Dragonite International Limited

叁龍國際有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 329)

Interim Report 2010

Corporate Information

EXECUTIVE DIRECTORS

Mr. Wong Yin Sen
Mr. Hon Lik
Mr. Wong Hei Lin
Ms. Ching Yuen Man, Angela
(appointed on 28 April 2010)
Mr. Au Yeung Kai Chor
(appointed on 7 May 2010)

NON-EXECUTIVE DIRECTOR

Mr. Frank H. Miu
(appointed as executive director on 12 April 2010 and re-designated as non-executive director on 7 May 2010)

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Pang Hong
Mr. Cheung Kwan Hung
(resigned on 28 June 2010)
Mr. Ding Xun
(resigned on 28 June 2010)
Mr. Chung Yuk Lun
(appointed on 14 April 2010)
Mr. Liu Kwong Sang
(appointed on 19 April 2010)
Mr. Lam Man Sum, Albert
(appointed on 28 April 2010)

AUDIT COMMITTEE

Mr. Pang Hong
Mr. Cheung Kwan Hung
(resigned on 28 June 2010)
Mr. Ding Xun
(resigned on 28 June 2010)
Mr. Chung Yuk Lun
(appointed on 14 April 2010)
Mr. Liu Kwong Sang
(appointed on 19 April 2010)
Mr. Lam Man Sum, Albert
(appointed on 28 April 2010)

COMPANY SECRETARY

Mr. Chan Yiu Nam

REGISTERED OFFICE

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

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

15th Floor
Hong Kong and Macau Building
Nos. 156-157 Connaught Road Central
Hong Kong

Corporate Information

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fulcrum Group (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 609
Grand Cayman, KY1-1107
Cayman Islands

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

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

PRINCIPAL BANKERS

in Hong Kong:

The Hong Kong and Shanghai Banking
Corporation Limited

in the PRC:

China Construction Bank
Shenyang Economic and Technology
Development Zone Branch

WEBSITE

www.dragonite.com.hk

STOCK CODE

329

Management Discussion and Analysis

BUSINESS REVIEW AND MARKET CONDITIONS

The following is the business review of the Group for the six-month ended 30 June 2010 (the "period under review") presented by the board of the directors of the Company (the "Board").

During the period under review, the Group recorded an unaudited consolidated turnover of approximately HK$14,576,000, representing a decrease of approximately 90% when compared with approximately HK$145,286,000 in the corresponding period in 2009. The unaudited consolidated loss attributable to shareholders for the period under review was approximately HK$134,653,000 (corresponding period in 2009: HK$6,521,000). On these bases, the loss per share for the period under review was approximately HK6.79 cents (corresponding period in 2009: approximately HK 0.37 cents).

Loss for the period increased by 1965% to approximately HK$134,653,000 when compared with the corresponding period in 2009 which was mainly attributed to the following adverse factors:

1. The sales of electronic cigarettes products were significantly reduced as a result of the growing threat from counterfeit brands and new regulatory restriction imposed against import of electronic cigarettes products by some overseas countries including but not limited to North America and Israel. Moreover, as mentioned in the annual report for the year ended 31 December 2009 of the Company (the "2009 Annual Report"), quality issue happened in one of our electronic cigarettes products in September 2009, sales return was continuously recorded in current period, which resulted in a negative turnover in the electronic cigarettes segment.

2. Since the second half of 2009, the Group was seriously affected by poor financial performance and lack of working capital to finance its trading operation. In order to improve the working capital of the Group by speeding up the selling of the inventory, the selling prices of the products were significantly reduced. As a result, low gross profit was recorded in current period.

3. Provision for impairment of inventory at about HK$41,114,000 was made as a result of technical or commercial obsolescence. Provision was also made for the returned electronic cigarette products due to quality issue mentioned above.

4. In the first half of 2010, the Group was concentrated on various capital restructuring exercises and fund raising activities in order to repay the convertible bonds, improve its working capital and financial position, which included borrowing of loans, placing of shares and rights issue etc. As a result, legal and professional expenses were significantly increased when compared with the corresponding period in 2009.

As for the pharmaceutical business, although the sales of Azithromycin Granules (II)(「阿奇霉素顆粒」) and Rosiglitazone Hydrochloride Capsules(「鹽酸吡格列酮膠囊」), our two key products, both increased during the first half of the year as compared with the same period of last year, their macro-sustainability was still not optimistic. The continued increase in prices of raw materials and energy, continued strategic price reduction of medicine and irrational price competition caused by tendering have brought negative effect to our production and operation. Overall sales and gross profits both decreased compared with the same period of last year.

As mentioned above, the management of the Company was concentrated on capital restructuring exercises to improve its working capital and financial position of the Group in the first half of 2010. Prior to the capital restructuring exercises, the Company was approximately HK$183,000,000 in debt. As at the date of this report, the Company is almost debt free and is operating with a healthy cash flow. The Company is also planning to raise a gross proceeds of at least HK$400 million in the forthcoming capital reorganisation (the "Capital Reorganisation") and rights issue (the "Rights Issue"), which have been announced in the announcement of the Company dated 21 July 2010. A surplus in net cash was sustained. The Group's balance sheet will be significantly strengthened if the Rights Issue can be completed.

Management Discussion and Analysis

In the first half of 2010, the electronic cigarettes business was still significantly affected by threat from counterfeit brands and regulatory restriction imposed on importation of electronic cigarettes products in some overseas markets. Regulatory obstacles have precluded the Company from formally entering markets including Australia, Singapore and Canada. Restrictions on the sales of nicotine-content products have dramatically lessened the appeal of electronic cigarette products in Europe, Japan, Israel and elsewhere. The ambiguous and constantly-shifting regulatory environment in the United States, Israel, Turkey and elsewhere has temporarily restricted all sales of electronic cigarettes in those markets.

Additionally, the exponential pace with which the flood of cheap, low-quality, high-volume counterfeit products have entered international markets in the past two years has had a dramatic effect on the Company's ability to design, market, protect and sell its invention both in the People's Republic of China (the "PRC") and around the world. The lack of concern for consumer safety and overall quality on the part of most of the counterfeit manufacturers and their associated foreign marketers means that not only governments and media but also businesses and consumers are wary of electronic cigarettes – and this has indirectly affected Company's reputation and sales as well.

NEW PRODUCT DEVELOPMENT

The Company owns both the original patents for the electronic cigarette and the RUYAN brand ("RUYAN") around the world.

The Company will launch new versions of its "one-time" use, recyclable RUYAN RAPP® personal vaporizer in the United States and RUYAN Jazz® in the rest of the world in September 2010. These two products will update the larger, 1st-generation products that were launched globally in 2009.

The RUYAN V10 exemplifies the basic principle of greater smoking simulation without the dangers generated by the 4,000 chemicals released with traditional smoking. This product has been test-marketed in selected global markets and will be formally launched to mass markets by the forth quarter of 2010.

Management Discussion and Analysis

RUYAN R&D will continue to develop mass, specialty, high-end and re-packaged products to meet the varied demand for non-tobacco smoking alternatives in various markets.

REGIONAL DEVELOPMENT

In the first half of the fiscal year, the Company continued working closely with partners and potential partners around the world to launch new products, to develop markets, and to address regulatory concerns and competition from illicit brands and manufacturers. A core RUYAN invention patent was approved in the United States and an invention patent was granted in Korea during the period under review.

Progress in United States

The U.S. Food and Drug Administration ("US FDA") has classified electronic cigarettes as drug delivery devices, subject to regulation under the Federal Food, Drug, and Cosmetic Act ("FDCA"). As a result, electronic cigarettes require market authorisation prior to importation and sale into the country. The Company and its partners in United States will continue to work closely with regulatory authorities at the federal and state levels to design and market RUYAN products along an acceptable regulatory path.

As disclosed in the announcement of the Company dated 27 July 2010, the patent application (patent application number 10/587, 707) for electronic atomization cigarette has been approved in the United States by the United States Patent And Trademark Office ("USPTO"). As the USPTO is considered by many patent experts to represent the "gold standard" for patent legitimacy and validity, this patent approval will help eliminate inferior product imitations and ensure high quality and safe products in global markets.

Progress in United Kingdom and Ireland

In February 2009, the Company agreed to cooperate with Nicocigs Ltd ("Nicocigs") of the United Kingdom for distribution of its products within the United Kingdom and Ireland. Nicocigs has established relationships with several prominent wholesalers in these markets and has begun to introduce RUYAN products to pharmaceutical, entertainment, internet, corporate, grocery and hyper-mart channels. Both RUYAN V10 and the new version of RUYAN Jazz® will be launched into large retail channels within the forth quarter of 2010, depending upon the outcome of regulatory considerations underway within the government and due for decision in September 2010. Legal actions against parties suspected of infringement on RUYAN's intellectual property rights in the United Kingdom and Ireland are forthcoming.

Progress in Other Markets

During the period under review, RUYAN products have been test-marketed in several other key markets, including France, Sweden, Malaysia, Russia and India. Sales inroads and sampling have been conducted with customers in many more locations. The Company treats quality and safety as its top concerns. With R&D on new products nearing completion and with the maturity of its patent system, the Company plans aggressive actions on a number of fronts to eliminate inferior product imitations and to ensure high quality and safe products in global markets in the near future.

The Company has already won several patent infringement cases in the PRC and now has the resources to proactively defend its intellectual property rights in global markets.

Management Discussion and Analysis

LIQUIDITY, FINANCIAL ANALYSIS AND CAPITAL STRUCTURE

As at 30 June 2010, the Group's net borrowing was HK$3,711,000 (31 December 2009: HK$152,000,000), in which all of the borrowings represented the liability component of fixed convertible bonds. Gearing ratio of the Group decreased from approximately 343.9% as at 31 December 2009 to approximately 2.24% as at 30 June 2010. This calculation is based on net borrowings mentioned above and shareholders fund of HK$165,865,000 (31 December 2009: HK$44,207,000). Cash and bank balances of approximately HK$37,807,000 (31 December 2009: HK$24,117,000) and total assets of approximately HK$216,987,000 (31 December 2009: HK$271,412,000). Net current assets of the Group on the same date amounted to approximately HK$125,502,000 (Net current liabilities as at 31 December 2009: HK$6,046,000). As at 30 June 2010, the balance of the inventories amounted to HK$52,241,000, representing a decrease of HK$47,036,000 when compared with the balance of that as at 31 December 2009.

As disclosed in the 2009 Annual Report, the Company recorded total borrowings of approximately HK$152 million which represented the outstanding convertible notes ("Convertible Notes"). Such amount was originally due for redemption on 31 July 2010, but for the default of partial payments due on 30 September 2009 and 31 December 2009, rendering the whole outstanding amount repayable on demand.

In February 2010, the Company received a conversion notice that the holder of the Convertible Notes in a principal amount of HK$12,291,390.72 exercised the conversion rights attaching thereto at the conversion price of HK$0.65 per share. As such, a total of 18,909,832 shares of the Company were issued and allotted.

In order to settle the remaining balance of the Convertible Notes and improve the financial position of the Group, the Company had sought new funds through the following exercises during the period:

1) On 21 March 2010, the Company entered into an agreement with a placing agent to place the zero-coupon convertible bonds ("New Convertible Bonds") with an aggregate principal amount of HK$250 million and the principal amount was subsequently reduced to HK$75 million on 7 June 2010. Accordingly, the placing of the New Convertible Bonds has been successfully completed on 22 June 2010 and net proceeds of HK$69.5 million was raised.

   In view of the prosperous future and development of the Company, the Company received conversion notices from certain placees regarding the conversion of their respective New Convertible Bonds in an aggregate amount of HK$70,000,000. As a result, 700 million of new shares have been issued and the outstanding principal amount of the New Convertible Bonds has reduced to HK$5,000,000 as at 30 June 2010.

2) On 16 April, 2010, the Company entered into a loan agreement and a facility letter with a lender which is an independent third party (the "lender"). The lender has agreed to provide to the Company an one year loan facility in the amount of HK$35,000,000 which will be secured by way of a charge over all the shares of Chenlong Group Limited, a wholly-owned subsidiary of the Company. On the same date, the Company had drawdown HK$25,000,000 of this one year loan facility. Details of the loan agreement have been set out in the Company's announcement dated 16 April 2010. The loan amount was fully settled as at 30 June 2010.

3) On 20 April 2010, the Company announced to the proposed rights issue on the basis of one rights share for every two shares held on the record date at the subscription price of HK$0.1 per rights share. This rights issue was completed on 3 June 2010 and net proceeds of HK$76.72 million were raised and 831,802,916 shares have been issued.

4) On 11 June 2010, the Company placed 332,721,166 shares to an independent investor at the subscription price of HK$0.1 per share. The placing was completed on 25 June 2010 and the Company received a net proceed of approximately HK$33.27 million.

5) In addition, 297,696,000 share options were exercised over the period under review. The net proceeds of approximately HK$44.36 million was received by the Company.

On 9 June 2010, the Company received a demand letter from two parties purporting to be the holders of all the outstanding Convertible Notes demanding immediate payment. The Company fully settled the balance of the Convertible Notes (inclusive of default interest) on 17 June 2010.

The fund raising activities in period under review were not only providing the Group with the funds to repay the liability under the Convertible Notes, but also placing the Company in a far stronger position to carry out the additional financing which we will need for future expansion. The management is of the view that the Group's incoming cash flow from the financing activities and business operations will provide sufficient funds for the Group to meet with the requirements of present operation and further business development in the foreseeable future.

FOREIGN EXCHANGE RISKS

The Group's operations conducted in the PRC are mainly settled in Renminbi. However, certain corporate activities (i.e. rights issue, placing of new shares, placing of convertible bonds) are conducted in Hong Kong dollars. Therefore, the Group is exposed to fluctuations in foreign exchange rate to a certain extent. Operating cash flow or liquidity of the Group is not subject to any exchange rate fluctuations. Currently, the Group has no formal hedging policies in place. The Group has not entered into any foreign currency exchange contracts or derivatives to hedge against the Group's currency risks.

INTERIM DIVIDEND

The Board resolved not to declare an interim dividend for the six months ended 30 June 2010 (2009: Nil).

DETAILS OF MATERIAL ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND ASSOCIATED COMPANIES

During the period under review, Chenlong Group Limited, a wholly-owned subsidiary of the Company, disposed of its entire interest in Charm Action Group Limited and its subsidiary ("Charm Action Group") to an independent third party at a cash consideration of US$1. The disposal was duly completed on 23 April 2010.

Save as disclosed above, there was no other material acquisition or disposal of subsidiaries and associated companies during the six months ended 30 June 2010.

SIGNIFICANT INVESTMENTS HELD

There was no material change in the significant investments held by the Group during the six months ended 30 June 2010.

CHARGE OF ASSETS

As at 30 June 2010, the Group had no bank deposits pledged to banks (2009: Nil).

CONTINGENT LIABILITIES

As at 30 June 2010, the Group did not provide any form of guarantees for any outside companies and was not liable to any material legal proceedings of which provision for contingent liabilities was required.

SHORT AND LONG TERM BUSINESS PROSPECTS AND DEVELOPMENT PLANS

Electronic Cigarette

The Company will continue to work with governments and international organizations around the world to address continuing concerns about safety and regulatory requirements of the electronic cigarette. Scientific testing will be continued. The Company strongly believes its invention benefits humankind the markets that are demanding practical solutions to the smoking pandemic.

Beginning from the second half of 2010, the Company will continue to speed up its marketing effort. The marketing strategies of RUYAN products will change from product-oriented approach in the past, which primarily be focused on the product itself, to market-oriented approach which will focus more on the appeal or social status the product provides.

The recent validation of the company's intellectual property in the United States and elsewhere over the past several years will enable the Company to strengthen and expand its strategic partnerships around the globe. Looking forward, the Company plans to continue to invest in research and development and to define the global market for the electronic cigarette. The Company is confident that by ramping up its R&D, intellectual property, marketing strategies and regulatory work in concert, the market demand for RUYAN products will pick up quickly in the near future.

Pharmaceuticals and health care products

In 2010, the Company will continue to speed up its marketing effort. The Company will consolidate the existing market share while promotion strategies are in progress to further the development of the high-end, mid-range and low-end markets. All these strategies will continue to be market-oriented. In the meantime, active and flexible marketing strategies are adopted for different items, regions and customers.

Proposed capital reorganisation and rights issue

As announced by the Company on 21 July 2010, the Company proposed to have a Capital Reorganization involving (i) every 40 issued and unissued shares of par value of HK$0.10 each be consolidated into one consolidated share of par value of HK$4, (ii) the par value of the each issued consolidated shares of the Company be reduced from HK$4 each to HK$0.1 each by cancelling a sum of HK$3.9 per consolidated share in issue, (iii) the entire amount of the authorised but unissued share capital of the Company be cancelled, and (iv) the authorised share capital of the Company be increased from HK$25,000,000 divided into 250,000,000 adjusted shares to HK$1,000,000,000 divided into 10,000,000,000 adjusted shares by the creation of an additional 9,750,000,000 new adjusted shares.

Subject to the completion of the Capital Reorganisation, the Company will carry out a Rights Issue of twenty rights shares for every one adjusted share at subscription price of HK$0.22 per rights share. The Capital Reorganisation is expected to be completed in December 2010 and the Rights Issue will be completed in February 2011. The estimated net proceeds of the Rights Issue is expected to be not less than HK$390.65 million to not more than HK$525.45 million.

Management Discussion and Analysis

The Company considers that the proposed Capital Reorganisation and Rights Issue will enable the Group to replenish the depleted capital base due to previous year's losses. As such, the Rights Issue is expected to help the Group strengthen its capital base and to enhance its financial position. Furthermore, the Rights Issue will give the qualifying shareholders under the Rights Issue the opportunity to maintain their respective pro-rata shareholdings interests in the Company and, hence the Board considers that fund raising through the Rights Issue is in the interests of the Company and its shareholders as a whole.

Going forward, the Company will focus on its existing core business. The Company will seek to strengthen these businesses to obtain investment opportunities that will provide favorable recurring income and investment returns to the Company.

EMPLOYEE POLICY, PERFORMANCE AND SALARY PROCEDURES

As at 30 June 2010, the Group employed a total of about 120 employees in the PRC and Hong Kong.

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

The Group will further establish its own corporate culture, strengthen staff training and implement the appraisal system, so as to let every staff member become part of the Company. As a result, a fair ground for competition can be established where all staff will be proud of the Company.

DIRECTORS' INTERESTS IN SHARES AND UNDERLYING SHARES

As at 30 June 2010, the interests and short positions of the directors and the chief executive of the Company and their associates in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (the "SFO")), as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO, or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") were as follows:

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

Name of director	Capacity	Number of issued ordinary shares of the Company *(Note 1)*	Number of underlying shares in respect of the options granted under the share option scheme of the Company *(Notes 1 & 3)*	Approximate percentage of the issued share capital of the Company
Mr. Wong Yin Sen	Beneficial owner		1,756,500 (L)	0.05%
	Interest of a controlled corporation	386,341,000 (L) *(Note 2)*		10.46%
Mr. Hon Lik	Beneficial owner		1,756,500 (L)	0.05%
	Interest of a controlled corporation	386,341,000 (L) *(Note 2)*		10.46%
Mr. Wong Hei Lin	Beneficial owner		1,756,500 (L)	0.05%
	Interest of a controlled corporation	386,341,000 (L) *(Note 2)*		10.46%
Mr. Pang Hong	Beneficial owner	Nil	1,171,000 (L)	0.03%

Notes:

(1) "L" denotes long position and "S" denotes short position.

(2) The 386,341,000 shares comprise 67,741,000 shares held by Ability Act Investments Limited and 318,600,000 shares held by Absolute Target Limited. Absolute Target Limited is owned as to 46.25% by Mr. Wong Yin Sen, 42.50% by Mr. Hon Lik and 11.25% by Mr. Wong Hei Lin. Ability Act Investments Limited is owned as to 4.75% by Goldtools Investments Limited which is wholly owned by Mr. Wong Hei Lin and 90.5% by Dragon Concept Investments Limited which is owned as to 52.11% and 47.89% by Mr. Wong Yin Sen and Mr. Hon Lik respectively.

(3) For details of the interests in underlying shares in respect of the options granted under the share option scheme of the Company, please refer to the section "Share Option Scheme" below.

Long positions in the shares of associated corporation of the Company

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

Save as disclosed above, as at 30 June 2010, none of the directors or the chief executive of the Company nor their associates had any interests or short positions in any shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of part XV of the SFO) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

SHARE OPTION SCHEME

The existing share option scheme was adopted by the Company on 30 May 2003 (the "Scheme") and is for the primary purpose of providing incentives to participants including, inter alia, employees, executive directors and non-executive directors of the Group, supplier of goods or services, customers of the Group, persons providing research, development or other technical support to the Group, shareholders of any member of the Group, advisers or consultants, or joint venture partners, and for such other purposes as the Board may approve from time to time.

The total number of shares in respect of which options may be granted under the Scheme is 369,449,049 shares, which is equivalent to 10% of the total number of shares of the Company in issue as at 23 July 2010, being the date of refreshment of the limit of the Scheme and the total issued share capital as at the date of this report.

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

(i) representing in aggregate over 0.1% of the shares of the Company in issue;

(ii) and having an aggregate value, based on the closing price of the shares of the Company as stated in the daily quotations sheets issued by the Stock Exchange on the date of grant in excess of HK$5 million, such grant of option shall be subject to prior approval of the shareholders of the Company who are not connected persons of the Company as defined in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules").

An option must be exercised within five years from the date of grant or such shorter period as the Board may notify to the grantee. Option granted must be taken up within 28 days from the date of offer, upon payment of HK$1 as consideration.

The exercise price is determined by the directors of the Company, and shall be at least the highest of (i) the closing price of the Company's shares on the date of grant, (ii) the average closing price of the shares for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's share.

The Scheme has a life of 10 years unless otherwise terminated in accordance with the terms of the Scheme.

The following table discloses movements in the Company's share options during the period:

Category of participants	Date of share options granted *(note i)*	No. of share options granted as at 1 January 2010	No. of share options granted during the period	No. of share options exercised during the period	No. of share options lapsed/ cancelled during the period	No. of share options adjusted during the period *(note iv)*	No. of share options outstanding as at 30 June 2010 *(HK$)*	Exercise period	Adjusted exercise price per share option *(note iv)*
Directors									
Wong Yin Sen	9 January 2008	1,500,000	–	–	–	256,500	1,756,500	11 January 2008 to 10 January 2013	0.512
Hon Lik	9 January 2008	1,500,000	–	–	–	256,500	1,756,500	4 February 2008 to 3 February 2013	0.512
Wong Hei Lin	9 January 2008	1,500,000	–	–	–	256,500	1,756,500	4 February 2008 to 3 February 2013	0.512
Pang Hong	9 January 2008	1,000,000	–	–	–	171,000	1,171,000	14 January 2008 to 13 January 2013	0.512
Cheung Kwan Hung *(note ii)*	9 January 2008	1,000,000	–	–	–	171,000	1,171,000	11 January 2008 to 10 January 2013	0.512
Ding Xun *(note ii)*	9 January 2008	1,000,000	–	–	–	171,000	1,171,000	22 January 2008 to 21 January 2013	0.512
		7,500,000					8,782,500		

Category of participants	Date of share options granted *(note i)*	No. of share options granted as at 1 January 2010	No. of share options granted during the period	No. of share options exercised during the period	No. of share options lapsed/ cancelled during the period	No. of share options adjusted during the period *(note iv)*	No. of share options outstanding as at 30 June 2010 *(HK$)*	Exercise period	Adjusted exercise price per share option *(note iv)*
Employees (in aggregate)									
	9 January 2008	22,600,000	–	–	–	3,864,600	26,464,600	6 February 2008 to 5 February 2013	0.512
	18 February 2008	1,000,000	–	–	–	171,000	1,171,000	17 March 2008 to 16 March 2013	0.598
	28 February 2008	4,000,000	–	–	–	684,000	4,684,000	27 March 2008 to 26 March 2013	0.598
	5 June 2008	2,000,000	–	–	–	342,000	2,342,000	3 July 2008 to 2 July 2013	0.529
	20 November 2009 *(note v)*	6,000,000	–	(1,000,000)	–	855,000	5,855,000	20 November 2009 to 19 November 2013	0.143
		35,600,000					40,516,600		
Others *(note iii)*									
	6 May 2008	2,000,000	–	–	–	342,000	2,342,000	3 June 2008 to 2 June 2013	0.521
	30 March 2009	15,000,000	–	–	–	2,565,000	17,565,000	30 March 2009 to 29 March 2013	0.342
	28 April 2010 *(note vi)*	–	130,336,000	(130,336,000)	–	–	–	28 April 2010 to 27 April 2015	0.2
	10 June 2010 *(note vii)*	–	166,360,583	(166,360,583)	–	–	–	10 June 2010 to 9 June 2015	0.109
		17,000,000					19,907,000		
Total		60,100,000					69,206,100		

Notes:

(i) There is no vesting period for the share options granted except for 21,600,000 (adjusted: 25,293,600) share options granted during 2008 are subject to a vesting period of three stages with 33.33% of such options granted becoming exercisable on the first anniversary, another 33.33% becoming exercisable on the second anniversary and the remaining 33.34% becoming exercisable on the third anniversary of the respective dates on which the options were accepted.

(ii) Mr. Cheung Kwan Hung and Mr. Ding Xun were resigned as an independent non-executive director on 28 June 2010 .

(iii) These are individuals who rendered consultancy services in respect of management of the Ruyan atomizing cigarettes to the Group. The Group granted share options to them for recognising their services similar to those rendered by other employees.

(iv) The number of share options and exercise price per share option were adjusted immediately after the completion of the rights issue on 3 June 2010.

(v) The weighted average closing price of the shares immediately before 2 March, 2010 on which the options were exercised was HK$0.21 per share.

(vi) The weighted average fair value of all options granted on 28 April, 2010 was HK$0.0525 per share. The fair value of the share options granted is calculated on 28 April, 2010, using the Black-Scholes model with the following assumptions: expected dividend yield of 0%, expected life of five years, expected volatility of 94% and risk-free interest rate of 2.026%. The weighted average closing price of the shares immediately before 28 April, 2010 on which the options were exercised was HK$0.162 per share.

(vii) The weighted average fair value of all options granted on 10 June, 2010 was HK$0.0304 per share. The fair value of the share options granted is calculated on 10 June, 2010, using the Black-Scholes model with the following assumptions: expected dividend yield of 0%, expected life of five years, expected volatility of 91% and risk-free interest rate of 1.594%. The weighted average closing price of the shares immediately before 10 June, 2010 on which the options were exercised was HK$0.115 per share.

(viii) The variables and assumption on which the option pricing model is based representing the best estimation of the Directors as to the circumstances existing at the time the options were granted. Changes in variables and assumption may result in changes in the fair value of the options.

The closing prices of the Company's shares immediately before 28 April, 2010 and 10 June, 2010, the dates of grant of the options in 2010, were HK$0.165 and HK$0.101, respectively. (The closing prices of the Company's shares immediately before 30 March, 2009 and 20 November, 2009, the dates of grant of the options in 2009, were HK$0.4 and HK$0.167 respectively; the closing prices of the Company's shares immediately before 9 January, 2008, 18 February, 2008, 28 February, 2008, 6 May, 2008 and 5 June, 2008, the dates of grant of the 2008 options, were HK$0.61, HK$0.70, HK$0.70, HK$0.61 and HK$0.62 respectively).

SUBSTANTIAL SHAREHOLDERS

So far as is known to directors of the Company, as at 30 June, 2010, the persons or companies (other than directors or chief executive of the Company) who had interests or short positions in the shares or underlying shares of the Company which fall to be disclosed to the Company under Part XV of the SFO, or which were recorded in the register of substantial shareholders required to be kept by the Company under section 336 of the SFO were as follows:

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

Name	Capacity	Number of shares of the Company *(Note 1)*	Approximate percentage of shareholding
Yu Man Fung Alice	Beneficial owner	639,269,166 (L)	17.30%
Absolute Target Limited *(Note 2)*	Beneficial owner	318,600,000 (L)	8.62%

Notes:

(1) "L" denotes long position and "S" denotes short position.

(2) Absolute Target Limited is owned as to 46.25%, 42.50% and 11.25% by Mr. Wong Yin Sen, Mr. Hon Lik and Mr. Wong Hei Lin respectively.

Other than as disclosed above, the Company has not been notified of any other relevant interests or short positions in the issued share capital of the Company as at 30 June, 2010.

PURCHASE, SALE OR REDEMPTION OF SECURITIES

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

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted the Model Code as set out in the Appendix 10 to the Listing Rules as its own code of conduct regarding securities transactions by the directors of the Company. Having made specific enquiry of all directors of the Company, they all confirmed that they have complied with the required standard set out in the Model Code during the six months ended 30 June 2010.

COMPLIANCE WITH CODE ON CORPORATE GOVERNANCE PRACTICES

The Company has complied with the code provisions of the Code on Corporate Governance Practices (the "Code") as set out in Appendix 14 to the Listing Rules during the period under review, with the following exception as having been elaborated in our 2009 Annual Report:

Management Discussion and Analysis

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

AUDIT COMMITTEE

The interim financial report during the period under review has been reviewed by the audit committee of the Board (the "Audit Committee"). The audit committee comprises four independent non-executive directors of the Company, namely Mr. Pang Hong, Mr. Chung Yuk Lun, Mr. Liu Kwong Sang and Mr. Lam Man Sum, Albert.

REMUNERATION COMMITTEE

The remuneration committee of the Board consists of four independent non-executive directors of the Company. Its duties include making recommendations on the Group's policy and structure for remuneration package of the directors and senior management, evaluation and making recommendations on other employees' benefit arrangements.

MEMBERS OF THE BOARD

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

Executive Directors
Mr. Wong Yin Sen
Mr. Hon Lik
Mr. Wong Hei Lin
Ms. Ching Yuen Man, Angela
Mr. Au Yeung Kai Chor

Non-executive Director
Mr. Frank H. Miu

Independent Non-executive Directors
Mr. Pang Hong
Mr. Chung Yuk Lun
Mr. Liu Kwong Sang
Mr. Lam Man Sum, Albert

On behalf of the Board
Dragonite International Limited
Wong Yin Sen
Chairman

Hong Kong, 24 August 2010

Condensed Consolidated Statement of Comprehensive Income

For the six months ended 30 June 2010

	NOTES	**30.6.2010 HK$'000 (unaudited)**	30.6.2009 HK$'000 (unaudited)
Revenue		**14,576**	145,286
Cost of sales		**(54,896)**	(60,080)
Gross (loss)/profit		**(40,320)**	85,206
Other income		**2,771**	1,700
Distribution cost		**(29,279)**	(49,734)
Administrative expenses		**(64,703)**	(52,119)
Change in fair value of investment held for trading		**(6,927)**	–
Change in fair value of derivative financial instruments		**(410)**	26,203
Gain on disposal of subsidiaries	*17*	**21,903**	–
Finance costs		**(17,441)**	(13,879)
Loss before tax		**(134,406)**	(2,623)
Income tax expense	*5*	**(247)**	(3,898)
Loss for the period	*6*	**(134,653)**	(6,521)
Other comprehensive income			
Exchange differences arising on translation		**1,292**	880
Total comprehensive expense for the period		**(133,361)**	(5,641)
Loss per share			
Basic	*8*	**HK(6.79) cents**	HK(0.37) cents

Condensed Consolidated Statement of Financial Position

At 30 June 2010

	NOTES	30.6.2010 HK$'000 (unaudited)	31.12.2009 HK$'000 (audited)
Non-current assets			
Property, plant and equipment	9	**41,238**	46,859
Goodwill		**–**	–
Available-for-sale investments	10	**–**	–
Intangible assets		**188**	730
Prepaid lease payments		**2,648**	2,664
		44,074	50,253
Current assets			
Inventories		**52,241**	99,277
Trade receivables	11	**19,176**	46,042
Deposits, prepayment and other receivables		**48,546**	48,701
Taxation recoverable		**–**	2,818
Amount due from a shareholder		**–**	127
Prepaid lease payments		**77**	77
Held-for-trading investments	12	**15,066**	–
Bank balances and cash		**37,807**	24,117
		172,913	221,159

Condensed Consolidated Statement of Financial Position

At 30 June 2010

	NOTES	30.6.2010 HK$'000 (unaudited)	31.12.2009 HK$'000 (audited)
Current liabilities			
Trade payables	13	**1,907**	6,602
Accruals and other payables		**41,061**	35,597
Derivative financial instruments	14	**1,699**	–
Convertible bonds	14	**–**	152,000
Amount due to a shareholder		**–**	10,000
Amount due to a minority shareholder		**–**	21,011
Taxation payable		**2,744**	1,995
		47,411	227,205
Net current assets (liabilities)		**125,502**	(6,046)
Total assets less current liabilities		**169,576**	44,207
Non-current liabilities			
Convertible bonds	14	**3,711**	–
		165,865	44,207
Capital and reserves			
Share capital	15	**369,449**	151,336
Reserves		**(203,584)**	(107,129)
		165,865	44,207

Condensed Consolidated Statement of Changes in Equity

For the six months ended 30 June 2010

	Share capital HK$'000	Share premium account HK$'000	Shareholders' contribution HK$'000 (note a)	Translation reserve HK$'000	Non-distributable reserves HK$'000 (note b)	Share option reserve HK$'000	Merger reserves HK$'000 (note c)	Special reserves HK$'000 (note d)	Accumulated profits HK$'000	Total equity attributable to owners HK$'000
At 1 January 2009 (audited)	151,336	1,182,410	21,780	84,942	24,737	10,510	(1,016,738)	3,142	21,088	483,207
Loss for the period	–	–	–	–	–	–	–	–	(6,521)	(6,521)
Exchange differences on translation	–	–	–	880	–	–	–	–	–	880
Total comprehensive expense for the period	–	–	–	880	–	–	–	–	(6,521)	(5,641)
Recognition of equity-settled share-based payments	–	–	–	–	–	908	–	–	–	908
At 30 June 2009 (unaudited)	151,336	1,182,410	21,780	85,822	24,737	11,418	(1,016,738)	3,142	14,567	478,474
At 1 January 2010 (audited)	**151,336**	**1,182,410**	**21,780**	**86,873**	**24,737**	**9,612**	**(1,016,738)**	**3,142**	**(418,945)**	**44,207**
Loss for the period	-	-	-	-	-	-	-	-	**(134,653)**	**(134,653)**
Exchange differences on translation	-	-	-	**1,292**	-	-	-	-	-	**1,292**
Total comprehensive expense for the period	-	-	-	**1,292**	-	-	-	-	**(134,653)**	**(133,361)**
Issue of new shares	**33,272**	-	-	-	-	-	-	-	-	**33,272**
Issue of new shares upon conversion of convertible bonds	**71,891**	**10,400**	-	-	-	-	-	-	-	**82,291**
Recognition of equity-settled share-based payments	-	-	-	-	-	**12,276**	-	-	-	**12,276**
Issue of new shares upon exercise of share options	**29,770**	**26,582**	-	-	-	**(11,984)**	-	-	-	**44,368**
Issue of new shares upon rights issue	**83,180**	-	-	-	-	-	-	-	-	**83,180**
Disposal of a subsidiary	-	-	-	**(368)**	-	-	-	-	-	**(368)**
At 30 June 2010 (unaudited)	**369,449**	**1,219,392**	**21,780**	**87,797**	**24,737**	**9,904**	**(1,016,738)**	**3,142**	**(553,598)**	**165,865**

Notes:

(a) Shareholders' contribution represents the amounts contributed by shareholders of SBT Investment (Holdings) Limited ("SBT') previously known as Best Partners Worldwide Limited.

(b) The non-distributable reserve represents statutory reserves appropriated from profit after tax of the Company's subsidiary in the People's Republic of China (the "PRC") under the PRC laws and regulations.

(c) The merger reserve represents (i) the share capital of SBT (ii) the carrying amount of equity interest in SBT held by the non-controlling parties and (iii) the fair value of the consideration paid for the acquisition of SBT.

(d) The special reserve of the Group represents reserve arising pursuant to Group Reorganisation on the basis that the Group Reorganisation had been effected on 1 January, 2000.

Condensed Consolidated Statement of Cash Flows

For the six months ended 30 June 2010

	30.6.2010 HK$'000 (unaudited)	30.6.2009 HK$'000 (unaudited)
Net cash used in operating activities	**(57,358)**	(70,239)
Investing activities		
Proceeds from disposal of property, plant and equipment	**1,392**	–
Purchase of property, plant and equipment	**(1,749)**	(2,344)
Net cash used in investing activities	**(357)**	(2,344)
Financing activities		
New other borrowings raised	**125,000**	–
Repayment of other borrowings	**(125,000)**	(718)
Interest paid	**(2,370)**	(1,888)
Redemption of convertible bonds	**(152,709)**	–
Issue of new shares	**160,820**	–
Proceeds from issue of convertible bonds	**75,000**	–
Repayments to shareholders	**(9,873)**	–
Net cash from (used in) financing activities	**70,868**	(2,606)
Net increase (decrease) in cash and cash equivalents	**13,153**	(75,189)
Cash and cash equivalents at beginning of the period	**24,117**	182,298
Effect of foreign exchange rate changes	**537**	(8,647)
Cash and cash equivalents at end of the period	**37,807**	98,462
Analysis of the balances of cash and cash equivalents		
Bank balances and cash	**37,807**	98,462

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 June 2010

1. GENERAL INFORMATION

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

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

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

2. BASIS OF PREPARATION

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

3. PRINCIPAL ACCOUNTING POLICIES

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

The accounting policies used in the condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual financial statement for the year ended 31 December 2009.

In the current period, the Group has applied, for the first time, the following new and revised standards, amendments or interpretations ("new and revised IFRSs") issued by Hong Kong Institute of Certified Public Accountants ("HKICPA") which are effective for the Group's financial period beginning on 1 January 2010.

HKFRSs (Amendments)	Amendment to HKFRS 5 as part of improvements to HKFRSs issued in 2008
HKFRSs (Amendments)	Improvements to HKFRSs issued in 2009
HKAS 27 (Revised)	Consolidated and separate financial statements
HKAS 39 (Amendment)	Eligible hedged items
HKFRS 1 (Amendment)	Additional exemptions for first-time adopters
HKFRS 2 (Amendment)	Group cash-settled share-based payment transactions
HKFRS 3 (Revised)	Business combinations
HK(IFRIC)-INT 17	Distributions of non-cash assets to owners

3. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

HKFRS 3 (Revised) Business Combinations

The Group applies HKFRS 3 (Revised) Business Combinations prospectively to business combinations for which the acquisition date is on or after 1 January 2010. The requirements in HKAS 27 (Revised) Consolidated and Separate Financial Statements in relation to accounting for changes in ownership interests in a subsidiary after control is obtained and for loss of control of a subsidiary are also applied prospectively by the Group on or after 1 January 2010. As there was no transaction during the current interim period in which HKFRS 3 (Revised) and HKAS 27 (Revised) are applicable, the application of HKFRS 3 (Revised), HKAS 27 (Revised) and the consequential amendments to other HKFRSs had no effect on the condensed consolidated financial statements of the Group for the current or prior accounting periods. Results of the Group in future periods may be affected by future transactions for which HKFRS 3 (Revised), HKAS 27 (Revised) and the consequential amendments to the other HKFRSs are applicable.

Amendment to HKAS 17 "Leases"

As part of Improvements to HKFRSs issued in 2009, HKAS 17 Leases has been amended in relation to the classification of leasehold land. Before the amendment to HKAS 17, the Group was required to classify leasehold land as operating leases and to present leasehold land as prepaid lease payments in the consolidated statement of financial position. The amendment has removed such a requirement. The amendment to HKAS 17 requires that the classification of leasehold land should be based on the general principles set out in HKAS 17, that is, whether or not substantially all risks and rewards incidental to ownership of a leased asset have been transferred to the lessee.

The application of the other new and revised HKFRSs had no effect on the condensed consolidated financial statements of the Group for the current or prior accounting periods.

3. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

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

HKFRSs (Amendments)	Improvements to HKFRSs 2010 [1]
HKAS 24 (Revised)	Related party disclosures [4]
HKAS 32 (Amendment)	Classification of right issues [2]
HKFRS 1 (Amendment)	Limited exemption from comparative HKFRS 7 disclosures for first-time adopters [3]
HKFRS 9	Financial instruments [5]
HK(IFRIC)-INT 14 (Amendment)	Prepayments of a minimum funding requirement [4]
HK(IFRIC)-INT 19	Extinguishing financial liabilities with equity instruments [3]

1 Effective for annual periods beginning on or after 1 July 2010 and 1 January 2011, as appropriate.
2 Effective for annual periods beginning on or after 1 February 2010.
3 Effective for annual periods beginning on or after 1 July 2010.
4 Effective for annual periods beginning on or after 1 January 2011.
5 Effective for annual periods beginning on or after 1 January 2013.

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

4. SEGMENTAL INFORMATION

Business segments

The Group's executive directors are the chief operating decision makers as they collectively make strategic decisions towards the Group's operations. Internal reports are reviewed by the Group's executive directors on monthly basis. The Group is principally engaged in production and sales of a series of health care products, pharmaceutical products and Ruyan atomizing cigarettes in the PRC. Nearly all identifiable assets of the Group are located in PRC. Information reported to the Group's management for the purpose of resources allocation and assessment of performance focuses on the type of products or services. Each type of product or service is managed by an unique business unit within the Group whose performance is assessed independently. The Group's operating segments under HKFRS 8 are therefore as follows:

(a) health care products, which are mainly represented by ginseng products

(b) pharmaceutical products, which are mainly represented by licensed medicines

(c) Ruyan atomizing cigarettes

4. SEGMENTAL INFORMATION (CONTINUED)

Business segments (continued)

Segment information for the six months ended 30 June 2010 and 2009 about these businesses is presented below.

	Health care products		Pharmaceutical products		Ruyan atomizing cigarettes		Total	
	2010	2009	**2010**	2009	**2010**	2009	**2010**	2009
	HK$'000	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000
Segment turnover	**5,982**	49,187	**12,937**	18,740	**(4,343)**	77,359	**14,576**	145,286
Segment result	**(60,857)**	4,106	**(1,023)**	5,599	**(6,903)**	(16,249)	**(68,783)**	(6,544)
Other income							**2,771**	1,700
Unallocated corporate expenses							**(43,616)**	(10,103)
Change in fair value of held for trading							**(6,927)**	–
Change in fair value of derivative financial instruments							**(410)**	26,203
Finance costs							**(17,441)**	(13,879)
Loss before tax							**(134,406)**	(2,623)

Segment loss represents the loss from/profit earned by each segment without allocation of central administration costs, directors' salaries, share option expenses, investment income, finance cost, change in fair value of held-for-trading investments, change in fair value of derivatives financial instruments and gain in disposal of subsidiaries. This is the measure reported to the chief operating decision maker for the purposes of resource allocation and performance assessment.

5. INCOME TAX EXPENSE

	Six months ended	
	30.6.2010	30.6.2009
	HK$'000	HK$'000
Income Tax in the PRC	**247**	3,898

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

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

6. LOSS FOR THE PERIOD

	Six months ended	
	30.6.2010	30.6.2009
	HK$'000	HK$'000
Loss for the period has been arrived at after charging (crediting):		
Advertising expenses	**15,857**	40,855
Allowance for bad and doubtful debts	**–**	17,354
Allowance for obsolete inventories (included in cost of sales)	**41,114**	–
Amortisation of intangible assets (included in cost of sales)	**480**	499
Amortisation of prepaid lease payments	**270**	341
Depreciation of property, plant and equipment	**5,472**	5,340
Staff costs (including directors' emoluments and share-based payment expenses)	**5,069**	11,857
Interest income	**(33)**	(60)

7. DIVIDEND

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

8. LOSS PER SHARE

The calculation of basic loss per share attributable to the owners of the Company is based on the following data:

	Six months ended	
	30.6.2010	30.6.2009
	HK$'000	HK$'000
Loss for the purpose of basic loss per share attributable to the owners of the Company	**(134,653)**	(6,521)

	Six months ended	
	30.6.2010	30.6.2009
	'000	'000
Weighted average number of shares for the purpose of basic loss per share	**1,982,329**	1,772,145

Pursuant to the prospectus dated 14 May 2010, shareholders of the Company are entitled to subscribe the rights shares at a subscription price of HK$0.1 per rights share on the basis of one rights share for every two shares. Accordingly, the number of ordinary shares for the purpose of basic loss per share had been adjusted for the effect of rights issue retrospectively for both periods.

No diluted loss per share has been presented for the six months ended 30 June 2010 and 2009 because the conversion of the convertible bonds and share options would reduce the loss per share and the outstanding share options were anti-dilutive.

9. MOVEMENT IN PROPERTY, PLANT AND EQUIPMENT

During the period, additions and disposal to the Group's property, plant and equipment amounted to approximately HK$1,749,000 (six months ended 30 June 2009: HK$2,344,000) and HK$2,722,000 (six months ended 30 June 2009: HK$5,913,000) respectively.

10. AVAILABLE-FOR-SALE INVESTMENTS

	30.6.2010 HK$'000	31.12.2009 HK$'000
Available-for-sales investments	**1,000**	1,000
Less: Impairment loss recognised	**(1,000)**	(1,000)
	–	–

11. TRADE RECEIVABLES

The Group allows an average credit period from 60 days to 270 days to its trade customers. The following is an aged analysis of trade receivables net of allowance of doubtful debts presented based on invoice date.

	30.6.2010 HK$'000	31.12.2009 HK$'000
0-60 days	**3,587**	28,657
61-90 days	**1,503**	12,938
91-180 days	**2,392**	4,447
181-270 days	**8,351**	–
More than 270 days	**3,343**	–
	19,176	46,042

12. HELD-FOR-TRADING INVESTMENTS

	30.6.2010 HK$'000	31.12.2009 HK$'000
Equity securities listed in Hong Kong, at fair value	**15,066**	–

13. TRADE PAYABLES

The following is an analysis of trade payables by age, presented based on invoice date.

	30.6.2010 HK$'000	31.12.2009 HK$'000
0-30 days	**–**	459
31-60 days	**6**	36
61-90 days	**–**	22
Over 90 days but less than 1 year	**1,256**	2,716
Over 1 year	**645**	3,369
	1,907	6,602

14. CONVERTIBLE BONDS AND DERIVATIVE FINANCIAL INSTRUMENTS

On 31 July 2007, the Company issued HK$151,000,000 convertible bonds (the "First Convertible Bonds") bearing coupons of 2.5% per annum payable semi-annually in arrear and matures on 31 July, 2012.

The net proceeds received from the issue of the First Convertible Bonds contain liability component and conversion option. The conversion option is not closely related to the liability component and is classified as a derivative because the conversion will not result in the Company issuing a fixed number of Share in settlement of a fixed amount of liability component. The issuer early redemption option and bondholders early redemption option are not closely related to the host contract as the early redemption amount is not closed to the amortised cost of the liability on the redemption date. Conversion option, issuer early redemption option and bondholders early redemption option are measured at fair value with change in fair value recognised in profit or loss.

On 7 August 2009, the bondholders and the Company come to an agreement to amend the terms of the First Convertible Bonds (thereafter the First Convertible Bonds with amended terms are referred as the "Second Convertible Bonds"). The approval of amendment was granted by the Stock Exchange on 14 August 2009 and the restructuring of First Convertible Bonds was completed on 28 August 2009.

First Conversion

On 3 February, 2010, a bondholder served a conversion notice to the Company for the conversion of 18,909,832 shares of the Second Convertible Bonds at HK$0.65 per share at an agreed principal amount of HK$12,291,391.

14. CONVERTIBLE BONDS AND DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

First Redemption

On 10 June, 2010, the bondholders served a redemption notice to the Company for the fully redemption of the remaining Second Convertible Bonds at an agreed redemption consideration of HK$152,709,092 being the outstanding principle together with default interest and redemption premium. The completion of the redemption took place on 17 June, 2010.

On 22 June, 2010, the Company issued HK$75,000,000 zero-coupon convertible bonds (the "Third Convertible Bonds"). The Third Convertible Bonds are denominated in HKD. It entitled the holders to convert them into ordinary shares of the Company at any time between the date of issue of the notes and their settlement date on 21 June 2012 at a conversion price of HK$0.10 per convertible loan note. If the notes have not been converted, they will be redeemed on 21 June, 2012 at par.

The net proceeds received from the issue of the Third Convertible Bonds contain liability component and conversion option. The conversion option is not closely related to the liability component and is classified as a derivative because the conversion will not result in the Company issuing a fixed number of shares in settlement of a fixed amount of liability component. Conversion option is measured at fair value with change in fair value recognised in profit or loss.

Second Conversion

During the period ended 30 June, 2010, the bondholders served a conversion notice to the Company for the conversion of 700,000,000 shares of the Third Convertible Bonds at HK$0.1 per share at an agreed consideration of HK$70,000,000. The liability component of the Third Convertible Bonds was HK$51,949,333 which was stated at the amortised cost using the effective interest method and the fair value of the derivative components of the Third Convertible Bonds at the date of Conversion was HK$18,050,667.

14. CONVERTIBLE BONDS AND DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

Second Conversion (continued)

The movement of the liability component and conversion option derivatives of the Second and the Third convertible bonds for the periods is set out as below:

First and Second Convertible Bonds

	Liability component	Conversion option derivatives	Total
	HK$'000	HK$'000	HK$'000
As at 1 January 2009	–	–	–
Restructuring of First Convertible Bonds	145,000	–	145,000
Interest charge	12,001	–	12,001
Redemption	(4,800)	–	(4,800)
Interest paid	(201)	–	(201)
As at 31 December 2009	152,000	–	152,000
First Conversion	(12,291)	–	(12,291)
Interest paid	13,000	–	13,000
First Redemption	(152,709)	–	(152,709)
As at 30 June 2010	–	–	–

14. CONVERTIBLE BONDS AND DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

Third Convertible Bond

	Liability component	Conversion option derivatives	Total
	HK$'000	HK$'000	HK$'000
As at 31 December 2009	–	–	–
Issue during the period	55,660	19,340	75,000
Second Conversion	(51,949)	(18,051)	(70,000)
Gain arising on change of fair value	–	410	410
As at 30 June 2010	3,711	1,699	5,410

The methods and assumptions applied for the valuation of the convertible bonds are as follows;

(1) Valuation of liability component

At the date of issue, the liability component was recognised at fair value. The fair value of liability component was calculated based on the present value of the contractually determined stream of future cash flows discounted at the required yield, which was determined with reference to the average yield of notes with similar credit rating and remaining time to maturity. In subsequent periods, the liability component is carried at amortised cost using the effective interest method. The effective interest rate of the liability component of Second Convertible Bonds and Third Convertible Bonds are 24% and 16.1% respectively. As the Second Convertible Bonds will be mature on 31 July, 2010, the liability component of the New Convertible Bonds is classified as current liability as at 31 December, 2009. As the bondholders of the Third Convertible Bonds have rights to give notice to the Company requesting the Company to redeem all or some of the Old Convertible Bonds on 21 June, 2012, the liability component of the Third Convertible Bonds was classified as non-current liability as at 30 June, 2010.

14. CONVERTIBLE BONDS AND DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

(2) Valuation of conversion option

Binomial model is used for valuation of conversion option of the Second and Third Convertible Bonds. The inputs into the model were as follows:

	2010	2009
Share price of the Company	**HK$0.106**	HK$0.184
Exercise price	**HK$0.10**	HK$0.65
Expected volatility	**45%**	35%
Expected remaining life	**1.98 years**	0.6 years
Risk-free interest rate	**0.77%**	0.17%

(a) Expected volatility was determined by calculating the historical volatility of the Company's share price.

(b) Expected life was the remaining life of the respective options.

(c) The risk free rate is determined by reference to the Hong Kong Government Bond Yield.

During the period, HK$410,000 (six months ended 30 June 2009: HK$26,203,000) was recognized in profit or loss as change in fair value of derivative financial instruments.

15. SHARE CAPITAL

	Number of shares '000	Share capital HK$'000
Ordinary shares of HK$0.10 each		
Authorised:		
At 1 January 2010	2,000,000	200,000
Increase in authorised share capital	8,000,000	800,000
	10,000,000	1,000,000
Issued:		
At 1 January 2010	1,513,360	151,336
Issue of subscription shares	332,721	33,272
Exercise of share options	297,696	29,770
Conversion of convertible bonds	718,910	71,891
Rights issue	831,803	83,180
	3,694,490	369,449

16. SHARE-BASED PAYMENTS

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

	Number of share options
Outstanding at 30 June 2010	69,206,100

16. SHARE-BASED PAYMENTS (CONTINUED)

In the current period, an amount of share-based payment expenses in respect of its share options of HK$12,276,000 (six months ended 30 June 2009: HK$908,000) has been recognised in the condensed consolidated statement of comprehensive income with a corresponding adjustment recognised in the Group's share option reserve.

The following table discloses movements in the Company's share options during the period:

Category of participants	Date of share options granted *(note i)*	No. of share options granted as at 1 January 2010	No. of share options granted during the period	No. of share options exercised during the period	No. of share options lapsed/ cancelled during the period	No. of share options adjusted during the period *(note iv)*	No. of share options outstanding as at 30 June 2010 (HK$)	Exercise period	Adjusted exercise price per share option *(note iv)*
Directors									
Wong Yin Sen	9 January 2008	1,500,000	–	–	–	256,500	1,756,500	11 January 2008 to 10 January 2013	0.512
Hon Lik	9 January 2008	1,500,000	–	–	–	256,500	1,756,500	4 February 2008 to 3 February 2013	0.512
Wong Hei Lin	9 January 2008	1,500,000	–	–	–	256,500	1,756,500	4 February 2008 to 3 February 2013	0.512
Pang Hong	9 January 2008	1,000,000	–	–	–	171,000	1,171,000	14 January 2008 to 13 January 2013	0.512
Cheung Kwan Hung *(note ii)*	9 January 2008	1,000,000	–	–	–	171,000	1,171,000	11 January 2008 to 10 January 2013	0.512
Ding Xun *(note ii)*	9 January 2008	1,000,000	–	–	–	171,000	1,171,000	22 January 2008 to 21 January 2013	0.512
		7,500,000					8,782,500		
Employees (in aggregate)									
	9 January 2008	22,600,000	–	–	–	3,864,600	26,464,600	6 February 2008 to 5 February 2013	0.512
	18 February 2008	1,000,000	–	–	–	171,000	1,171,000	17 March 2008 to 16 March 2013	0.598
	28 February 2008	4,000,000	–	–	–	684,000	4,684,000	27 March 2008 to 26 March 2013	0.598
	5 June 2008	2,000,000	–	–	–	342,000	2,342,000	3 July 2008 to 2 July 2013	0.529
	20 November 2009 *(note v)*	6,000,000	–	(1,000,000)	–	855,000	5,855,000	20 November 2009 to 19 November 2013	0.143
		35,600,000					40,516,600		

16. SHARE-BASED PAYMENTS (CONTINUED)

Category of participants	Date of share options granted *(note i)*	No. of share options granted as at 1 January 2010	No. of share options granted during the period	No. of share options exercised during the period	No. of share options lapsed/ cancelled during the period	No. of share options adjusted during the period *(note iv)*	No. of share options outstanding as at 30 June 2010 *(HK$)*	Exercise period	Adjusted exercise price per share option *(note iv)*
Others *(note iii)*									
	6 May 2008	2,000,000	–	–	–	342,000	2,342,000	3 June 2008 to 2 June 2013	0.521
	30 March 2009	15,000,000	–	–	–	2,565,000	17,565,000	30 March 2009 to 29 March 2013	0.342
	28 April 2010 *(note vi)*	–	130,336,000	(130,336,000)	–	–	–	28 April 2010 to 27 April 2015	0.2
	10 June 2010 *(note vii)*	–	166,360,583	(166,360,583)	–	–	–	10 June 2010 to 9 June 2015	0.109
		17,000,000					19,907,000		
Total		60,100,000					69,206,100		

Notes:

(i) There is no vesting period for the share options granted except for 21,600,000 (adjusted: 25,293,600) share options granted during 2008 are subject to a vesting period of three stages with 33.33% of such options granted becoming exercisable on the first anniversary, another 33.33% becoming exercisable on the second anniversary and the remaining 33.34% becoming exercisable on the third anniversary of the respective dates on which the options were accepted.

(ii) Mr. Cheung Kwan Hung and Mr. Ding Xun were resigned as an independent non-executive director on 28 June 2010 .

(iii) These are individuals who rendered consultancy services in respect of management of the Ruyan atomizing cigarettes to the Group. The Group granted share options to them for recognising their services similar to those rendered by other employees.

(iv) The number of share options and exercise price per share option were adjusted immediately after the completion of the rights issue on 3 June 2010.

(v) The weighted average closing price of the shares immediately before 2 March, 2010 on which the options were exercised was HK$0.21 per share.

16. SHARE-BASED PAYMENTS (CONTINUED)

(vi) The weighted average fair value of all options granted on 28 April, 2010 was HK$0.0525 per share. The fair value of the share options granted is calculated on 28 April, 2010, using the Black-Scholes model with the following assumptions: expected dividend yield of 0%, expected life of five years, expected volatility of 94% and risk-free interest rate of 2.026%. The weighted average closing price of the shares immediately before 28 April, 2010 on which the options were exercised was HK$0.162 per share.

(vii) The weighted average fair value of all options granted on 10 June, 2010 was HK$0.0304 per share. The fair value of the share options granted is calculated on 10 June, 2010, using the Black-Scholes model with the following assumptions: expected dividend yield of 0%, expected life of five years, expected volatility of 91% and risk-free interest rate of 1.594%. The weighted average closing price of the shares immediately before 10 June, 2010 on which the options were exercised was HK$0.115 per share.

(viii) The variables and assumption on which the option pricing model is based representing the best estimation of the Directors as to the circumstances existing at the time the options were granted. Changes in variables and assumption may result in changes in the fair value of the options.

The closing prices of the Company's shares immediately before 28 April, 2010 and 10 June, 2010, the dates of grant of the options in 2010, were HK$0.165 and HK$0.101, respectively. (The closing prices of the Company's shares immediately before 30 March, 2009 and 20 November, 2009, the dates of grant of the options in 2009, were HK$0.4 and HK$0.167 respectively; the closing prices of the Company's shares immediately before 9 January, 2008, 18 February, 2008, 28 February, 2008, 6 May, 2008 and 5 June, 2008, the dates of grant of the 2008 options, were HK$0.61, HK$0.70, HK$0.70, HK$0.61 and HK$0.62 respectively).

17. DISPOSAL OF SUBSIDIARIES

On 23 April, 2010, the Group has disposed the Charm Action Group Limited and its subsidiary ("Charm Action Group") at the consideration of US$1. The net liabilities of the Charm Action Group at the date of disposal were as follows:

	HK$'000
Net liabilities disposed of	
Property, plant and equipment	3
Inventories	13
Trade receivables	164
Bank balances and cash	389
Trade payables	(1,647)
Amount due to related companies	(20,457)
	(21,535)
Cash Consideration	–
Release of translation reserve	(368)
Gain on disposal of subsidiaries	(21,903)
Net cash outflow arising on disposal	
Cash consideration	–
Bank balances and cash disposed of	(389)
	(389)

18. RELATED PARTY TRANSACTIONS

The remuneration of key management during the period was HK$1,851,167 (six months ended 30 June 2009: HK$3,986,000).

19. EVENTS AFTER THE END OF THE INTERIM PERIOD

On 21 July 2010, it was announced by the Company that the board of directors of the Company proposed to put forward to the shareholders of the Company a proposal which included a capital reorganisation (the "Capital Reorganisation"), change of board size and a rights issue (the "Rights Issue").

(i) The Capital Reorganisation includes:–

– a proposed share consolidation (the "Share Consolidation") whereby every 40 issued and unissued shares of par value of HK$0.10 each will be consolidated into one consolidated share of HK$4 each (the "Consolidated Share");

– a proposed capital reduction whereby upon the Share Consolidation becoming effective, the nominal value of all the issued Consolidated Shares shall be reduced from HK$4 each to HK$0.10 each, and the issued and paid up capital of the Company shall be cancelled to the extent of HK$3.9 per Consolidated Share in issue, and the entire amount of the authorised but unissued share capital of the Company be cancelled (the "Capital Reduction");

– a proposed share premium cancellation whereby upon the Capital Reduction becoming effective, the entire amount standing to the credit of the share premium account of the Company be cancelled (the " Share Premium Cancellation"); and

– the authorised share capital will be increased to HK$1,000,000,000 divided into 10,000,000,000 shares.

19. EVENTS AFTER THE END OF THE INTERIM PERIOD (CONTINUED)

(ii) Change of board size

The Company proposed to change the board lot size for trading on The Stock Exchange of Hong Kong Limited from 2,000 shares to 10,000 adjusted shares upon the Capital Reorganisation becoming effective.

(iii) The Rights Issue

Upon the Capital Reorganisation becoming effective, the Company proposed to issue not less than 1,847,245,240 but not more than 2,478,902,780 rights shares at a subscription price of HK$0.22 per rights share, on the basis of twenty rights shares for every share in issue on the record date.

For details of the Capital Reorganisation, change of board size and the Rights Issue, please refer to the announcement of the Company dated 21 July 2010.