			Five months ended 31 May
	2006	2007	2008	2009
Turnover days of trade receivables[1]	67.1	64.4	67.0	71.7

(1) Turnover days of trade receivables is derived by dividing the arithmetic mean of the opening and closing balances of trade receivables for the relevant period by revenue and multiplying this figure by 365 days with respect to turnover days of trade receivables for a year or multiplying this figure 150 days with respect to turnover days of trade receivables for a five-month period.

The stability of turnover days of our trade receivables during the Track Record Period was primarily a result of tighter control and monitoring of our accounts receivables, as well as the increase in transactions for note receivables and accounts receivables financing, partly offset by our increased sales to hospital customers to whom we granted longer credit periods.

CNPGC has re-allocated to us certain medical reserve funds after allocation and payment of such funds to CNPGC by the PRC Central Government in order for it to purchase medical products (including medicines) required to respond to major disasters, epidemics and other emergencies pursuant to the Measures of the State for the Financial Administration of Medical Reserve Funds (國家醫藥儲備基金財務管理辦法). Upon approval of CNPGC and the relevant PRC government authorities, this fund may be used by us to offset trade receivables from specific customers who received medical merchandise from us where there is any major disaster, epidemic and other emergency. In the years ended 31 December 2006, 2007 and 2008, we used funds of RMB59.2 million, RMB437,000 and RMB4,000, respectively, to offset trade receivables of such customers. For the five months ended 31 May 2009, we did not use any medical reserve funds to offset trade receivables from our customers. With respect to these transactions, we recognized the delivery of the pharmaceutical products and medical reserves as pharmaceutical distribution sales, which were made on a cost break even basis without profit margin.

Prepayments and other receivables

Prepayment and other receivables comprise prepayments, value-added tax recoverables, deposits, staff advances, prepaid expenses, receivables arising from disposal of land use rights, amounts due from related parties and other receivables, less provision for impairment. Prepayments primarily represent prepayments to our suppliers in connection with our purchase of pharmaceutical and healthcare products and, to a lesser extent, the prepayments in relation to construction work and operating expenses. Deposits primarily represent security bonds provided in the hospital tendering process and rental deposits for leased properties. Staff advances primarily include prepayments to staff of relevant expenses for business trips. Other receivables primarily include export tax refunds and receivables from disposal of our subsidiaries. As of 31 December 2006, 2007 and 2008 and 31 May 2009, our prepayments and other receivables, after provisions for impairment, were RMB519.2 million, RMB605.5 million, RMB616.9 million and RMB572.3 million, respectively.

As of 31 December 2006, 2007 and 2008 and 31 May 2009, we had provisions for impairment of prepayment and other receivables of approximately RMB55.8 million, RMB74.5 million, RMB51.3 million and RMB41.6 million, respectively. Such provisions primarily consist of our provisions for impairment of the receivables arising from disposals of land use rights and subsidiaries, prepayments to third parties and advances to a supplier. The changes in our provisions for impairment of prepayments and other receivables was primarily due to our recovery of certain receivables arising from disposal of land use rights in 2008, for which we had previously made provisions in 2007. Such recovery, in the amount of approximately RMB18.9 million, was paid by the purchaser of our land use rights in 2008.

Available-for-sale financial assets

Available-for-sale financial assets are our non-derivative financial assets in listed and unlisted equity securities that are designated as available-for-sale and not classified in the categories of financial assets at fair value through profit or loss or loans and receivables. The fair value of listed equity investments is based on quoted market value. The fair value of unlisted investments is determined based on the consideration for disposal of similar available-for sale financial assets by us during relevant periods, or if there is no disposal or similar investment during relevant periods, we estimate the fair values of these investments based on the historical performance of these companies, market conditions and the prospects for the applicable company's industry. The following table sets forth a breakdown of our available-for-sale financial assets as of the dates indicated:

	As of 31 December			As of 31 May
	2006	2007	2008	2009
	(RMB in thousands)			
Listed equity investments, at fair value	16,165	35,828	21,137	36,521
Unlisted equity investments, at fair value	19,500	21,154	31,789	21,144
	35,665	56,982	52,926	57,665
Less: Current Portion	(15)	(15)	(15)	(15)
	35,650	56,967	52,911	57,650

Our listed equity investments mainly consisted of our investments in Jiangsu Lianhuan Pharmaceutical Co., Ltd., a company listed on the Shanghai Stock Exchange. The changes in the amounts of our listed investments were primarily due to the changes in the market price of the shares of Jiangsu Lianhuan Pharmaceutical Co., Ltd. on the Shanghai Stock Exchange.

Trade payables

Our trade payables mainly comprise amounts outstanding for our purchasing of merchandise and raw materials. We recognize our trade payables initially at fair value and subsequently measure them at amortized cost using the effective interest method.

The following table sets forth our trade payables as of the dates indicated:

	As of 31 December			As of 31 May
	2006	2007	2008	2009
	(RMB in millions)			
Account payables	4,241.9	5,298.2	6,380.5	7,776.1
Notes payables	1,387.9	1,911.4	2,672.6	2,628.1
Total	5,629.8	7,209.6	9,053.1	10,404.2

The following table sets forth an aging analysis of trade payables as of the dates indicated:

	As of 31 December						As of 31 May	
	2006		2007		2008		2009	
	RMB	(%)	RMB	(%)	RMB	(%)	RMB	(%)
	(in millions, except for percentages)							
Current to three months	4,745.5	84.4	6,445.5	89.4	8,266.7	91.4	9,584.6	92.1
Three to six months	394.7	7.0	441.7	6.1	293.8	3.2	481.1	4.6
Six months to one year	272.8	4.8	148.0	2.1	254.1	2.8	122.2	1.2
One to two years	56.6	1.0	46.3	0.6	76.6	0.8	60.7	0.6
Over two years	160.2	2.8	128.1	1.8	161.9	1.8	155.6	1.5
Total	**5,629.8**	**100.0**	**7,209.6**	**100.0**	**9,053.1**	**100.0**	**10,404.2**	**100.0**

For purchase of pharmaceutical products, our suppliers of pharmaceutical distribution and retail pharmacy operations generally grant us a credit period of up to 180 days. In 2008, the credit period granted by our suppliers ranged from 45 to 180 days. We settle outstanding payables through bank note and wire transfer.

The following table sets forth the turnover days of our trade payables for the periods indicated:

	Year ended 31 December			Five months ended 31 May
	2006	2007	2008	2009
Turnover days of trade payables[(1)]	84.7	82.0	84.4	87.9

(1) Turnover days of trade payables is derived by dividing the arithmetic mean of the opening and closing balances of trade payables for the relevant period by cost of sales and multiplied by 365 days with respect to turnover days of trade payables for a year or multiplied by 150 days with respect to turnover days of trade payables for a five-month period.

The stability of our trade payables during the Track Record Period was primarily due to our working capital management efforts and was in line with the stable turnover days of our trade receivables.

Accruals and other payables

Accruals and other payables comprise accruals of operating expenses, account receivables collection on behalf of banks for factoring programs, salary and welfare payables, advances from customers, other deposits, tax payable other than income tax and value-added tax, amounts due to related parties and other payables. Accruals of operating expenses primarily represent payables in connection with transport and consulting services. Salary and welfare payables primarily represent accruals of annual bonuses for the previous financial year. Other payables primarily include sales rebates and various payables required for our daily business operations. As of 31 December 2006, 2007 and 2008 and 31 May 2009, our accruals and other payables were RMB872.5 million, RMB996.9 million, RMB860.5 million and RMB1,028.0 million, respectively.

Liquidity ratios

Our current assets divided by current liabilities, or current ratio, was 1.14, 1.09, 1.15 and 1.14 as of 31 December 2006, 2007 and 2008 and 31 May 2009, respectively. Our current assets after subtraction of inventories divided by current liabilities, or quick ratio, was 0.89, 0.85, 0.89 and 0.89 as of 31 December 2006, 2007 and 2008 and 31 May 2009, respectively.

Our cash and cash equivalents and pledged deposits exceeded our total interest-bearing borrowings during the Track Record Period, and therefore, we were in a net cash position. As of

31 December 2006, 2007 and 2008 and 31 May 2009, we had cash and cash equivalents of RMB1,838.8 million, RMB1,955.6 million, RMB1,712.1 million and RMB2,602.1 million, respectively.

Indebtedness

As of 31 May 2009, we had aggregate banking facilities of RMB12,920.5 million available to us, of which we had RMB6,602.1 million that were not utilized and available to be drawn down. These banking facilities primarily comprised short-term working capital loans. Of our total borrowings as of 31 May 2009, RMB2,464.9 million was due within one year and RMB60.0 million was due within a period of more than one year. During the Track Record Period, we did not experience any difficulties with renewing our bank loans with our lenders. The following table sets forth a breakdown of our short-term and long-term borrowings as of the dates indicated.

	As of 31 December			As of 31 May	As of 31 July
	2006	2007	2008	2009	2009
					(unaudited)
			(RMB in millions)		
Short-term bank borrowings[1]	1,704.4	1,521.6	1,504.2	2,464.9	2,507.0
Long-term bank borrowings	177.7	157.7	130.0	60.0	60.0
Parent company borrowings	-	640.0	-	-	-
Total	1,882.1	2,319.3	1,634.2	2,524.9	2,567.0

(1) Includes current portion of long-term borrowings.

As of 31 May 2009, all of our bank borrowings bore variable interest at rates ranging from 3.65% to 7.20% per year, calculated based upon the current PBOC benchmark rate, which was 5.31% as of 31 May 2009. Substantially all of our bank borrowings were denominated in Renminbi.

As of 31 December 2006, 2007 and 2008 and 31 May 2009, the weighted average interest rate on our bank borrowings was 5.2%, 5.7%, 5.8% and 4.9%, respectively. The interest rates of our RMB denominated bank borrowings are reset periodically according to the benchmark rate announced by the PBOC.

The following table sets forth a breakdown of our secured and unsecured bank borrowings as of the dates indicated:

	As of 31 December			As of 31 May	As of 31 July
	2006	2007	2008	2009	2009
					(unaudited)
			(RMB in millions)		
Unsecured bank borrowings	1,761.2	863.2	1,208.6	2,129.3	2,180.5
Secured bank borrowings	120.9	816.1	425.6	395.6	386.5
Total	1,882.1	1,679.3	1,634.2	2,524.9	2,567.0

Our secured bank loans are generally secured by:

- pledges over certain of our property, plant and equipment, which had an aggregate net book value of approximately RMB155.1 million, RMB213.6 million, RMB147.6 million and RMB65.6 million as of 31 December 2006, 2007 and 2008 and 31 May 2009, respectively;

- pledges over our land use rights, which had an aggregate net book value of approximately RMB42.2 million, RMB41.4 million and RMB40.6 million as of 31 December 2006, 2007 and 2008, respectively;
- pledges over our investment properties, which had an aggregate net book value of RMB30.0 million as of 31 December 2007;
- pledges over our bank deposits, which were in an aggregate amount of RMB446.1 million, RMB8.4 million and RMB18.0 million as of 31 December 2007 and 2008 and 31 May 2009, respectively; and
- pledges over our notes receivables, which were in an aggregate amount of approximately RMB122.5 million, RMB234.2 million and RMB204.8 million as of 31 December 2007 and 2008 and 31 May 2009, respectively, and accounts receivables, which were in an aggregate amount of approximately RMB44.3 million and RMB86.1 million as of 31 December 2008 and 31 May 2009.

As of 31 May 2009, none of our borrowings were guaranteed by CNPGC or Sinopharm Investment.

The following table sets forth the maturity profile of our interest-bearing bank borrowings as of the dates indicated:

	As of 31 December			As of 31 May	As of 31 July
	2006	2007	2008	2009	2009
					(unaudited)
	(RMB in millions)				
Within one year	1,704.4	1,521.6	1,504.2	2,464.9	2,507.0
Between 1-2 years	-	57.7	30.0	30.0	30.0
Between 2-5 years	177.7	100.0	100.0	30.0	30.0
Over 5 years	-	-	-	-	-
Total	**1,882.1**	**1,679.3**	**1,634.2**	**2,524.9**	**2,567.0**

Our gearing ratio was 107%, 138%, 72% and 98% as of 31 December 2006, 2007 and 2008 and 31 May 2009, respectively. Gearing ratio is our total bank borrowings and loans from our parent company divided by our total equity. The changes in gearing ratio during the Track Record Period was primarily due to borrowings from our parent company in 2007 in the amount of RMB640.0 million, which was repaid in December 2008 and the increase in short-term borrowings in the five months ended 31 May 2009.

Our borrowing requirements are not subject to seasonality. Other than as disclosed above, there has been no material change in our indebtedness since 31 May 2009.

The agreements under our banking facilities contain certain customary covenants. Several of our loan agreements for our bank borrowings restrict our ability to pay dividends or make early repayments and require us to maintain certain financial ratios. We were in compliance with all relevant covenants in our loan agreements as of the Latest Practicable Date. We do not believe that these covenants will have a material adverse effect on our ability to make additional borrowings or issue debt or equity securities in the future.

As of 31 December 2007, we also had borrowings from our parent company in the amount of RMB640.0 million. The loan from our parent company was unsecured and bore interest at a weighted average rate of 4.0% for the year ended 31 December 2007 and we repaid the loan to our parent company in December 2008. We had no outstanding shareholders' loans as of 31 December 2006 and 2008.

Contingent liabilities

As of 31 July 2009, our Company did not have any hire purchase commitments, guarantees or other material contingent liabilities.

Advances to Related Parties

As of 31 December 2006, 2007 and 2008 and 31 May 2009, the amount of advances we made to related parties was approximately RMB49.2 million, RMB38.3 million, RMB29.1 million and RMB39.3 million, respectively. Such advances were mainly short-term funds provided to maintain business relationships with our related parties and at the related parties' requests. We did not receive any interest from such advances during these years.

Pursuant to the relevant PRC laws and regulations, including but not limited the PRC General Rules on Loans (貸款通則), no PRC corporation is allowed to make any advancement of a loan to another corporation without approval. Failure to comply with the PRC General Rules on Loans may subject the lender to a fine of not less than one time but not more than five times the amount of the illegal gains as a result of the breach. According to our PRC legal counsel, Chen & Co. Law Firm, our advances made to related parties constituted breaches of the General Rules on Loans and our Articles of Association. However, since we did not receive any gains or interest from such advances, our PRC legal advisers, Chen & Co. Law Firm, are of the view that we will not be subject to any penalties or liability for such advances. In addition, as we will not be subject to any penalties or liability for such advances to related parties, our PRC counsel is of the view that our Directors also will not be subject to any liability for interest-free advances, in accordance with the PRC Company Law and our Articles of Association. Notwithstanding this, Sinopharm Investment will indemnify us for any losses or damages arising from the advances made if we are subject to any penalty or fine resulting from our non-compliance of the PRC General Rules on Loans.

As of the Latest Practicable Date, such advances were repaid in full. In order to ensure that similar advances will not recur in the future, our senior management and executive directors will adhere to and monitor more closely our compliance with relevant PRC laws and regulations and our Articles of Association. We will also distribute lists of our related parties internally to our subsidiaries and our internal control, finance and compliance departments will conduct audits from time to time in this regard.

Commitments and Contractual Obligations

Commitments

Operating leases

We lease certain buildings under operating lease arrangements, with leases negotiated for terms ranging from one to five years. The terms of the leases generally require us to pay security deposits. The following table sets forth our future aggregate minimum operating lease payments under non-cancelable operating leases as of the dates indicated:

	As of 31 December			As of 31 May
	2006	2007	2008	2009
	(RMB in millions)			
No later than one year	21.9	36.9	50.6	64.0
Later than one year and not later than five years	27.0	82.3	87.8	108.9
Later than five years	-	-	-	
Total	**48.8**	**119.2**	**138.4**	**172.9**

Capital commitments

In addition to operating lease commitments, we also have certain capital commitments. The following table sets forth our capital commitments as of the dates indicated:

	As of 31 December			As of 31 May
	2006	2007	2008	2009
	(RMB in millions)			
Contracted, but not provided for:				
In respect of the acquisition of property, plant and equipment	58.3	88.7	47.4	28.3
Authorized, but not contracted for:				
In respect of the acquisition of property, plant and equipment	219.6	334.2	138.4	121.8

The capital commitments described above are with respect to expansion of existing facilities and construction of new logistics facilities used in our pharmaceutical distribution and chemical reagent operations and production facilities for our pharmaceutical manufacturing operations. Our sources of funding for such capital commitments are cash generated from our operations and bank borrowings.

There has been no material change to our indebtedness and capital commitments since 31 July 2009.

Contractual obligations

As of 31 May 2009, our contractual obligations amounted to RMB2,878.8 million, arising from debt obligations, operating lease commitments and capital commitments. The following table sets forth our contractual obligations as of 31 May 2009.

	Payments Due by Period				
	Total	Less than 1 year	1-2 years	2-5 years	More than 5 years
	(RMB in millions)				
Debt obligations[1]	2,524.9	2,464.9	30.0	30.0	-
Interest on debt obligations[2]	30.9	28.9	1.8	0.2	-
Operating lease commitments	172.9	64.0	47.8	61.2	-
Capital commitments	150.1	150.1	-	-	-
Total	2,878.8	2,707.9	79.6	91.4	-

(1) Excludes required interest payments. Interest on debt obligations is reflected in a separate line in the table.

(2) Interest on loans is calculated based on the current interest rate of each loan, ranging from 3.65% to 7.20% per annum, using the PBOC benchmark rate of 5.31% as of 31 May 2009.

Off-balance Sheet Arrangements

As of 31 May 2009, being the date of our most recent financial statements, we did not have any off-balance sheet arrangements.

Quantitative and Qualitative Analysis about Market Risk

We are exposed to various types of market risks in the ordinary course of our business, including fluctuations in interest rates and foreign exchange rates, credit risk, liquidation risk and inflation risk. We manage our exposure to these and other market risks through regular operating and financial activities.

In 2008, triggered by the liquidity crisis in the capital markets, global economic conditions deteriorated. Although the PRC continued to have positive GDP growth in the year, the rate of growth slowed down significantly compared to the preceding year, and major economic indicators, including employment rates, levels of consumer spending and exports, declined. In addition, many financial institutions worldwide tightened lines of credit, reducing funding available for near-term economic growth. In addition, the terms of such funding, when available, became more onerous and the cost of such funding increased. Further, capital markets activity declined, also contributing to general reductions in available funding for business expansion, and the equity and currency markets exhibited high levels of volatility. Pharmaceutical consumption has traditionally been relatively unaffected by economic downturns; however, an extended downturn could lead to a decline in overall prescriptions and sales of pharmaceutical products corresponding with the growth of the uninsured and underinsured population in China. Although the PRC Government has announced fiscal stimulus measures to combat the effects of the economic downturn, including spending an additional RMB850 billion from 2009 to 2011 on a healthcare reform plan to increase healthcare infrastructure, the availability and coverage of health insurance and healthcare spending, such measures may not be successful or may take a significant period of time to increase the level of economic activity. We will monitor the potential impact of global economic conditions and accompanying credit tightening, as well as the creditworthiness of our customers and suppliers, and the PRC Government's fiscal stimulus and healthcare reform efforts and its other involvement in the economic crisis. We are not able to currently predict, however, when economic and liquidity conditions will improve, or what the full impact of these conditions will be on our financial condition and results of operations.

Interest rate risk

Our exposure to the risk of changes in market interest rates primarily relates to our interest-bearing borrowings. We regularly review and monitor the level of a mix of fixed and floating rate borrowings in order to manage the interest rate risk. As of 31 May 2009, we had RMB2,524.9 million in bank borrowings that bore variable interest rates ranging from 3.65% to 7.20%, with a weighted average interest rate of 4.9% as of 31 May 2009.

Additional increases in interest rates could potentially result in an increase in our cost of borrowing, which could negatively affect our business and results of operations. The PBOC regulates the interest rates of our Renminbi-denominated borrowings. On 28 October 2004, the PBOC raised both its benchmark lending and deposit interest rates by 0.27% to 5.58% for one-year Renminbi loans and 2.25% for one-year deposits, respectively, with effect from 29 October 2004. This increase was the first time lending and deposit interest rates had been raised since July 1995 and July 1993, respectively. The PBOC also abolished the upper limit on Renminbi lending rates and permitted banks to offer deposit rates below the PBOC benchmark rate. From April 2006 to September 2008, the PBOC has further raised its benchmark lending interest rates for one-year Renminbi loans seven times, most recently in December 2007 by 0.18%. However, since September 2008, the PBOC lowered its benchmark lending interest rates for one-year Renminbi loans five times, most recently in December 2008 by 0.27%. As of the date of this document, the current lending interest rate for one-year Renminbi loans is 5.31% per year. The PBOC-published benchmark one-year lending rates in China as of 31 December 2006, 2007 and 2008 and 31 May 2009 were 6.12%, 7.47%, 5.31% and 5.31%, respectively. As of 31 December 2006, 2007 and 2008 and 31 May 2009, if interest rates on bank borrowings had been 15% higher/lower than the actual primary rates, announced by the PBOC of 6.12%, 7.47%, 5.31% and 5.31%, respectively with all other variables held constant, our post-tax profit for the years would have been approximately RMB7.1 million, RMB8.1 million, RMB13.7 million and RMB5.3 million respectively, lower/higher, mainly as a result of higher/lower interest expense on bank borrowings.

We do not anticipate a significant impact resulting from changes in interest rates, although our future interest income and interest expenses may fluctuate in line with changes in interest rates. We have not historically used, and do not expect to use in the future, any derivative financial instruments to manage our interest rate exposure.

Foreign exchange risk

Substantially all of our revenue and expenses are denominated in RMB. As a result, our exposure to fluctuations in foreign currencies is not substantial. However, we are exposed to some degree of fluctuations in foreign currencies. We receive foreign currencies for the sale of pharmaceutical products overseas in our other business operations. In the five months ended 31 May 2009, we received approximately 0.3% of our revenues in foreign currencies, derived from sales to overseas customers in our other business operations. We also need foreign currencies to make our purchases of pharmaceutical products from our overseas suppliers for our pharmaceutical distribution and retail pharmacy operations. We also use foreign currencies to pay for imported equipment and materials. As of 31 May 2009, our cash and cash equivalents denominated in foreign currencies primarily consisted of US$307,459 as well as Euro96,501 and our trade payables denominated in foreign currencies primarily consisted of US$82.4 million and Euro 6,705.

The Renminbi is not freely convertible into other currencies and conversion of the Renminbi into foreign currencies is subject to foreign exchange control rules and regulations promulgated by the

PRC Government. In July 2005, the PRC Government introduced a managed floating exchange rate system to allow the Renminbi to fluctuate within a regulated band based on market supply and demand and by reference to a basket of currencies. On the same day, the Renminbi appreciated by approximately 2% against the U.S. dollar. The PRC Government has since made, and may in the future make, further adjustments to the exchange rate system. When the Renminbi appreciates, the value of foreign currency denominated assets will decline against the Renminbi.

We use Renminbi as the reporting and functional currency for our financial statements. All transactions in currencies other than Renminbi during the year are recorded at the exchange rates prevailing on the respective relevant dates of such transactions. Monetary assets and liabilities existing at the balance sheet date denominated in currencies other than Renminbi are re-measured at the exchange rates prevailing on such date. Exchange differences are recorded in our consolidated income statement. Fluctuations in exchange rates may also affect our balance sheet.

As of 31 December 2006, 2007 and 2008 and 31 May 2009, if the exchange rate of the RMB had increased or decreased by 10% against the U.S. dollar, HK dollar and the Euro, respectively, with all other variables held constant, our post-tax profit for the years and period would have increased or decreased by approximately RMB8.6 million, RMB38.9 million, RMB19.7 million and RMB46.0 million, respectively, mainly as a result of foreign exchange loss or gain on translation of U.S. dollar, HK dollar and Euro denominated cash and cash equivalents and trade payables.

We do not believe that we currently have any significant direct foreign currency exchange rate risk and have not hedged exposures denominated in foreign currencies or any other derivative financial instruments.

Credit risk

Substantially all of our cash and cash equivalents are held in major financial institutions located in China, which our management believes are of high credit quality. We have policies that limit the amount of credit exposure to any financial institutions. In addition, our sales to retail customers are made in cash or by credit card to limit the amount of credit exposure to any wholesale customers. Our historical experience in collection of trade receivables falls within the recorded allowances. Moreover, because our exposure is spread over a diversified portfolio of customers, there is no significant concentration of credit risk.

However, disruptions in the worldwide financial markets and other macroeconomic challenges currently affecting the PRC economy and the global economic outlook could adversely affect our customers and suppliers in a number of ways, which could adversely affect us. The slowdown in the growth of the PRC economy, and any attendant affects on the levels of consumer and commercial spending may cause customers to reduce, modify, delay or cancel plans to purchase our products, and may cause suppliers to reduce their sales to us or change terms of sales. If our customers' cash flow or operating and financial performance deteriorates, or if they are unable to make scheduled payments or obtain credit, they may not be able to pay, or may delay payment of, trade receivables owed to us. Likewise, for similar reasons, suppliers may restrict credit or impose different payment terms. Any inability of our customers to pay us for products or demands by suppliers for different payment terms may have an adverse impact on our management's cash flow forecasts and assessment of the impairment of trade receivables. To the extent that information is available, our management has properly reflected revised estimates of expected future cash flows in their impairment assessments. As of the Latest Practicable Date, we had not experienced any material adverse change to our business operations or our cash flows as a result of the recent disruptions in global economic conditions, nor have we been subject to any bankruptcy filings or defaults on the part of our major suppliers or customers.

Liquidity risk

Our liquidity is primarily dependent on our ability to maintain adequate cash inflows from our operations to meet our debt obligations as they become due, and our ability to obtain external financing to meet our committed future capital expenditures. We currently finance our working capital requirement through a combination of funds generated from operations and bank borrowings. We had obtained banking facilities of approximately RMB12,920.5 million mainly from various reputable commercial banks in the PRC as of 31 May 2009, of which an amount of approximately RMB6,602.1 million was not utilized, and the cash outflows of our Company from investing activities were less than RMB300.0 million in each of the periods in the Track Record Period. Taking into account these factors and our expected cash generated from operations, and taking into account the planned expansion in our business activities in the coming year, the Directors are of the view that we will not have any difficulty in obtaining sufficient financial resources to meet our liquidity needs within 12 months from the date of this document. In addition, as most of our banking facilities were obtained from various PRC reputable commercial banks, the Directors are also of the view that our unutilized banking facilities will not be significantly affected by sub-prime lending issues which are currently affecting certain overseas commercial banks.

In this regard, our access to credit markets has not been adversely affected by the recent liquidity crisis and accompanying credit tightening by financial institutions. As of the Latest Practicable Date, we had not been subject to any notice of withdrawal, or potential withdrawal, of our existing or committed bank credit facilities, nor have we received any requests by bank or other creditors to repay outstanding loan facilities or debt securities in advance of their maturity dates or to increase the amount of collateral for any secured bank borrowings or debt securities. However, although we believe we will be able to fund our outstanding commitments and renew our outstanding bank credit facilities, we are subject to various risks and uncertainties in our ability to do so. The ongoing liquidity crisis could affect our ability to obtain new borrowings or refinance our existing borrowings at the same terms and costs of previous borrowings. We believe we are taking all necessary measures to maintain sufficient liquidity reserves to support the sustainability and growth of our business in the current circumstances and to repay our outstanding borrowings when they fall due.

Inflation risk

In the year ended 31 December 2008 and the five months ended 31 July 2009, the Customer Price Index in China increased to 105.9% and decreased to 98.2%, respectively, according to the PRC National Bureau of Statistics. Our directors are of the view that inflation has not had a material effect on our results of operations.

PROFIT FORECAST

We believe that on the bases and assumptions as set out in Appendix III to this document and in the absence of unforeseen circumstances as set forth in Rule 11.17 of the Hong Kong Listing Rules, our forecast consolidated profit attributable to equity holders of the Company for the year ending 31 December 2009 is expected to be not less than RMB[●] million under HKFRS.

DIVIDEND POLICY

We declared approximately RMB165.8 million, RMB298.2 million, RMB105.7 million and RMB279.5 million as dividends for the years ended 31 December 2006, 2007 and 2008, and the five months ended 31 May 2009, respectively. Our Board of Directors will determine the payment of future dividends, if any, with respect to our Shares on a per Share basis. Any dividend shall be subject to shareholders' approval. Under the PRC Company Law and our Articles of Association, all of our shareholders have equal rights to dividends and distribution.

For holders of our Domestic Shares, cash dividend payments, if any, will be declared by our Board of Directors, subject to shareholders' approval, in Renminbi and paid in Renminbi.

In addition to cash, dividends may be distributed in the form of Shares. Any distribution of Shares, however, must be approved by special resolution of the shareholders. For holders of our Domestic Shares, dividends in the form of Shares will be distributed in the form of additional Domestic Shares.

The declaration of dividends is subject to the discretion of our Board of Directors and the approval of our shareholders, which we expect will take into account factors such as the following:

- our financial results;
- our shareholders' interests;
- general business conditions and strategies;
- our capital requirements;
- contractual restrictions on the payment of dividends by us to our shareholders or by our subsidiaries to us;
- taxation considerations;
- possible effects on our creditworthiness;
- statutory and regulatory restrictions; and
- any other factors our Board of Directors may deem relevant.

In accordance with the applicable requirements of the PRC Company Law, we may only distribute dividends after we have made allowance for:

- recovery of accumulated losses, if any;
- allocations to a statutory common reserve fund equivalent to 10% of our after-tax profit attributable to equity holders of the Company, as determined under PRC accounting rules and regulations; and
- allocations to a discretionary common reserve fund as approved by our shareholders in a shareholders' meeting.

The allocations to the statutory common reserve fund is currently 10% of our after-tax profit attributable to equity holders of the Company for the fiscal year determined in accordance with PRC accounting rules and regulations. When the accumulated allocations to the statutory common reserve fund reach 50% of our Company's registered capital, we will no longer be required to make allowances for allocation to the statutory common reserve fund.

Under PRC law, dividends may be paid only out of distributable profits, which are our retained earnings, as determined in accordance with PRC accounting rules and regulations and HKFRS, whichever is lower, less allocations to the statutory and discretionary common reserve fund. We will not ordinarily pay any dividends in a year in which we do not have any distributable profits.

A Special Dividend is expected to be paid to CNPGC and Sinopharm Investment by 31 December 2009. For details regarding the Special Dividend, please refer to the section headed "Special Dividend" below. In addition, the Company intends to distribute not less than 25% of its distributable profits as of 31 December 2009. However, we can give no assurance that any dividends ultimately will be paid. You should consider the assumptions underlying our forecast contained in "Appendix III — Profit Forecast" to this document, the risk factors affecting our Company contained in the section headed "Risk Factors" and the cautionary notice regarding forward-looking statements contained in the section headed "Forward-looking Statements" in this document.

SPECIAL DIVIDEND

On 22 December 2008, our shareholders' meeting resolved to distribute to CNPGC and Sinopharm Investment our distributable profits as of the last day of the month immediately preceding [●], after making the required allocations for the statutory common reserve fund (the "Special Dividend").

Assuming [●] is in September 2009, we estimate that the Special Dividend will not exceed RMB833.8 million, by reference to our consolidated retained earnings as of 31 May 2009 in the amount of RMB644.8 million and our estimated distributable profits generated in the period from 1 June 2009 to 31 August 2009 in the amount of approximately RMB189.0 million, which is calculated based on our profit forecast for the year ending 31 December 2009 and after making the required allocations for the statutory common reserve fund. Our two listed subsidiaries will declare and pay their dividends, subject to approval by their respective shareholders.

Pursuant to an ordinary resolution passed by our shareholders on 19 August 2009, we declared our audited distributable profits as of 31 May 2009, being part of the Special Dividend, in the total amount of RMB279.5 million (the "First Special Dividend") to CNPGC and Sinopharm Investment. The First Special Dividend was fully paid on 31 August 2009 and was financed by our internal cash resources. The rest of the Special Dividend (the "Final Special Dividend"), which we estimate will not exceed RMB554.3 million, will be declared and paid after [●]. The financial statements of the Company as of the last day of the month immediately preceding [●] will be audited (the "Special Audit"). The Final Special Dividend will be determined based on our distributable profits as reflected in such audited financial statements prepared in accordance with PRC GAAP or HKFRS, whichever is lower, after making allocations for the required statutory common reserve fund. We will only declare and pay the Final Special Dividend after completion of the Special Audit, following which we will publish an announcement of the actual amount of the Final Special Dividend. The Final Special Dividend is expected to be paid to CNPGC and Sinopharm Investment by 31 December 2009 from our available cash and cash equivalents on hand.

Although the Final Special Dividend will only be paid after [●], our Directors consider the Company's cash resources are sufficient to cover the full payment of the Final Special Dividend.

We have sufficient cash surplus to finance our operations from internally generated cashflow and to maintain a satisfactory financial position through the steady growth of our business. As of 31 July 2009, our Company's total unaudited balance of cash and cash equivalents were approximately RMB1,661.0 million, before the payment of the First Special Dividend of RMB279.5 million. In addition, our Directors estimate that our consolidated net profit attributable to our Shareholders for the eight months ended 31 August 2009 will not be less than RMB560 million. In light of the above, our Directors are of the view that we have, and will have, sufficient funds to make payment of the Final Special Dividend, and we will continue to have sufficient working capital upon the full payment of the Final Special Dividend without using any of the net proceeds from the [●].

Our Directors further confirm that the payment of the Final Special Dividend will not adversely affect our financial position, having regard to our operating cash flow and the expected timing of such payment.

Investors in the [●] should note that they will not be entitled to share in the Final Special Dividend, and therefore, any distributable profits available for distribution to the Company's shareholders after the [●] will exclude the amount of the Final Special Dividend to be paid to CNPGC and Sinopharm Investment.

The declaration of the Special Dividend is made by us as a commercial decision. The amount of the Special Dividend is not indicative of our Company's future profits or the dividends that we may declare or pay in the future.

DISTRIBUTABLE RESERVES

According to our Articles of Association, the amount of retained profits available for distribution to our shareholders is the lower of the amount determined in accordance with PRC accounting rules and regulations and the amount determined in accordance with HKFRS. As of 31 May 2009, we had distributable profit amounting to approximately RMB279.5 million, which was determined according to HKFRS after deduction of the minimum transfers to the statutory common reserve fund as set out above.

PROPERTY VALUE RECONCILIATION

Particulars of our property interests are set out in Appendix V to this document. Jones Lang LaSalle Sallmanns Limited has valued our property interests as of 30 June 2009. A summary of values and valuation certificates issued by Jones Lang LaSalle Sallmanns Limited are included in Appendix V to this document.

The table below sets forth the reconciliation of aggregate amounts of buildings from our audited consolidated financial statements as of 31 May 2009 to the unaudited net book value of our Company's property interests as of 30 June 2009:

	(RMB in millions)
Net book value of our property interests as of 31 May 2009	886.2
Addition	2.9
Depreciation	(4.3)
Disposal	(6.8)
Net book value as of 30 June 2009	878.0
Valuation surplus as of 30 June 2009	631.3
Valuation on land use right as of 30 June 2009 per "Appendix V — Property Valuation"	640.6
Valuation as of 30 June 2009 per "Appendix V — Property Valuation"	2,149.8

NO MATERIAL ADVERSE CHANGE

Our Directors confirm that they have performed sufficient due diligence to ensure that, up to the date of this document, there has been no material adverse change in our financial or trading position since 31 May 2009 (being the date to which our Company's latest consolidated audited financial results were prepared) and there is no event since 31 May 2009 which would materially affect the information shown in the Accountant's Report set out in Appendix I to this document.