

1. CORPORATE INFORMATION

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 20 September 2002 under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands.

The companies comprising the Group underwent a reorganisation on 21 June 2003 to rationalise the Group's structure in preparation for the listing of the shares of the Company on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), pursuant to which the Company became the holding company of the Group (the "Group Reorganisation").

During the year, the Group was principally engaged in the development, manufacture and sale of non-patented chemical medicines including cephalosporin in bulk medicine and powder for injection form, their intermediate pharmaceuticals and system specific medicines in the People's Republic of China (the "PRC"). In the opinion of the directors, Fortune United Group Limited, a company incorporated in the British Virgin Islands, is the holding company of the Company.

The shares of the Company were listed on the Main Board of the Stock Exchange on 11 July 2003.

2. IMPACT OF RECENTLY ISSUED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

The following revised, amended and new standards which are generally effective for accounting periods beginning on or after 1 January 2005 may result in changes in the future as to how the Group's financial performance and financial position are prepared and presented:

- IAS 1 Presentation of Financial Statements (amended 2004);
- IAS 2 Inventories (revised 2003);
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors (revised 2003);
- IAS 10 Events after the Balance Sheet Date (amended 2004);
- IAS 16 Property, Plant and Equipment (amended 2004);
- IAS 17 Leases (amended 2004);
- IAS 24 Related Party Disclosures (revised 2003);
- IAS 27 Consolidated and Separate Financial Statements (amended 2004);
- IAS 32 Financial Instruments: Disclosure and Presentation (amended 2004);
- IAS 33 Earnings per Share (amended 2004);
- IAS 39 Financial Instruments: Recognition and Measurement (amended 2004); and
- IFRS 2 Share-Based Payments.

The Group has not early adopted these revised, amended and new standards for the year ended 31 December 2004. The Group has commenced its assessment of the impact of these standards but it is not yet in a position to state whether these standards would have a material impact on its results of operations and financial position.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board, the disclosure requirements of the Hong Kong Companies Ordinance and the Rules Governing the Listing of Securities on the Stock Exchange. They have been prepared under the historical cost convention, except for the periodic remeasurement of certain short term listed investments, as further explained below.

BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries. The financial statements of the subsidiaries are prepared using consistent accounting policies. Subsidiaries are consolidated from the date on which control is transferred to the Group and ceased to be consolidated from the date on which control is transferred out of the Group. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the results and net assets of the Company's subsidiaries.

The consolidated financial statements for the year ended 31 December 2003 were prepared by adopting uniting of interests method of accounting as a result of the Group Reorganisation which involved entities under common control. Under this method, the Company had been treated as the holding company of its subsidiaries for the year ended 31 December 2003 rather than from the date of acquisition of the subsidiaries. The consolidated results, statements of changes in equity, cash flows and the consolidated balance sheets of the companies now comprising the Group had been prepared as if the current Group structure were in existence throughout 2003.

SUBSIDIARIES

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

RELATED PARTIES

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

IMPAIRMENT OF ASSETS

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use and its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the income statement in the period in which it arises.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is credited to the income statement in the period in which it arises.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment losses.

The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the property, plant and equipment, the expenditure is capitalised as an additional cost of the property, plant and equipment.

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life, after taking into account its estimated residual value. The estimated useful lives of property, plant and equipment are as follows:

Buildings	20 years
Machinery and other equipment	5 to 10 years
Office equipment	5 years
Motor vehicles	5 years

The gain or loss on disposal or retirement of property, plant and equipment recognised in the income statement is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

LAND USE RIGHTS

Land use rights are stated at cost less accumulated amortisation. Land use rights are amortised on the straight-line basis over a period of 50 years.

CONSTRUCTION IN PROGRESS

Construction in progress represents property, plant and equipment under construction and is stated at cost. The acquisition period of an asset includes the period when the asset is under construction, installation and testing. Cost comprises direct costs of construction and capitalised borrowing costs on related borrowed funds during the period of construction. Construction in progress is transferred to the appropriate category of plant and equipment when it is completed and ready for its intended use. No depreciation is provided on construction in progress until the asset is completed and is ready for its intended use.

RESEARCH AND DEVELOPMENT COSTS

All research costs are charged to the income statement as incurred.

Expenditure incurred on projects to develop new products are capitalised and deferred only when the projects are clearly defined, the expenditure is separately identifiable and can be measured reliably; there is reasonable certainty that the projects are technically feasible; and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred.

Deferred development costs are stated at cost less any impairment losses and are amortised using the straight-line basis over the commercial lives of the underlying products not exceeding ten years, commencing from the date when the products are put into commercial production.

OPERATING LEASES

Leases where substantially all the rewards and risks of ownership of assets remain with the lessors are accounted for as operating leases. Where the Group is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

TRADE AND OTHER RECEIVABLES

Trade receivables, which generally have terms of about 60 days, are recognised and carried at original invoice amount less allowance for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off as incurred.

Prepayments, deposits and other receivables are recognised and carried at cost less allowance for any uncollectible amounts.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

TRADE AND OTHER PAYABLES

Liabilities for trade and other payables which are normally settled on terms of about 90 to 180 days are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the Group.

INTEREST-BEARING LOANS AND BORROWINGS

All loans and borrowings, which are interest-bearing and held to maturity, are initially recognised at cost, being the fair value of the consideration received, and are subsequently measured at amortised cost.

BORROWING COSTS

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e. assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale.

SHORT TERM INVESTMENTS

Short term investments are investments in equity securities held for trading purposes and are stated at their fair values on the basis of their quoted market prices at the balance sheet date, on an individual investment basis. The gains or losses arising from changes in the fair value of a security are credited or charged to the income statement in the period in which they arise.

INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour, subcontracting fees and an appropriate proportion of overheads.

Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents in the balance sheets comprise cash in hand and at banks and short term deposits with an original maturity of three months or less.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

INCOME TAX

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Currently enacted tax rates are used to determine deferred tax.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax assets and unused tax losses can be utilised.

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

GOVERNMENT GRANTS

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Where the grant is related to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

REVENUE RECOGNITION

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

- (a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;
- (b) interest income, on a time proportion basis, taking into account the principal outstanding and the effective interest rate applicable; and
- (c) dividend income, when the shareholders' right to receive payment has been established.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

RETIREMENT BENEFITS SCHEMES

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for those employees who are eligible to participate in the MPF Scheme. Contributions are made based on a percentage of the employees' basic salaries and charged to the income statement as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund. The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme.

The employees of the Group's subsidiaries which operate in the PRC (the "PRC Subsidiaries") are required to participate in a central pension scheme operated by the local municipal government. The contributions are charged to the income statement as they become payable in accordance with the rules of the central pension scheme.

ACCOMMODATION BENEFITS

Contributions to an accommodation fund administered by the Public Accumulation Funds Administration Centre are charged to the income statement as incurred.

SHARE OPTION SCHEME

The Company operates a share option scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The financial impact of share options granted under the share option scheme is not recorded in the Group's balance sheet until such time as the options are exercised, and no charge is recorded in the income statement or balance sheet for their cost. Upon the exercise of share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Options which are cancelled prior to their exercise date, or which lapse, are deleted from the register of outstanding options.

DIVIDENDS

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared, because the Company's memorandum and articles of association grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

FOREIGN CURRENCIES

The principal activities of the Group are transacted in RMB. Accordingly, the Group's functional and reporting currency is RMB.

Foreign currency transactions are recorded at the applicable rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into RMB at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the income statement.

On consolidation, the financial statements of the Company and its subsidiaries, other than the PRC Subsidiaries, are translated into RMB at the applicable rates of exchange ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

4. SEGMENT INFORMATION

The Group's turnover and profit were mainly derived from the sale of medicines by the PRC Subsidiaries to customers in the PRC. The principal assets employed by the Group are located in the PRC. Accordingly, no segmental analysis by business and geographical segments is provided.

5. TURNOVER AND REVENUE

Turnover represents the net invoiced value of goods sold, net of value-added tax, after allowances for returns, trade discounts and various types of business tax and government surcharges where applicable.

	Group	
	2004	2003
	RMB'000	RMB'000
Turnover		
Sale of goods	585,058	491,881
Less: Sales tax and government surcharges	(300)	(493)
	<u>584,758</u>	<u>491,388</u>
Turnover		
Other revenue		
Interest income from bank balances	1,165	770
Government grants	50	67
Dividend income from short term investments	110	—
Gain on disposal of short term investments	105	8
Others	526	22
	<u>1,956</u>	<u>867</u>
Other revenue		
Total revenue	<u><u>586,714</u></u>	<u><u>492,255</u></u>

Notes to Financial Statements

31 December 2004

6. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities is arrived at after charging/(crediting) :

	<i>Notes</i>	Group	
		2004	2003
		RMB'000	RMB'000
Auditors' remuneration		691	893
Cost of inventories sold		392,081	285,485
Amortisation of:			
Deferred development costs *	18	742	566
Land use rights **	16	306	212
Depreciation	15	12,389	6,097
Loss on disposal of property, plant and equipment		1,427	128
Minimum lease payments under operating leases in respect of buildings		963	631
Staff costs (including directors' remuneration (note 8)):			
Retirement costs	10	4,071	2,715
Accommodation benefits	10	2,734	1,348
Salaries and other staff costs		32,877	23,474
Total staff costs		39,682	27,537
Research and development costs		12,309	10,305
Exchange losses, net		42	48
Unrealised loss on revaluation of short term investments		247	—
Interest income		(1,165)	(770)
Dividend income from short term investments		(110)	—
Gain on disposal of short term investments		(105)	(8)

* The amortisation of deferred development costs for the year are included in "Other operating expenses" on the face of the consolidated income statement.

** The amortisation of land use rights for the year are included in "Administrative expenses" on the face of the consolidated income statement.

7. FINANCE COSTS

	Group	
	2004	2003
	RMB'000	RMB'000
Interest on bank loans	—	897
Less: Interest capitalised	—	(88)
	<u>—</u>	<u>809</u>
	<u>—</u>	<u>809</u>

8. DIRECTORS' REMUNERATION

Directors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Companies Ordinance, is as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Fees	<u>175</u>	<u>115</u>
Other emoluments:		
Salaries, allowances and benefits in kind	3,649	1,707
Performance related bonuses	29	—
Pension scheme contributions	<u>64</u>	<u>28</u>
	<u>3,742</u>	<u>1,735</u>
	<u>3,917</u>	<u>1,850</u>

Fees include RMB175,000 (2003: RMB115,000) payable to the independent non-executive directors. There were no other emoluments payable to the independent non-executive directors during the year (2003: Nil).

Notes to Financial Statements

31 December 2004

8. DIRECTORS' REMUNERATION (Cont'd)

The number of directors whose remuneration fell within the following bands is as follows:

	Number of directors	
	2004	2003
Nil to HK\$1,000,000	10	8

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

During the year, certain directors were granted share options in respect of their services to the Group under the share option scheme of the Company, further details of which are set out in note 28 to the financial statements. No value in respect of the share options granted during the year has been charged to the income statement, or is otherwise included in the above directors' remuneration disclosures.

9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included three (2003: four) directors, details of whose remuneration are set out in note 8 above. Details of the remuneration of the remaining two (2003: two) non-director, highest paid employees for the year are as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Salaries, allowances and benefits in kind	914	567
Performance related bonuses	12	—
Pension scheme contributions	26	18
	952	585

The number of non-director, highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees	
	2004	2003
Nil to HK\$1,000,000	2	2

During the year, 2,300,000 share options were granted to the two non-director, highest paid employees in respect of their services to the Group, further details of which are included in the disclosures in note 28 to the financial statements. No value in respect of the share options granted during the year has been charged to the income statement, or is otherwise included in the above non-director, highest paid employees' remuneration disclosures.

10. RETIREMENT BENEFITS AND ACCOMMODATION BENEFITS

In compliance with the Mandatory Provident Fund Schemes Ordinance ("MPF Ordinance"), the Company has participated in the MPF scheme, a defined contribution scheme managed by an independent trustee, to provide retirement benefits to its Hong Kong employees. Contributions to the MPF scheme are made in accordance with the statutory limits prescribed by the MPF Ordinance.

As stipulated by the PRC state regulations, the PRC Subsidiaries participate in a defined contribution retirement scheme. All employees are entitled to an annual pension equal to a fixed proportion of the average basic salary amount within the geographical area of their last employment at their retirement date. The PRC Subsidiaries are required to make contributions to the local social security bureau at 20% to 22.5% (2003: 20% to 22.5%) of the previous year's average basic salaries within the geographical area where the employees are under employment with the PRC Subsidiaries. The Group has no obligation for the payment of pension benefits beyond the annual contribution as set out above.

According to the relevant rules and regulations of the PRC, the PRC Subsidiaries and their employees are each required to make contributions to an accommodation fund at 7% to 10% (2003: 7% to 10%) of the salaries and wages of the employees which is administered by Public Accumulation Funds Administration Centre. There is no further obligation on the part of the Group except for such contribution to the accommodation fund.

At 31 December 2004, the Group had no significant obligations apart from the contributions as stated above.

11. TAX

(I) INCOME TAX EXPENSE

The income tax expense, all current, charged to the consolidated income statement for the year ended 31 December 2004 was as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Income tax expense	7,947	13,704
Tax refund	(1,722)	(9,708)
	<u>6,225</u>	<u>3,996</u>

No provision for Hong Kong profits tax has been made as the Group had no profits arising in Hong Kong during the year.

Notes to Financial Statements

31 December 2004

11. TAX (Cont'd)

(I) INCOME TAX EXPENSE (Cont'd)

According to the Income Tax Law of the PRC, four subsidiaries of the Company, namely Suzhou Dawnrays Pharmaceuticals Co., Ltd. ("Suzhou Dawnrays Pharmaceuticals"), Suzhou Dawnrays Chemical Co., Ltd. ("Suzhou Dawnrays Chemical"), Suzhou Dawnrays Pharmaceutical Technology Co., Ltd. ("Suzhou Dawnrays Technology") and Shanghai Dawnrays Chemical Co., Ltd. ("Shanghai Dawnrays Chemical"), which operate in approved economic development zones of the PRC, are exempted from corporate income tax of the PRC for the two years starting from the first profitable year of operation, after setting off losses carried forward, and are entitled to a 50% relief from corporate income tax of the PRC for the following three years.

Suzhou Dawnrays Pharmaceuticals is in its fourth profitable year in 2004 and therefore its applicable income tax rate is 12%. However, Suzhou Dawnrays Pharmaceuticals obtained tax approval from the relevant tax authorities as a qualified foreign-owned manufacturing enterprise engaging in technology-intensive and knowledge-intensive projects ("Double-intensive Enterprise"). According to PRC tax laws and regulations, Suzhou Dawnrays Pharmaceuticals is subject to the corporate income tax of the PRC at a rate of 7.5% from 1 January 2003 to 31 December 2005, and at 15% from 1 January 2006 onwards. Its status as a Double-intensive Enterprise is subject to periodic reassessment by the relevant PRC government authorities.

The paid-up capital of Suzhou Dawnrays Pharmaceuticals was increased by US\$15,000,000 from US\$10,000,000 to US\$25,000,000 during the year. According to PRC tax laws and regulations, taxable profits generated in the first two years and the three years thereafter from the aforesaid additional capital is exempted from corporate income tax and taxed at a 50% reduced rate, respectively. The relevant PRC tax laws and regulations also granted enterprises qualified an option to use the tax concession in respect of the taxable profit in the following year after the additional capital has been contributed. Since the operation period for the aforesaid additional capital injected is less than six months, Suzhou Dawnrays Pharmaceuticals has opted to commence the tax concession in 2005. Consequently, profits generated from the aforesaid additional capital is still subject to the corporate income tax of the PRC at a rate of 7.5% in 2004.

Shanghai Dawnrays Chemical is in its third profitable year based on the income for statutory financial reporting purposes. It is subject to the corporate income tax of the PRC at a rate of 12% and local corporate income tax at a rate of 1.5% from 1 January 2004 to 31 December 2006.

Suzhou Dawnrays Chemical and Suzhou Dawnrays Technology had no assessable profits and therefore, no provision for income tax has been made for the year.

No provision for deferred tax has been made as the net effect of all temporary differences is immaterial.

11. TAX (Cont'd)

(I) INCOME TAX EXPENSE (Cont'd)

The reconciliation between tax expense and the product of accounting profit in the accompanying consolidated results of operation multiplied by the applicable income tax rate is as follows:

Group – 2004

	RMB'000	%
Profit before tax	86,412	
Tax at the statutory tax rate	28,516	33.0
Lower tax rate for specific provinces or local authorities	(21,735)	(25.2)
Expenses not deductible for tax	1,166	1.3
Tax charge at the Group's effective rate	7,947	9.1

Group – 2003

	RMB'000	%
Profit before tax	112,424	
Tax at the statutory tax rate	37,100	33.0
Lower tax rate for specific provinces or local authorities	(23,609)	(21.0)
Expenses not deductible for tax	213	0.2
Tax charge at the Group's effective rate	13,704	12.2

(II) TAX REFUND

As Suzhou Dawnrays Pharmaceuticals is an approved Double-intensive Enterprise as mentioned above, Suzhou Dawnrays Pharmaceuticals received a refund of the excess of the corporate income tax paid in 2003 in relation to the aforesaid reduced corporate income tax rate amounting to RMB4,818,000 in 2004.

Pursuant to board resolutions of Suzhou Dawnrays Pharmaceuticals dated 15 December 2003 and 8 March 2004, Suzhou Dawnrays Pharmaceuticals declared a dividend of RMB82,205,630 to Dawnrays International Company Limited ("Dawnrays International") pertaining to the year ended 31 December 2003. Pursuant to board resolutions of Dawnrays International dated 18 December 2003 and 9 March 2004, Dawnrays International reinvested the aforesaid dividend of RMB82,205,630 into Suzhou Dawnrays Pharmaceuticals. According to PRC tax laws and regulations, Dawnrays International accrued a tax refund in relation to the aforesaid reinvestment amounting to RMB9,708,000 in 2003, based on the then effective corporate income tax of 12%. As Suzhou Dawnrays Pharmaceuticals is now an approved Double-intensive Enterprise, Dawnrays International reduced the tax refund accrued in relation to the aforesaid reinvestment to RMB6,612,000 by RMB3,096,000 which has been charged to the current year tax expense.

Notes to Financial Statements

31 December 2004

12. NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net profit from ordinary activities attributable to shareholders for the year ended 31 December 2004 dealt with in the financial statements of the Company was RMB4,184,000 (2003: RMB79,767,000).

13. DIVIDENDS

	Company	
	2004 RMB'000	2003 RMB'000
Dividend pertaining to the prior year declared during the year	29,840	69,245
Interim – HK\$0.015 (2003: HK\$0.015) per ordinary share	12,760	12,760
	<u>42,600</u>	<u>82,005</u>
Proposed final – HK\$0.023 (2003: HK\$0.035) per ordinary share	<u>19,543</u>	<u>29,840</u>

On 7 March 2005, the Company declared a final dividend for the year ended 31 December 2004, at HK\$0.023 per share, amounting to a total sum of HK\$18,400,000 (equivalent to RMB19,543,000).

14. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the net profit attributable to shareholders for the year of RMB80,171,000 (2003: RMB108,022,000), and the weighted average of 800,000,000 (2003: 696,438,356) ordinary shares in issue during the year.

As the exercise price of outstanding share options is higher than the average fair value of the ordinary share during the year, the conversion to ordinary shares would increase earnings per share.

The diluted earnings per share amount for the year ended 31 December 2004 has not been presented, as the share options outstanding during the year had an anti-dilutive effect on the basic earnings per share calculation.

15. PROPERTY, PLANT AND EQUIPMENT

	Group				
	Buildings	Machinery and other equipment	Office equipment	Motor vehicles	Total
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Cost:					
At beginning of year	41,902	86,684	6,095	6,952	141,633
Additions	—	1,029	1,246	2,133	4,408
Transferred from construction in progress	38,601	38,137	53	—	76,791
Disposals	(1,230)	(1,619)	(553)	(188)	(3,590)
At 31 December 2004	79,273	124,231	6,841	8,897	219,242
Accumulated depreciation:					
At beginning of year	5,297	16,861	2,488	1,073	25,719
Provided for the year	2,599	7,391	735	1,664	12,389
Disposals	(303)	(972)	(492)	(115)	(1,882)
At 31 December 2004	7,593	23,280	2,731	2,622	36,226
Net book value:					
At 31 December 2004	71,680	100,951	4,110	6,275	183,016
At 31 December 2003	36,605	69,823	3,607	5,879	115,914

Buildings with net book values of RMB3,500,000 as at 31 December 2003 were pledged to banks to obtain credit lines from banks, such credit lines had not been utilised as at 31 December 2003. The pledge was subsequently released by the banks in January 2004.

Notes to Financial Statements

31 December 2004

15. PROPERTY, PLANT AND EQUIPMENT (Cont'd)

	Company
	Office equipment
	RMB'000
Cost:	
At beginning of year	652
Additions	70
	<hr/>
At 31 December 2004	722
	<hr/>
Accumulated depreciation:	
At beginning of year	—
Provided for the year	193
	<hr/>
At 31 December 2004	193
	<hr/>
Net book value:	
At 31 December 2004	529
	<hr/> <hr/>
At 31 December 2003	652
	<hr/> <hr/>

16. LAND USE RIGHTS

	Group
	RMB'000
Cost:	
At beginning of year	14,926
Additions	—
	<hr/>
At 31 December 2004	14,926
	<hr/>
Accumulated amortisation:	
At beginning of year	803
Provided for the year	306
	<hr/>
At 31 December 2004	1,109
	<hr/>
Net book value:	
At 31 December 2004	13,817
	<hr/> <hr/>
At 31 December 2003	14,123
	<hr/> <hr/>

17. CONSTRUCTION IN PROGRESS

	Group
	<i>RMB'000</i>
At beginning of year	57,529
Additions	59,951
Transferred to property, plant and equipment	(76,791)
	<u>40,689</u>
At 31 December 2004	<u>40,689</u>

18. DEFERRED DEVELOPMENT COSTS

	Group
	<i>RMB'000</i>
Cost:	
At beginning of year	11,647
Additions	3,616
	<u>15,263</u>
At 31 December 2004	<u>15,263</u>
Accumulated amortisation:	
At beginning of year	860
Provided for the year	742
	<u>1,602</u>
At 31 December 2004	<u>1,602</u>
Net book value:	
At 31 December 2004	<u>13,661</u>
At 31 December 2003	<u>10,787</u>

Notes to Financial Statements

31 December 2004

19. INTERESTS IN SUBSIDIARIES

	Company	
	2004 RMB'000	2003 RMB'000
Unlisted shares, at cost	100,175	100,175
Amounts due from subsidiaries	149,391	147,976
	<u>249,566</u>	<u>248,151</u>

The amounts due from subsidiaries of RMB149,391,000 (2003: RMB147,976,000) are trading balances which, although technically are repayable under the original terms of the transactions giving rise thereto, have been deferred for a longer term and are therefore classified as non-current.

Particulars of the subsidiaries are as follows:

Name	Place of incorporation/ registration and operations	Nominal value of issued shares/ paid-up capital	Percentage of equity attributable to the Group	Principal activities
<i>Directly held</i>				
Dawnrays International Company Limited	British Virgin Islands	US\$100	100	Investment holding
<i>Indirectly held</i>				
Suzhou Dawnrays Pharmaceuticals Co., Ltd.	PRC	US\$25,000,000	100	Manufacture and sale of pharmaceutical products
Shanghai Dawnrays Chemical Co., Ltd.	PRC	US\$680,000	92	Manufacture and sale of pharmaceutical intermediates
Suzhou Dawnrays Pharmaceutical Technology Co., Ltd.	PRC	US\$480,413	100	Research and development of pharmaceutical technology and products

19. INTERESTS IN SUBSIDIARIES (Cont'd)

Name	Place of incorporation/ registration and operations	Nominal value of issued shares/ paid-up capital	Percentage of equity attributable to the Group	Principal activities
Suzhou Dawnrays Chemical Co., Ltd.	PRC	US\$3,667,452	100	Manufacture and sale of pharmaceutical intermediates
Dawnrays Pharma (Hong Kong) Limited	Hong Kong	HK\$1	100	Dormant

20. INVENTORIES

	Group	
	2004 RMB'000	2003 RMB'000
Raw materials	13,759	13,862
Work in progress	48,645	20,489
Finished goods	22,362	19,991
	<u>84,766</u>	<u>54,342</u>

No inventories were stated at net realisable value at 31 December 2004 (2003: Nil).

Notes to Financial Statements

31 December 2004

21. TRADE AND NOTES RECEIVABLES

An aged analysis of the trade and notes receivables as at the balance sheet date, based on invoice date, is as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Trade receivables		
Outstanding balances with ages:		
Within 90 days	119,210	101,461
Between 91 to 180 days	2,932	3,937
Between 181 to 270 days	1,135	1,654
Between 271 to 360 days	990	566
Over one year	199	683
	<u>124,466</u>	<u>108,301</u>
Notes receivables		
Outstanding balances with ages:		
Within 90 days	54,318	34,247
Between 91 to 180 days	57,736	11,759
	<u>112,054</u>	<u>46,006</u>
	236,520	154,307
Less: Provision for bad and doubtful debts	<u>(510)</u>	<u>(510)</u>
	<u><u>236,010</u></u>	<u><u>153,797</u></u>

Included in the Group's trade receivables is an amount due from a company in which the chief executive of the Company is a director, of RMB3,450,000 (2003: Nil), which are repayable on similar credit terms to those offered to the major customers of the Group.

Notes to Financial Statements

31 December 2004

22. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group		Company	
	2004	2003	2004	2003
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Tax refund	6,612	9,708	—	—
Prepayments	7,056	5,476	—	—
Deposits and other debtors	2,476	2,297	361	365
	<u>16,144</u>	<u>17,481</u>	<u>361</u>	<u>365</u>

23. SHORT TERM INVESTMENTS

	Group		Company	
	2004	2003	2004	2003
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Listed equity investments, at market value:				
Hong Kong	598	—	598	—
	<u>598</u>	<u>—</u>	<u>598</u>	<u>—</u>

24. CASH AND CASH EQUIVALENTS

	Group		Company	
	2004	2003	2004	2003
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Cash and bank balances	45,174	61,706	6,444	6,401
Time deposits	53,208	72,815	27,208	67,814
Cash and cash equivalents	<u>98,382</u>	<u>134,521</u>	<u>33,652</u>	<u>74,215</u>

Notes to Financial Statements

31 December 2004

25. TRADE AND NOTES PAYABLES

An aged analysis of the trade and notes payables as at the balance sheet date, based on invoice date, is as follows:

	Group	
	2004 RMB'000	2003 RMB'000
Outstanding balances with ages:		
Within 90 days	107,486	104,598
Between 91 to 180 days	126,472	30,867
Between 181 to 270 days	42	6,045
Between 271 to 360 days	41	283
Over one year	236	439
	<u>234,277</u>	<u>142,232</u>

26. OTHER PAYABLES AND ACCRUALS

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Other payables	34,406	34,678	—	—
Accruals	4,120	1,757	773	1,115
	<u>38,526</u>	<u>36,435</u>	<u>773</u>	<u>1,115</u>

27. SHARE CAPITAL

SHARES

	2004 RMB'000	2003 RMB'000
Authorised:		
10,000,000,000 (2003: 10,000,000,000) ordinary shares of HK\$0.1 each	<u>1,000,000</u>	<u>1,000,000</u>
Issued and fully paid:		
800,000,000 (2003: 800,000,000) ordinary shares of HK\$0.1 each	<u>80,000</u>	<u>80,000</u>
Equivalent to RMB'000	<u>84,880</u>	<u>84,880</u>

27. SHARE CAPITAL (Cont'd)

SHARE OPTIONS

Details of the Company's share option scheme and the share options issued under the scheme are included in note 28 to the financial statements.

28. SHARE OPTION SCHEME

The Company operates a share option scheme (the "Scheme") for the purpose of providing incentives and rewards to eligible persons (including the Company's directors, employees of the Group and other eligible participants as defined under the Scheme) who contribute to the success of the Group's operations. The Scheme was adopted on 21 June 2003 and will remain in force for 10 years from that date until 20 June 2013.

The maximum number of share currently permitted to be issued upon the exercise of options under the Scheme is an equivalent to 10% of the shares of the Company in issue upon listing (unless refreshed) which is 80,000,000 shares, which represents 10% of the issued share capital of the Company at the date of this annual report. The maximum number of shares issuable under share options to each eligible person in the Scheme within any 12-month period, is limited to 1% of the shares of the Company in issue at that time. Any further grant of share options in excess of this limit is subject to shareholders' separately approval in a general meeting.

Share options granted to a director, chief executive or substantial shareholder of the Company, or to any of their associates, are subject to approval in advance by the independent non-executive directors. In addition, any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their associates, in excess of 0.1% of the shares of the Company in issue at any time or with an aggregate value (based on the closing price of the Company's shares at the date of the grant) in excess of HK\$5 million, within any 12-month period, are subject to shareholders' approval in advance in a general meeting.

An option may be exercised in accordance with the terms of the Scheme at any time during a period commencing on such date on or after the date on which the option is granted as the Board may determine in granting the option and expiring at the close of business on such date as the Board may determine in granting the option but in any event shall not exceed ten years from the date of grant.

A non-refundable remittance of HK\$10 by way of consideration for the grant of an option is required to be paid by each grantee upon acceptance of the option.

The exercise price of the share options is determinable by the directors, but shall not be less than the higher of (i) the Stock Exchange closing price of the Company's shares on the date of the offer of the share options; and (ii) the average Stock Exchange closing price of the Company's shares for the five trading days immediately preceding the date of the offer, provided that the exercise price shall not be less than the nominal value of the ordinary shares of the Company.

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

Notes to Financial Statements

31 December 2004

28. SHARE OPTION SCHEME (Cont'd)

The following share options were outstanding under the Scheme during the year:

Name or category of participant	Number of share options				Date of grant of share options*	Exercise period of share options	Exercise price of share options** HK\$	Price of Company's shares***	
	At 1 January 2004	Granted during the year	Lapsed during the year	At 31 December 2004				At grant date of options HK\$	At exercise date of options HK\$
Directors									
Ms. Li Kei Ling	700,000	—	—	700,000	11 November 2003	11 November 2004 to 10 November 2007	0.83	0.87	N/A
Mr. Hung Yung Lai	700,000	—	—	700,000	11 November 2003	11 November 2004 to 10 November 2007	0.83	0.87	N/A
Mr. Zhang Jing Xing	1,500,000	—	—	1,500,000	11 November 2003	11 November 2004 to 10 November 2007	0.83	0.87	N/A
Mr. Lam Kam Wah	848,000	—	—	848,000	11 November 2003	11 November 2004 to 10 November 2007	0.83	0.87	N/A
	—	1,000,000	—	1,000,000	17 November 2004	17 November 2005 to 16 November 2010	0.63	0.62	N/A
	848,000	1,000,000	—	1,848,000					
Mr. Li Tung Ming	1,048,000	—	—	1,048,000	11 November 2003	11 November 2004 to 10 November 2007	0.83	0.87	N/A
Mr. Xu Kehan	548,000	—	—	548,000	11 November 2003	11 November 2004 to 10 November 2007	0.83	0.87	N/A
	—	1,500,000	—	1,500,000	17 November 2004	17 November 2005 to 16 November 2010	0.63	0.62	N/A
	548,000	1,500,000	—	2,048,000					
Chief executive									
Mr. Dong Shao Zhi	—	2,000,000	—	2,000,000	17 November 2004	17 November 2005 to 16 November 2010	0.63	0.62	N/A
Other employees									
In aggregate	34,572,000	—	(3,484,000)	31,088,000	11 November 2003	11 November 2004 to 10 November 2007	0.83	0.87	N/A
	—	23,360,000	—	23,360,000	28 December 2004	28 December 2005 to 27 December 2010	0.58	0.59	N/A
	34,572,000	23,360,000	(3,484,000)	54,448,000					
	39,916,000	27,860,000	(3,484,000)	64,292,000					

28. SHARE OPTION SCHEME (Cont'd)

- * The vesting period of the share options is from the date of the grant until the commencement of the exercise period.
- ** The exercise price of the share options is subject to adjustment in accordance with the terms of the Scheme in the case of rights or bonus issues, or other similar changes in the Company's share capital.
- *** The price of the Company's shares disclosed as at the date of the grant of the share options is the Stock Exchange closing price on the trading day immediately prior to the date of the grant of the options. The price of the Company's shares disclosed as at the date of the exercise of the share options is the weighted average of the Stock Exchange closing prices.

At the balance sheet date, the Company had 64,292,000 share options outstanding under the Scheme, which represented approximately 8% of the Company's shares in issue as at that date. Up to the balance sheet date, none of such options granted was exercised or cancelled. The exercise in full of the remaining share options would, under the present capital structure of the Company, would result in the issue of 64,292,000 additional ordinary shares of the Company, additional share capital of HK\$6,429,200 (before share issue expenses).

29. RESERVES

The amounts of the Company's and the Group's reserves and the movements therein for the current and prior years are presented in the statements of changes in equity on pages 29 to 30 of the financial statements.

(I) CONTRIBUTION SURPLUS

The contribution surplus of the Group represents the difference between the aggregate of the nominal value of the paid-up capital of the subsidiaries acquired pursuant to the Group Reorganisation as set out in note 1, over the nominal value of the Company's shares issued in exchange therefor. The contribution surplus of the Company represents the excess of the then consolidated net assets of the subsidiaries acquired pursuant to the Group Reorganisation, over the nominal value of the Company's shares issued in exchange therefor.

(II) STATUTORY SURPLUS RESERVE ("SSR")

In accordance with the Company Law of the PRC and the articles of association of the PRC Subsidiaries, the PRC Subsidiaries are each required to allocate 10% of their profit after tax, as determined in accordance with PRC General Accepted Accounting Principles, to the SSR until such reserve reaches 50% of the registered capital of the PRC Subsidiaries. Part of the SSR may be converted to increase paid-up capital, provided that the remaining balance after the capitalisation is not less than 25% of the registered capital.

Notes to Financial Statements

31 December 2004

30. FINANCIAL INSTRUMENTS

FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group is exposed to market risk, including primarily, changes in interest rates. The Group does not hold or issue derivative financial instruments for trading purposes.

The Group does not hedge interest rate fluctuations.

EXCHANGE RATE RISK

The Group did not have significant exposure to market risk for changes in foreign currency exchange rates for the year ended 31 December 2004.

CREDIT RISK

Credit risk arising from the inability of a counterpart to meet the terms of the Group's financial instrument contracts is generally limited to the amounts, if any, by which the counterpart's obligations exceed the obligations of the Group. The Group minimises its exposure to credit risk by only dealing with counterparts with acceptable credit ratings.

NET FAIR VALUES

The aggregate net fair values of the financial assets and financial liabilities of the Group are not materially different from their carrying amounts.

CREDIT RISK EXPOSURES

The Group's maximum exposure to credit risk (not taking into account the value of any collateral or other securities held) in the event that the counterparts fail to perform their obligations as at 31 December 2004 in relation to each class of recognised financial assets is the carrying amount of those assets as indicated in the balance sheets.

SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

Concentration of credit risk exists when changes in economic, industrial or geographic factors similarly affect groups of counterparts whose aggregate credit exposure is significant in relation to the Group's total credit exposure. Significant concentration of credit risk arises from exposure to substantial amounts due from hospitals and medical institutions operating in the PRC.

31. COMMITMENTS

(I) LEASE COMMITMENTS

At 31 December 2004, the Group and the Company had total future minimum lease rentals payable under non-cancellable operating leases falling due as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Within one year	1,131	935	500	439
In the second to fifth years, inclusive	1,855	2,404	438	814
After five years	971	1,295	—	—
	<u>3,957</u>	<u>4,634</u>	<u>938</u>	<u>1,253</u>

(II) CAPITAL COMMITMENTS

	Group	
	2004 RMB'000	2003 RMB'000
Contracted, but not provided for:		
Land use rights	631	—
Buildings	3,420	17,150
Plant and machinery	4,965	7,817
	<u>9,016</u>	<u>24,967</u>
Authorised, but not contracted for:		
Plant and machinery	82,973	78,979
	<u>91,989</u>	<u>103,946</u>

Notes to Financial Statements

31 December 2004

32. RELATED PARTY TRANSACTIONS

The Group had the following related party transactions during the year ended 31 December 2004:

		Group		Company	
	Notes	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Recurring transaction:					
Sales of products to Livzon Pharmaceutical Group Inc.	(a)	3,889	—	—	—
Non-recurring transaction:					
Rental paid to Sing Lee Pharmaceutical Import & Export Co., Limited for lease of office premises	(b)	—	319	—	319

Notes:

- (a) The Company's chief executive, Mr. Dong Shao Zhi is also a director of Livzon Pharmaceutical Group Inc. ("Livzon"). The sales included the transaction with Livzon from July 2004 (date of Mr. Dong Shao Zhi's appointment) to the year end, which were made according to the published prices and conditions offered to the major customers of the Group. Details of the Group's trade balance with Livzon as at the balance sheet date is disclosed in note 21 to the financial statements.
- (b) Sing Lee Pharmaceutical Import & Export Co., Limited is a company equally owned by Ms. Li Kei Ling and Mr. Hung Yung Lai.

33. POST BALANCE SHEET EVENT

On 7 March 2005, the Company declared a final dividend for the year ended 31 December 2004, at HK\$0.023 per share, amounting to a total sum of HK\$18,400,000 (equivalent to RMB19,543,000).

34. COMPARATIVE FIGURES

Certain comparative amounts have been reclassified to conform with the current year's presentation.

35. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 7 March 2005.