

# Notes to Financial Statements

31 December, 2004

## 1. CORPORATE INFORMATION

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 2 February, 2000 under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. The Company's shares were listed on The Growth Enterprise Market (the "GEM") of the Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 29 September, 2000. On approval by the Stock Exchange, the Company's shares were withdrawn from the GEM and were listed on the main board from 8 December, 2003.

The head office and principal place of business of the Company in Hong Kong is located at Unit 9, 41st Floor, Office Tower, Convention Plaza, 1 Harbour Road, Wanchai, Hong Kong.

During the year, the Group has continued to be principally engaged in the research and development, production and sale of a series of biopharmaceutical products for the medical treatment of ophthalmic diseases and a series of modernised Chinese medicines and chemical medicines for the treatment of hepatitis; and the investment in sino-foreign equity joint ventures, whose principal activities are the manufacture, distribution and sale of pharmaceutical products.

## 2. IMPACT OF RECENTLY ISSUED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

The Hong Kong Institute of Certified Public Accountants has issued a number of new Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January, 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December, 2004. The new HKFRSs may result in changes in the future as to how the Group's financial performance and financial position are prepared and presented.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### **Basis of preparation**

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the periodic remeasurement of certain fixed assets as further explained in note 14.

### **Basis of consolidation**

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December, 2004. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. 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.

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

#### **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 Company's interests in subsidiaries are stated at cost less any impairment losses.

#### **Joint venture companies**

A joint venture company is a company set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture company operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture company's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

A joint venture company is treated as:

- (a) a subsidiary, if the Group/Company has unilateral control, directly or indirectly over the joint venture company;
- (b) a jointly-controlled entity, if the Group/Company does not have unilateral control, but has joint control, directly or indirectly, over the joint venture company;
- (c) an associate, if the Group/Company does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture company's registered capital and is in a position to exercise significant influence over the joint venture company; or
- (d) a long term investment, if the Group/Company holds, directly or indirectly, less than 20% of the joint venture company's registered capital and has neither joint control of, nor is in a position to exercise significant influence over the joint venture company.

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

#### **Jointly-controlled entity**

A jointly-controlled entity is a joint venture company which is subject to joint control, resulting in none of the participating parties having unilateral control over the economic activity of the jointly-controlled entity.

The Group's share of the post-acquisition results and reserves of jointly-controlled entity is included in the consolidated profit and loss account and consolidated reserves, respectively. The Group's interest in a jointly-controlled entity is stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses. Goodwill arising from the acquisition of a jointly-controlled entity is included as part of the Group's interest in a jointly-controlled entity.

The results of a jointly-controlled entity are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's interest in a jointly-controlled entity is treated as long term assets and is stated at cost less any impairment losses.

#### **Goodwill**

Goodwill arising on the acquisition of subsidiaries and a jointly-controlled entity represents the excess of the cost of the acquisition over the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition.

Goodwill arising on acquisition is recognised in the consolidated balance sheet as an asset and amortised on the straight-line basis over the respective estimated useful lives of 8 and 10 years. In the case of jointly-controlled entities, any unamortised goodwill is included in the carrying amount thereof, rather than as a separately identified asset on the consolidated balance sheet.

On disposal of subsidiaries and jointly-controlled entity, the gain or loss on disposal is calculated by reference to the net assets at the date of disposal, including the attributable amount of goodwill which remains unamortised and any relevant reserves, as appropriate.

The carrying amount of goodwill is reviewed annually and written down for impairment when it is considered necessary. A previously recognised impairment loss for goodwill is not reversed unless the impairment loss was caused by a specific external event of an exceptional nature that was not expected to recur, and subsequent external events have occurred which have reversed the effect of that event.

#### **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 profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

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 year. A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

#### Fixed assets and depreciation

Fixed assets, other than construction in progress, are stated at cost or valuation 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 fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account 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 fixed asset, the expenditure is capitalised as an additional cost of that asset.

Changes in the value of fixed assets are dealt with as movements in the revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on an individual asset basis, the excess of the deficit is charged to the profit and loss account. Any subsequent revaluation surplus is credited to the profit and loss account to the extent of the deficit previously charged. On disposal of a revalued asset, the relevant portion of the revaluation reserve realised in respect of a previous valuation is transferred to retained profits as a movement in reserves.

Depreciation is calculated on the straight-line basis to write off the cost or valuation of each asset, less its estimated residual value, over its estimated useful life. The principal annual rates used for this purpose are as follows:

Leasehold buildings	4% – 5%
Land use rights	4% – 5%
Leasehold improvements	5% – 20%
Plant and machinery	5% – 9%
Motor vehicles	9% – 18%
Furniture and fixtures	18%

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

#### **Fixed assets and depreciation (Cont'd)**

Land use rights are stated at cost or valuation less accumulated amortisation less any impairment losses. Amortisation is calculated on the straight-line basis to write off the cost or valuation of the land use rights over the respective period of land use rights.

Improvements to leasehold buildings are depreciated over the shorter of the lease term and the rate of 20% per annum.

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress represents factory buildings, plant and machinery and other fixed assets under construction or installation, and is stated at cost less any impairment losses and is not depreciated. Cost comprises the direct costs of construction, installation and testing. Construction in progress is reclassified to the appropriate category of fixed assets when completed and ready for use.

#### **Intangible assets**

##### *Patents*

Purchased patents are stated at cost less any impairment losses and are amortised on the straight-line basis over the respective estimated useful lives of not exceeding 10 years.

##### *Research and development costs*

All research costs are charged to the profit and loss account as incurred.

Expenditure incurred on projects to develop new products is 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**

Deferred development costs are stated at cost less any impairment losses and are amortised using the straight-line basis over the commercial lives of underlying products not exceeding five 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 the assets remain with the lessor are accounted for as operating leases. Where the Group is a lessee, rental payables under the operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

#### **Long term investment**

Long term investment represents non-trading investment in unlisted equity securities intended to be held on a long term basis.

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

#### Long term investment (Cont'd)

Unlisted securities are stated at cost less any impairment losses, on an individual basis. An impairment loss is recognised only if the carrying amount exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises.

#### 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 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

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

#### Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made for the amount of the obligation.

#### Income tax

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

Deferred 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.

Deferred tax liabilities are recognised for all taxable temporary differences:

- except where the deferred tax liability arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

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

#### Income tax (Cont'd)

Deferred tax assets are recognised for all deductible temporary differences, carryforward 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 carryforward of unused tax assets and unused tax losses can be utilised:

- except where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

#### Government grants

Government grants are recognized at their fair values where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates 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 is intended to compensate. Where the grant relates to an asset, the fair value is deducted from the carrying amount of the asset and released to the profit and loss account by way of a reduced depreciation charge.

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

#### 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:

- (i) 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;
- (ii) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable; and
- (iii) dividend income, when the shareholders' right to receive payment has been established.

#### Employee benefits

##### *Pension schemes*

The Company operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for all of those employees who are eligible to participate in the MPF Scheme. Contributions are made based on a percentage of the employees' basic salaries and are charged to the profit and loss account 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 Company in an independently administered fund. The Company's employer contributions vest fully with the employees when contributed into the MPF Scheme.

The employees of the Company's subsidiaries which operate in Mainland China are required to participate in a central pension scheme operated by the local municipal government. These subsidiaries are required to contribute 20 – 23% of the payroll costs to the central pension scheme. The contributions are charged to the profit and loss account as they become payable in accordance with the rules of the central pension scheme.

##### *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 Company's or the Group's balance sheet until such time as the options are exercised, and no charge is recorded in the profit and loss account 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. Share options which are cancelled prior to their exercise date, or which lapse, are deleted from the register of outstanding share options.

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

#### **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. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalised.

All other borrowing costs are recognised as expenses when incurred.

#### **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.

#### **Foreign currencies**

Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the profit and loss account.

On consolidation, the financial statements of subsidiaries and a jointly-controlled entity in Mainland China are translated into Hong Kong dollars using the net investment method. The profit and loss accounts of subsidiaries and the jointly-controlled entity in Mainland China are translated into Hong Kong dollars at the weighted average exchange rates for the year, and their balance sheets are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

For the purpose of the consolidated cash flow statement, the cash flow of subsidiaries in Mainland China is translated into Hong Kong dollars at the exchange rates ruling at the date of the cash flows. Frequently recurring cash flows of subsidiaries in Mainland China which arise throughout the year are translated into Hong Kong dollars at the weighted average exchange rates for the year.

### 4. SEGMENT INFORMATION

Segment information is presented by way of the Group's primary segment reporting basis, by business segment. In determining the Group's geographical segments, revenues are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets. No further geographical segment information is presented as over 90% of the Group's customers and operations are located in Mainland China.

The Group's operating businesses are structured and managed separately, according to the nature of their operations and the products and services they provide. Each of the Group's business segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other business segments. During the year, the directors reviewed the segment information disclosure, and information on biopharmaceutical, modernised Chinese and chemical medicines were further analysed. Summary details of the business segments are as follows:

- (a) the biopharmaceutical medicines segment comprises the manufacture, sale and distribution of the biopharmaceutical medicine products;
- (b) the modernised Chinese medicines and chemical medicines segment comprises the manufacture, sale and distribution of the modernised Chinese medicine and chemical medicine products; and
- (c) the investment segment is engaged in long term investment.

## 4. SEGMENT INFORMATION (Cont'd)

	For the year ended 31 December,	
	2004 HK\$'000	2003 HK\$'000
Segment revenue:		
Biopharmaceutical medicines	484,161	378,553
Modernised Chinese medicines and chemical medicines	555,495	436,356
Investment	10,727	6,791
	<b>1,050,383</b>	<b>821,700</b>
Segment results:		
Biopharmaceutical medicines	160,392	88,051
Modernised Chinese medicines and chemical medicines	125,137	97,881
Investment	4,030	(1,580)
	<b>289,559</b>	<b>184,352</b>
Unallocated expenses	(34,078)	(26,200)
Other revenue	10,347	9,318
Profit from operating activities	<b>265,828</b>	<b>167,470</b>
Finance costs	(1,348)	(1,380)
Share of profit of:		
A jointly-controlled entity (note a)	54,985	7,411
Amortisation of goodwill on acquisition of a jointly-controlled entity	(4,462)	(267)
Profit before tax	<b>315,003</b>	<b>173,234</b>
Tax	(29,940)	(23,299)
Profit before minority interests	<b>285,063</b>	<b>149,935</b>
Minority interests	(116,726)	(68,320)
Net profit from ordinary activities attributable to shareholders	<b>168,337</b>	<b>81,615</b>

Note:

- (a) The jointly-controlled entity is in the business segment of modernised Chinese medicines and chemical medicines.

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### 4. SEGMENT INFORMATION (Cont'd)

	As at 31 December,	
	2004	2003
	HK\$'000	HK\$'000
Segment assets:		
Biopharmaceutical medicines	324,434	220,045
Modernised Chinese medicines and chemical medicines	364,945	302,780
Investment	220,940	213,178
	910,319	736,003
Unallocated assets	7,964	–
	918,283	736,003
Segment liabilities:		
Biopharmaceutical medicines	94,477	73,903
Modernised Chinese medicines and chemical medicines	85,068	80,356
Investment	55,944	85,410
	235,489	239,669
Unallocated liabilities	12,233	–
	247,722	239,669
Other segment information:		
Depreciation and amortisation:		
Biopharmaceutical medicines	13,058	12,433
Modernised Chinese medicines and chemical medicines	13,823	12,126
Investment	1,142	1,146
	28,023	25,705
(Reversal of)/deficit on revaluation of leasehold buildings:		
Biopharmaceutical medicines	(712)	712
Other non-cash expenses:		
Biopharmaceutical medicines	456	285
Modernised Chinese medicines and chemical medicines	1,747	617
	2,203	902
Capital expenditure:		
Biopharmaceutical medicines	55,446	39,875
Modernised Chinese medicines and chemical medicines	46,930	10,212
Investment	1,231	3,830
	103,607	53,917

## 5. TURNOVER AND OTHER REVENUE AND GAINS

Turnover represents the net invoiced value of goods sold, after allowances for sales returns and discounts, and dividend income from an unlisted investment.

An analysis of turnover and other revenue and gains is as follows:

	2004 HK\$'000	2003 HK\$'000
<b>TURNOVER</b>		
Sale of goods	<b>1,039,656</b>	814,909
Dividend income from an unlisted investment	<b>10,727</b>	6,791
	<b>1,050,383</b>	821,700
<b>OTHER REVENUE</b>		
Interest income	<b>3,899</b>	2,652
Government grants	<b>1,226</b>	3,567
Sale of scrap materials	<b>2,105</b>	865
Others	<b>1,600</b>	2,234
	<b>8,830</b>	9,318
<b>GAINS</b>		
Gain on disposal of subsidiary (note 34)	<b>805</b>	—
Reversal of revaluation deficit (note 14)	<b>712</b>	—
	<b>1,517</b>	—
	<b>10,347</b>	9,318

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### 6. PROFIT FROM OPERATING ACTIVITIES

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

	Notes	2004 HK\$'000	2003 HK\$'000
Cost of inventories sold		<b>186,312</b>	168,696
Depreciation	14	<b>25,774</b>	24,049
Amortisation of intangible assets *	15	<b>1,323</b>	474
Amortisation of goodwill *	17	<b>926</b>	915
Minimum lease payments under operating leases:			
Land and buildings		<b>8,012</b>	9,522
Loss on disposal of fixed assets		<b>2,203</b>	902
Provision for doubtful debts		<b>161</b>	1,494
Research and development costs		<b>35,737</b>	32,070
Auditors' remuneration		<b>800</b>	627
Staff costs (including directors' remuneration, note 8)			
Wages and salaries		<b>131,762</b>	94,032
Pension scheme contributions **		<b>13,984</b>	11,509
		<b>145,746</b>	105,541
Exchange (gain)/losses, net		<b>(490)</b>	1,016

Notes:

\* The amortisation of intangible assets (i.e. patents) and goodwill for the year are included in "Cost of sales" and "Other operating expenses" on the face of the consolidated profit and loss account, respectively.

\*\* During the year, certain of the subsidiaries in Mainland China were members of a pension contribution scheme managed by the respective local governments. Contributions made during the year were based on 20% – 23% (2003: 20% – 23%) of the employees' salaries and were charged to the consolidated profit and loss account as they became payable.

For Hong Kong employees eligible for the MPF Scheme, the Group contributed 5% of the employees' salaries for the year ended 31 December, 2004 (2003: 5%).

## 7. FINANCE COSTS

	2004 HK\$'000	2003 HK\$'000
Interest on bank loans wholly repayable within one year	604	790
Interest on convertible bonds	744	590
	<b>1,348</b>	1,380

## 8. DIRECTORS' REMUNERATION

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

	2004 HK\$'000	2003 HK\$'000
Fees	173	114
Other emoluments:		
Salaries, allowances and benefits in kind	3,138	3,238
Pension scheme contributions	33	42
Discretionary bonuses	2,866	1,420
	<b>6,037</b>	4,700
	<b>6,210</b>	4,814

All the directors' fees were paid to the independent non-executive directors. There were no other emoluments payable to the independent non-executive directors during the year (2003: nil). The non-executive director did not receive any emoluments during the year (2003: nil).

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

	2004	2003
Nil to HK\$1,000,000	6	5
HK\$1,000,001 to HK\$1,500,000	–	1
HK\$2,000,001 to HK\$2,500,000	–	1
HK\$4,500,001 to HK\$5,000,000	1	–
	<b>7</b>	7

There was no arrangement under which a director waived or agreed to waive any remuneration during the current and prior years.

No share options were granted to the directors for the current and prior years in respect of their services to the Group.

No share options (2003: 16,800,000 share options, after adjusting the share subdivision effect) were exercised by the directors during the year.

## 9. FIVE HIGHEST PAID EMPLOYEES

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

	2004 HK\$'000	2003 HK\$'000
Salaries, allowances and benefits in kind	1,692	946
Pension scheme contributions	42	21
Discretionary bonuses	3,022	728
	<b>4,756</b>	1,695

The remuneration of all the non-director, highest paid employees fell within the band of nil to HK\$1,500,000.

During the year, no emoluments were paid by the Group to the directors or the other highest paid employees either as an inducement to join or upon joining the Group, or as compensation for loss of office (2003: nil).

During the year, no share options were granted to the non-directors, highest paid employees (2003: nil).

## 10. TAX

No provision for Hong Kong profits tax has been made as the Group had no assessable profits derived from or earned in Hong Kong during the current and prior years. Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries in which the Group operates based on existing legislation, interpretations and practices in respect thereof.

	Group	
	2004 HK\$'000	2003 HK\$'000
Provision for the year:		
Current – Mainland China income tax	30,466	22,330
Deferred tax (note 29)	(7,964)	–
	<b>22,502</b>	22,330
Share of tax attributable to:		
A jointly-controlled entity	7,438	969
Total tax charge for the year	<b>29,940</b>	23,299

## 10. TAX (Cont'd)

Pursuant to the Income Tax Law of Mainland China Concerning Foreign Investment Enterprises and Foreign Enterprises and various local income tax laws (the "Income Tax Laws"), joint venture companies are subject to the statutory corporate income tax rate of 33% (comprising 30% state income tax plus 3% local income tax) unless the enterprise is qualified as a "High and New Technology Enterprise" for which more favourable effective corporate income tax rates apply. The Group's principal operating subsidiaries qualify as "High and New Technology Enterprises" for which a preferential corporate income tax rate of 15% applies.

Jiangsu Chia Tai-Tianqing Pharmaceutical Co., Ltd. ("JCTT"), one of the Group's principal operating subsidiaries, is exempt from corporate income tax for the two years commencing from its first year with assessable profits after deducting tax losses brought forward, and is entitled to a 50% exemption from the full corporate income tax rate for the succeeding three years (the "Tax Exemption"). The Tax Exemption expired on 31 December, 2002. As JCTT qualifies as an "Advanced Technology Enterprise", it is entitled to extend the period of a reduced corporate income tax rate for another three years on expiry of the Tax Exemption, provided that the minimum corporate income tax rate is not lower than 10%. Consequently, JCTT is subject to a corporate income tax rate of 10% in 2004.

Shandong Chia Tai Freda Pharmaceutical Co., Ltd. ("CTF"), another principal operating subsidiary of the Group, is also entitled to the Tax Exemption. The Tax Exemption expired on 31 December, 2001. As CTF qualifies as an "Advanced Technology Enterprise", it is entitled to extend the period of a reduced corporate income tax rate for another three years on expiry of the Tax Exemption, provided that the minimum corporate income tax rate is not lower than 10%. Consequently, CTF has been subject to a corporate income tax rate of 10% since 2002. The preferential tax rate for "Advanced Technology Enterprise" expired on 31 December, 2004.

Shandong Chia Tai Freda New Packaging Resources Co., Ltd. ("CTFP"), another operating subsidiary of the Group is also entitled to the Tax Exemption. CTFP is entitled to the 50% exemption for its corporate income tax and therefore, CTFP's corporate income tax rate was 7.5% for the year ended 31 December, 2004. The Tax Exemption will expire on 31 December, 2006.

Nanjing Chia Tai Tianqing Pharmaceutical Co., Ltd. ("NJCTT"), another principal operating subsidiary of the Group, is also entitled to the Tax Exemption. NJCTT is entitled to the preferential corporate income tax rate of 15% as it is located in Nanjing technology development area.

Beijing Tide Pharmaceutical Co., Ltd. ("Beijing Tide"), a jointly-controlled entity of the Group, is also entitled to the Tax Exemption. Beijing Tide's statutory corporate income tax rate is 24%. As Beijing Tide is also entitled to 50% exemption for its corporate income tax, its corporate income tax rate was 12% for the year ended 31 December, 2004. The Tax Exemption expired on 31 December, 2004. As Beijing Tide qualifies as an "Advanced Technology Enterprise", it is entitled to extend the period of a reduced corporate income tax rate for another three years on expiry of the Tax Exemption. Consequently, Beijing Tide is subject to a corporate income tax rate of 12% from 2005 to 2007.

## Notes to Financial Statements

31 December, 2004

### 10. TAX (Cont'd)

A reconciliation of the tax expense applicable to profit before tax using the statutory rates for the countries in which the Company and its subsidiaries and jointly-controlled entity are domiciled to the tax expense at the effective tax rates are as follows:

	<b>Group</b>	
	<b>2004</b>	<b>2003</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Profit before tax	<b>315,003</b>	173,234
Tax at the statutory tax rate of 33%	<b>103,951</b>	57,167
Less: preferential tax rate reduction by 18%	<b>(56,701)</b>	(31,182)
Expenses not deductible for tax	<b>7,270</b>	7,425
Non-taxable income	<b>(1,609)</b>	(1,019)
Tax losses of subsidiaries	<b>6,441</b>	5,821
Tax exemptions/deductions	<b>(29,412)</b>	(14,913)
Actual tax expense	<b>29,940</b>	23,299

### 11. 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 HK\$74,897,000 (2003: HK\$10,573,000) (note 32).

### 12. DIVIDENDS

	<b>Group and Company</b>	
	<b>2004</b>	<b>2003</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Interim dividend		
– HK\$0.04 (2003: HK\$0.0125 after adjustment of share subdivision) per ordinary share	<b>54,102</b>	16,600
Proposed final dividend		
– HK\$0.04 (2003: HK\$0.025 after adjustment of share subdivision) per ordinary share	<b>55,084</b>	33,200
	<b>109,186</b>	49,800

The proposed final dividend for the current year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting. The proposed final dividend for the prior year was approved by the Company's shareholders at the annual general meeting.

### 13. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the net profit attributable to shareholders for the year of HK\$168,337,000 (2003: HK\$81,615,000), and the weighted average number of 1,333,112,789 (2003: 1,326,947,944) ordinary shares in issue during the year.

The calculation of diluted earnings per share is based on the net profit attributable to shareholders for the year of HK\$168,337,000 (2003: HK\$81,615,000) and interest of HK\$354,000 (2003: HK\$590,000) on convertible bonds. The weighted average number of ordinary shares used in calculation is 1,333,112,789 (2003: 1,326,947,944) ordinary shares in issue during the year, as used in the basic earnings per share calculation; the weighted average of 58,919,969 (2003: 48,987,864) ordinary shares assumed to have been issued at no consideration on the deemed exercise of all share options during the year and the weighted average of 60,210,526 (2003: 98,556,308) ordinary shares assumed to have been issued on the deemed exercise of all convertible bonds during the year.

The total number of shares in issue used in the basic and diluted earnings per share calculation for 2003 have been adjusted to reflect the sub-division of shares during the year (note 30).

### 14. FIXED ASSETS

#### Group

	Leasehold buildings HK\$'000	Land use rights HK\$'000	Leasehold improve- ments HK\$'000	Plant and machinery HK\$'000	Motor vehicles HK\$'000	Furniture and fixtures HK\$'000	Con- struction in progress HK\$'000	Total HK\$'000
Cost or valuation:								
At beginning of year	60,050	6,100	23,009	106,074	17,368	24,176	29,686	266,463
Additions	541	17,644	540	7,033	3,034	6,957	66,918	102,667
Surplus on revaluation	2,429	1,047	–	–	–	–	–	3,476
Disposal of a subsidiary	–	–	–	–	–	(302)	–	(302)
Disposals	(2,625)	–	–	(4,774)	(269)	(2,265)	–	(9,933)
Transfers	12,681	–	–	6,409	56	35	(19,181)	–
Exchange realignment	117	6	25	188	9	51	47	443
At 31 December, 2004	73,193	24,797	23,574	114,930	20,198	28,652	77,470	362,814
Analysis of cost or valuation:								
At cost	–	–	23,574	114,930	20,198	28,652	77,470	264,824
At valuation	73,193	24,797	–	–	–	–	–	97,990
	73,193	24,797	23,574	114,930	20,198	28,652	77,470	362,814
Accumulated depreciation:								
At beginning of year	–	–	10,103	40,945	6,412	11,052	–	68,512
Provided during the year	3,248	129	2,862	12,514	3,145	3,876	–	25,774
Written back on revaluation	(1,156)	(129)	–	–	–	–	–	(1,285)
Disposal of a subsidiary	–	–	–	–	–	(122)	–	(122)
Disposals	(2,119)	–	–	(3,218)	(194)	(2,000)	–	(7,531)
Exchange realignment	27	–	6	64	6	14	–	117
At 31 December, 2004	–	–	12,971	50,305	9,369	12,820	–	85,465
Net book value:								
At 31 December, 2004	73,193	24,797	10,603	64,625	10,829	15,832	77,470	277,349
At 31 December, 2003	60,050	6,100	12,906	65,129	10,956	13,124	29,686	197,951

## 14. FIXED ASSETS (Cont'd)

## Company

	Motor vehicles <i>HK\$'000</i>	Furniture and fixtures <i>HK\$'000</i>	Total <i>HK\$'000</i>
Cost:			
At beginning of year	3,422	364	3,786
Additions	–	1,231	1,231
Exchange realignment	(14)	14	–
At 31 December, 2004	3,408	1,609	5,017
Accumulated depreciation:			
At beginning of year	415	194	609
Provided during the year	836	306	1,142
Exchange realignment	(1)	1	–
At 31 December, 2004	1,250	501	1,751
Net book value:			
At 31 December, 2004	2,158	1,108	3,266
At 31 December, 2003	3,007	170	3,177

The Group's leasehold buildings are all situated in the PRC and are held under long term leases.

The Group's leasehold buildings and land use rights as at 31 December, 2004 were revalued as at that date by DTZ Debenham Tie Leung Limited, independent professionally qualified valuers at an aggregate open market value of HK\$97,990,000 (2003: HK\$66,150,000) based on their existing use. The revaluation resulted in a surplus of HK\$5,209,000 (2003: HK\$8,533,000) and a deficit of HK\$448,000 (2003: HK\$712,000). The Group has credited HK\$2,395,000 (2003: HK\$4,555,000) to the revaluation reserve and reversed HK\$712,000 (2003: charged HK\$392,000) from the profit and loss account, respectively, in the current year.

Had the leasehold buildings and land use rights been carried at historical cost less accumulated depreciation, their carrying values would have been approximately HK\$87,130,000 as at 31 December, 2004.

As at 31 December, 2004, the Group had not obtained title certificates for certain acquired leasehold buildings and land use rights at net book values of HK\$10,713,000 and HK\$17,465,000, respectively (2003: HK\$24,071,000 and HK\$3,113,000, respectively). The directors are of the opinion that the title certificates will be obtained in due course.

## 15. INTANGIBLE ASSETS

## Patents

	Group	
	2004 HK\$'000	2003 HK\$'000
Cost:		
At beginning of year	4,432	2,563
Transferred from deferred development cost	4,700	–
Additions	1,371	1,869
At 31 December	10,503	4,432
Accumulated amortisation:		
At beginning of year	648	174
Provided during the year	1,323	474
At 31 December	1,971	648
Net book value	8,532	3,784

## 16. DEFERRED DEVELOPMENT COSTS

	Group	
	2004 HK\$'000	2003 HK\$'000
Cost:		
At beginning of year	11,024	–
Transferred to intangible assets	(4,700)	–
Additions	940	11,024
Exchange realignment	17	–
At 31 December	7,281	11,024

There is no amortisation for the two years ended 31 December, 2004 and 2003 as the products have not yet been put into commercial production.

## 17. GOODWILL

	Group	
	2004 HK\$'000	2003 HK\$'000
Cost:		
At beginning of year	8,245	6,781
Addition	–	1,464
At 31 December	8,245	8,245
Accumulated amortisation:		
At beginning of year	5,308	4,393
Provided during the year	926	915
At 31 December	6,234	5,308
Net book value	2,011	2,937

## Notes to Financial Statements

31 December, 2004

### 18. INTERESTS IN SUBSIDIARIES

	Company	
	2004 HK\$'000	2003 HK\$'000
Unlisted shares, at cost	131,300	131,299
Due from subsidiaries	82,606	81,273
Due to subsidiaries	(18,551)	(19,280)
	195,355	193,292

The amounts due from/(to) subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

Particulars of the subsidiaries are as follows:

Company name	Place of incorporation/ registration and operations	Paid-up/ registered capital	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
Ace Elite Investments Limited	British Virgin Islands/ Mainland China	US\$50,000 Ordinary	100	–	Investment holding
Beijing Chia Tai Green Continent Pharmaceutical Co., Ltd.	Mainland China	US\$1,000,000	–	75	Research and development of pharmaceutical products
Champion First Investments Limited	British Virgin Islands/ Mainland China	US\$2 Ordinary	100	–	Investment holding
Chia Tai Healthcare (Holdings) Limited	British Virgin Islands/ Mainland China	US\$50,000 Ordinary	100	–	Investment holding
Chia Tai Pharmaceutical (Lianyungang) Company Limited	British Virgin Islands/ Mainland China	US\$3 Ordinary	100	–	Investment holding
China Biotech & Drug Development Limited	Hong Kong	HK\$100 Ordinary	–	85	Research and development of pharmaceutical products

## 18. INTERESTS IN SUBSIDIARIES (Cont'd)

Company name	Place of incorporation/ registration and operations	Paid-up/ registered capital	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
Jiangsu Chia Tai-Tianqing Pharmaceutical Co., Ltd.	Mainland China	RMB99,000,000	–	60	Development, manufacture and distribution of pharmaceutical products
Magnificent Technology Limited	British Virgin Islands/Hong Kong	US\$1 Ordinary	100	–	Investment holding
Nanjing Chia Tai Tianqing Pharmaceutical Co., Ltd.	Mainland China	US\$5,050,000	–	51	Manufacture and sale of pharmaceutical products
Shandong Chia Tai Freda Pharmaceutical Co., Ltd.	Mainland China	RMB42,000,000	–	55	Development, manufacture and distribution of pharmaceutical products
Shandong Chia Tai Freda New Packaging Resources Co., Ltd.	Mainland China	RMB11,000,000	–	55	Production and sale of packaging materials
Sino Biopharmaceutical (Beijing) Limited	British Virgin Islands/ Mainland China	US\$50,000 Ordinary	100	–	Investment holding
Sino Concept Technology Limited	Hong Kong	HK\$10,100 Ordinary	100	–	Investment holding and provision of management services
Talent Forward Limited	British Virgin Islands/ Mainland China	US\$50,000 Ordinary	100	–	Investment holding

During the year, Hainan Chia Tai Freda Medicine Co., Ltd was disposed to a third party for a consideration of HK\$659,000 and Hainan Chia Tai Freda Pharmaceutical Co., Ltd was liquidated. Further details of the disposal and liquidation are included in note 34 to the financial statements.

## Notes to Financial Statements

31 December, 2004

### 19. INTEREST IN A JOINTLY-CONTROLLED ENTITY

	Group	
	2004	2003
	HK\$'000	HK\$'000
Share of net assets	84,275	36,728
Goodwill on acquisition	39,889	44,351
	<b>124,164</b>	<b>81,079</b>

The amortisation of goodwill provided during the year amounted to HK\$4,462,000 (2003: HK\$267,000).

Particulars of the jointly-controlled entity are as follows:

Name	Business structure	Place of incorporation/ registration and operations	Ownership interest	Percentage of Voting power	Profit sharing	Principal activities
Beijing Tide Pharmaceutical Company Limited	Corporate	Mainland China	35	31	35	Development, manufacture and distribution of pharmaceutical products

Investment in the jointly-controlled entity is indirectly held by the Company. As at 31 December, 2004, the aggregate amounts of current assets, non-current assets, current liabilities, turnover and net profit after tax of this jointly-controlled entity were as follows:

	Group	
	2004	2003
	HK\$'000	HK\$'000
Current assets	230,966	226,120
Non-current assets	113,786	35,710
Current liabilities	67,864	109,685
Turnover	280,212	180,617
Net profit after tax	135,848	87,519

**20. LONG TERM INVESTMENT**

	<b>Group</b>	
	<b>2004</b>	<b>2003</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Unlisted equity investment, at cost	<b>29,820</b>	29,820

The amount represents the Group's 5% equity investment in Chia Tai Qingchunbao Pharmaceutical Co., Ltd., which is engaged in the manufacture, distribution and sale of pharmaceutical products primarily made from natural herbal ingredients in Mainland China.

**21. INVENTORIES**

	<b>Group</b>	
	<b>2004</b>	<b>2003</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Raw materials	<b>19,576</b>	19,261
Work in progress	<b>11,687</b>	10,127
Finished goods	<b>27,125</b>	24,952
Spare parts and consumables	<b>624</b>	3,355
	<b>59,012</b>	57,695

No inventories were carried at net realisable value as at the balance sheet dates (2003: Nil).

**22. TRADE RECEIVABLES**

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit term is generally up to 90 days. The Group seeks to maintain strict control over its outstanding receivables and has a credit control department to minimise credit risk. Overdue balances are reviewed regularly by senior management.

An aged analysis of the Group's trade receivables as at the balance sheet dates, based on invoice date and net of provisions, is as follows:

	<b>Group</b>	
	<b>2004</b>	<b>2003</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Current to 90 days	<b>81,978</b>	52,857
91 days to 180 days	<b>14,209</b>	1,669
Over 180 days	<b>1,740</b>	24
	<b>97,927</b>	54,550

## Notes to Financial Statements

31 December, 2004

### 23. OTHER RECEIVABLES

	Group		Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Advances to suppliers	18,118	2,043	–	–
Other receivables	8,853	4,709	1,769	1,508
Prepaid expenses	1,038	1,562	294	593
	<b>28,009</b>	8,314	<b>2,063</b>	2,101

### 24. CASH AND CASH EQUIVALENTS

	Group		Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Cash and bank balances	183,696	170,313	2,028	5,799
Time deposits	92,518	118,536	60,195	68,292
Cash and cash equivalents	<b>276,214</b>	288,849	<b>62,223</b>	74,091

At the balance sheet date, the cash and bank balances of the Group denominated in Renminbi ("RMB") amounted to HK\$202,098,000 (2003: HK\$188,592,000). The RMB is not freely convertible into other currencies, however, under Mainland China's Foreign Exchange Control Regulations and Administration of Settlement, Sales and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorized to conduct foreign exchange business.

### 25. TRADE PAYABLES

An aged analysis of the Group's trade payables as at the balance sheet dates, based on invoice date, is as follows:

	Group	
	2004 HK\$'000	2003 HK\$'000
Current to 90 days	16,018	19,340
91 days to 180 days	349	578
Over 180 days	670	1,506
	<b>17,037</b>	21,424

**26. TAXES PAYABLE OTHER THAN PROFITS TAX**

	<b>Group</b>	
	<b>2004</b>	<b>2003</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Value-added tax	<b>9,053</b>	6,025
Individual income tax	<b>3,920</b>	4,708
Property tax	<b>386</b>	367
	<b>13,359</b>	11,100

**27. OTHER PAYABLES AND ACCRUALS**

	<b>Group</b>		<b>Company</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>
Advances from customers	<b>12,946</b>	8,797	–	–
Accrued payroll and bonus	<b>25,646</b>	25,194	<b>782</b>	149
Other payables	<b>35,043</b>	29,936	<b>960</b>	3
Accrued expenses	<b>48,839</b>	33,021	<b>3,204</b>	2,002
Housing fund	<b>700</b>	980	–	–
Staff welfare and bonus fund	<b>33,881</b>	18,900	<b>11</b>	50
	<b>157,055</b>	116,828	<b>4,957</b>	2,204

**28. AMOUNTS DUE TO RELATED COMPANIES**

The amounts due to related companies are unsecured, interest-free and have no fixed terms of repayment.

**29. DEFERRED TAX**

The movements in deferred tax liabilities and assets during the year are as follows:

***Deferred tax liabilities*****Group**

	<b>2004</b>
	<b>Revaluation of properties</b>
	<b>HK\$'000</b>
Deferred tax charge arising from revaluation of properties during the year	<b>2,527</b>
Gross deferred tax liability at 31 December, 2004	<b>2,527</b>

## Notes to Financial Statements

31 December, 2004

### 29. DEFERRED TAX (Cont'd)

#### Deferred tax assets

	Accruals HK\$'000	Provision for trade receivables HK\$'000	Fixed assets depreciation HK\$'000	Total HK\$'000
At 1 January, 2004	–	–	–	–
Deferred tax credited to the profit and loss account during the year (note 10)	5,971	539	1,454	7,964
Gross deferred tax assets At 31 December, 2004	5,971	539	1,454	7,964

### 30. SHARE CAPITAL

	Group and Company	
	2004 HK\$'000	2003 HK\$'000
Authorised:		
4,000,000,000 ordinary shares of HK\$0.025 each (2003: 1,000,000,000 ordinary shares of HK\$0.10 each)	100,000	100,000
Issued and fully paid:		
1,377,109,684 ordinary shares of HK\$0.025 each (2003: 332,000,000 ordinary shares of HK\$0.10 each)	34,428	33,200

The movements in the Company's issued capital during the year are summarised as follows:

	Number of shares in issue	Issued share capital HK\$'000	Share premium account HK\$'000	Total HK\$'000
At 1 January, 2003	320,000,000	32,000	90,038	122,038
Share options exercised (a)	12,000,000	1,200	7,680	8,880
At 31 December, 2003 and 1 January, 2004	332,000,000	33,200	97,718	130,918
Sub-division of shares (b)	996,000,000	–	–	–
On conversion of convertible bonds (c)	49,109,684	1,228	33,763	34,991
At 31 December, 2004	1,377,109,684	34,428	131,481	165,909

### 30. SHARE CAPITAL (Cont'd)

*Notes:*

- (a) On 8 January, 2003, 12,000,000 share options were exercised and the Company issued 12,000,000 new shares of HK\$0.10 each at a price of HK\$0.74 per share for a total cash consideration, before expenses, of HK\$8,880,000.
- (b) Pursuant to the approval of the shareholders on 27 April, 2004, for every issued and un-issued share of HK\$0.10 to be subdivided into four shares of HK\$0.025 each, 332,000,000 issued shares were sub-divided into 1,328,000,000 shares.
- (c) On 24 November, 2004, the holder of the 2002 Convertible Bond exercised the rights to convert an amount of US\$4,500,000 into 49,109,684 shares at a conversion price of HK\$0.7125 each, representing an increase in the issued share capital of approximately HK\$1,200,000 and an increase in the share premium account of approximately HK\$33,800,000 (note 33).

Details of the Company's share options scheme are included in note 31 to the financial statements.

### 31. SHARE OPTION SCHEMES

#### (a) The Existing Scheme

The Company operates a share option scheme (the "Existing Scheme") for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The Existing Scheme became effective on 19 September, 2000. On 26 April, 2002, the Existing Scheme was terminated and replaced by a new share option scheme, as detailed below under the heading "The New Scheme". Upon the termination of the Existing Scheme, no further share options will be granted pursuant to the Existing Scheme, however the Existing Scheme will, in all other respects, remain in force to the extent necessary to give effect to the exercise of the outstanding share options previously granted pursuant thereto. The outstanding share options will continue to be valid and exercisable in accordance with the rules of the Existing Scheme.

Eligible participants of the Existing Scheme included employees or executive directors of the Company or any of its subsidiaries. The directors of the Company are authorised to invite, at their discretion, eligible participants to take up options to subscribe for shares of the Company (the "Shares"). Unless otherwise cancelled or amended, the Existing Scheme will remain in force for a period of 10 years commencing on 19 September, 2000.

The maximum number of unexercised share options currently permitted to be granted under the Existing Scheme is an amount equivalent, upon their exercise, to 10% of the Shares in issue for a period of 10 consecutive years. The maximum number of shares issuable under share options to each eligible participant in the Existing Scheme within any 12-month period, is limited to 10% of the Shares in issue at any time. No option may be granted to any eligible participants which, if exercised in full, would result in such eligible participants becoming entitled to subscribe for such number of Shares as, and when aggregated with the total number of Shares already issued and remaining issuable to him or her under the Existing Scheme, would exceed 25% of the aggregate number of Shares for the time being issued and are issuable under the Existing Scheme.

### 31. SHARE OPTION SCHEMES (Cont'd)

#### (a) The Existing Scheme (Cont'd)

The offer of a grant of share options may be accepted within 21 days from the date of the offer, upon payment of a nominal consideration of HK\$1 in total by the grantee. The exercise period of the share options granted is determinable by the directors of the Company, which may commence from the date immediately following the date of grant and ending on such date as the directors of the Company may determine but in any event not exceeding 10 years from the date of grant of such share options.

The exercise price of the share options is determinable by the directors, but may 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 as stated in the daily quotation sheet of the Stock Exchange; 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 as stated in the daily quotation sheets of the Stock Exchange.

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

Pursuant to Clause 9.6 of the Rules of the Existing Scheme, if there is any alteration in the capital structure of the Company while any Option remains exercisable, whether by way of capitalization of profits or reserves, rights issued, consolidation, subdivision or reduction of the share capital of the Company (other than an issue of Shares as consideration in respect of a transaction to which the Company is a party) or otherwise, such corresponding alterations (if any) shall be made in:

- (a) the number of Shares (without fractional entitlements) subject to the Option so far as unexercised; and/or
- (b) the Subscription Price; and/or
- (c) the method of exercise of the Option.

Pursuant to the announcement dated 27 April, 2004, the subdivision of every issued and un-issued shares of HK\$0.10 each into four shares of HK\$0.025 each was approved by the shareholders.

## 31. SHARE OPTION SCHEMES (Cont'd)

## (a) The Existing Scheme (Cont'd)

Accordingly, the outstanding share options under the Existing Scheme have been altered as follows:

Name or category of participant	Number of share options				Price of the Company's shares ****					
	At 1 January 2004	On sub- division of shares* during the year	Exercised during the year	At 31 December 2004	Date of grant of share options*	Exercise period of share options	Exercise price per share option**  HK\$	Adjusted	At grant date of options  HK\$	At exercise date of options  HK\$
								exercise		
								price per share option***  HK\$		
Directors										
Tse Ping	4,500,000	13,500,000	–	18,000,000	2 January, 2001	3 January, 2003 to 1 January, 2007	0.74	0.185	0.74	–
Wang Jinyu	600,000	1,800,000	–	2,400,000	2 January, 2001	3 January, 2003 to 1 January, 2007	0.74	0.185	0.74	–
Tao Huiqi	600,000	1,800,000	–	2,400,000	2 January, 2001	3 January, 2003 to 1 January, 2007	0.74	0.185	0.74	–
	5,700,000	17,100,000	–	22,800,000						
Other employees										
In aggregate	12,300,000	36,900,000	–	49,200,000	2 January, 2001	3 January, 2003 to 1 January, 2007	0.74	0.185	0.74	–
	18,000,000	54,000,000	–	72,000,000						

\* The vesting period of the share options is from the date of grant until the commencement of the exercise period.

\*\* The exercise price of the share options is subject to adjustment in the case of rights or bonus issues, or other similar changes in the Company's share capital.

\*\*\* Pursuant to the Rules of the Existing Scheme, the exercise price per share option has been altered subsequent to the approved subdivision of shares by shareholders.

\*\*\*\* The price of the Company's shares disclosed as at the date of the share options is the Stock Exchange closing price on the date of grant of the options and the exercise date of the options.

At the balance sheet date, the Company had 72,000,000 share options outstanding under the Existing Scheme. The exercise in full of the remaining share options would, under the present capital structure of the Company, result in the issue of 72,000,000 additional ordinary shares of the Company and additional share capital of HK\$1,800,000 and share premium of HK\$11,520,000 (before issue expenses).

No share options were exercised or granted during the year.

**31. SHARE OPTION SCHEMES (Cont'd)****(b) The New Scheme**

Following the amendments to Chapter 23 of the GEM Listing Rules which came into effect on 1 October, 2001, no share options may be granted under the Existing Scheme unless such grant is made in compliance with the amended rules. To enable the Company to reward and provide incentives to eligible participants who may contribute to the success of the Group's operations, a new share option scheme (the "New Scheme") was adopted by the Company on 26 April, 2002 and at the same time the Existing Scheme was terminated. The New Scheme remains in force for ten years commencing from 26 April, 2002. On approval by the Stock Exchange for listing of the Company's shares on the main board, the Company adopted a proposed share option scheme (the "Proposed Scheme") and terminated the New Scheme pursuant to an ordinary resolution passed by the shareholders of the Company on 24 November, 2003. No share options were granted under the New Scheme since 26 April, 2002.

**(c) The Proposed Scheme (hereafter to be known as the "2003 Scheme")**

The Proposed Scheme (hereafter to be known as the "2003 Scheme") became effective on 8 December, 2003 upon the listing of the Company's shares on the Main Board, unless otherwise cancelled or amended, the 2003 Scheme remains in force for 10 years from that date.

The purpose of the 2003 Scheme is to enable the directors of the Company to grant share options to selected eligible participants as incentives or rewards for their contribution or potential contribution to the Group. Under the 2003 Scheme, the eligibility of the participants for the grant of any options shall be determined by the directors of the Company from time to time on the basis of their contribution or potential contribution to the development and growth of the Group and the directors may at their discretion, invite any person belonging to any of the following classes of participants to take up options for the Shares:

- (i) any director or proposed director (whether executive or non-executive, including any independent non-executive director), employee or proposed employee (whether full time or part time) of any member of the Group or any controlling shareholder ("Controlling Shareholder" as defined under rules of the share option scheme adopted by the shareholders of the Company at an extraordinary general meeting on 24 November, 2003) or any company controlled by a Controlling Shareholder ("Controlling Shareholder's Company");
- (ii) any individual for the time being selected to work for any member of the Group or any Controlling Shareholder or any Controlling Shareholder's Company;
- (iii) any holder of any securities issued by any member of the Group or any Controlling Shareholder or any Controlling Shareholder's Company;
- (iv) any business or joint venture partner, contractor, agent or representative of any member of the Group or any Controlling Shareholder or any Controlling Shareholder's Company;
- (v) any person or entity that provides research, development or other technological support or any advisory, consultancy, professional or other services incidental to the business of the Company and/or its subsidiaries to any member of the Group or any Controlling Shareholder or any Controlling Shareholder's Company;

**31. SHARE OPTION SCHEMES (Cont'd)****(c) The Proposed Scheme (hereafter to be known as the "2003 Scheme") (Cont'd)**

- (vi) any investor, vendor, supplier, producer, developer, agent, licensor service provider of any member of the Group or any Controlling Shareholder or any Controlling Shareholder's Company;
- (vii) any customer, licensee (including any sub-licensee), wholesaler, retailer, trader or distributor of goods or services of any member of the Group or any Controlling Shareholder or any Controlling Shareholder's Company;
- (viii) any landlord or tenant (including sub-tenant) of any member of the Group, or any Controlling Shareholder or any Controlling Shareholder's Company; and
- (ix) any company controlled by one or more persons belonging to any of the above classes of participants.

The maximum number of shares which may be allotted to and issued upon the exercise of all outstanding share options granted and yet to be exercised under the 2003 Scheme and any other share option schemes of the Company must not in aggregate exceed 30% of the relevant class of shares of the Company in issue at any time.

The total number of shares which may be allotted to and issued upon the exercise of all options to be granted under the 2003 Scheme and any other share option schemes of the Company must not in aggregate exceed 10% of the relevant class of shares of the Company in issue as at the date of adoption of the 2003 Scheme, unless shareholders' approval of the Company has been obtained.

The total number of shares issued and to be issued upon exercise of options granted under the 2003 Scheme and any other share option schemes of the Company to each participant, including cancelled, exercised and outstanding option, in any 12-month period up to the date of grant, shall not exceed 1% of the issued share capital of the Company. Any further grant of share options in excess of such limit is subject to shareholders' 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. Where any grant of share options to a substantial shareholder of the Company or an independent non-executive director of the Company, or any of their respective associates, would result in the total number of Shares issued and to be issued upon exercise of share options already granted and to be granted to such person under the 2003 Scheme and any other share option schemes of the Company (including option exercised, cancelled and outstanding) in any 12-month period up to and including the date of such grant (a) representing in aggregate over 0.1% of the Shares in issue; and (b) having an aggregate value (based on the closing price of the Shares at the date of each grant) in excess of HK\$5 million, such further grant of options must be approved by the shareholders in a general meeting.

Any change in the terms of the share options granted to a substantial shareholder of the Company or any independent non-executive director, or any of their respective associates must be approved by the shareholders in a general meeting.

### 31. SHARE OPTION SCHEMES (Cont'd)

**(c) The Proposed Scheme (hereafter to be known as the "2003 Scheme") (Cont'd)**

The offer of a grant of share options may be accepted within 30 days from the date of the offer, upon payment of a nominal consideration of HK\$1 in total by the grantee. A share option may be exercised in accordance with the terms of the 2003 Scheme at any time during a period to be determined on the date of offer of grant of share option and notified by the directors to each grantee. The exercise period may commence once the offer of the grant is accepted by the grantee within the prescribed time from the date of its offer and shall end in any event not later than 10 years from the date grant of the share option. Unless otherwise determined by the directors and provided in the offer of the grant of options to a grantee, there is no minimum period required under the 2003 Scheme for the holding of a share option before it can be exercised.

The exercise price of the Shares under the 2003 Scheme shall be a price determined by the board of directors but shall not be less than the highest of (i) the closing price of the Shares on the date of the offer of the grant; (ii) the average closing price of the Shares for the five business days immediately preceding the date of the offer of grant; and (iii) the nominal value of the Shares.

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

Pursuant to Clause 10 of the Rules of the 2003 Scheme regarding the alteration in the capital structure of the Company and the approval of the shareholders for the subdivision of the every issued and un-issued shares of HK\$0.10 each into four shares of HK\$0.025 each, the outstanding share options and the exercise price have been adjusted under the 2003 Scheme accordingly.

No share options were granted under the 2003 Scheme during the year.

## 32. RESERVES

## Group

		Share	Contributed	Leasehold	Statutory	Exchange	Retained	Total
		premium	surplus	properties	reserve	fluctuation	profits	
	Notes	account	HK\$'000	reserve	reserve	funds	reserve	HK\$'000
		HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January, 2003		90,038	52,605	28,924	2,546	4,565	361	51,889
Issue of shares		7,680	–	–	–	–	–	7,680
Interim dividend for 2003	12	–	–	–	–	–	–	(16,600)
Net profit for the year		–	–	–	–	–	–	81,615
Transfer from retained profits		–	–	–	–	16,339	–	(16,339)
Proposed final dividend 2003	12	–	–	–	–	–	–	(33,200)
Surplus on revaluation of leasehold buildings	14	–	–	–	4,555	–	–	–
Exchange realignment		–	–	–	–	(51)	(1,341)	–
At 31 December, 2003 and 1 January, 2004		97,718	52,605	28,924	7,101	20,853	(980)	67,365
Issue of shares	30	33,763	–	–	–	–	–	–
Interim dividend for 2004	12	–	–	–	–	–	–	(54,102)
Net profit for the year		–	–	–	–	–	–	168,337
Transfer from retained profits		–	–	–	–	56,842	–	(56,842)
Proposed final dividend 2004	12	–	–	–	–	–	–	(55,084)
Surplus on revaluation of leasehold buildings	14	–	–	–	971	–	–	–
Exchange realignment		–	–	–	–	(57)	671	–
At 31 December, 2004		131,481	52,605	28,924	8,072	77,638	(309)	69,674
Reserves retained by:								
Company and subsidiaries		131,481	52,605	28,924	8,072	77,638	(309)	15,685
A jointly-controlled entity		–	–	–	–	–	–	53,989
At 31 December, 2004		131,481	52,605	28,924	8,072	77,638	(309)	69,674
Company and subsidiaries		97,718	52,605	28,924	7,101	20,853	(980)	60,923
A jointly-controlled entity		–	–	–	–	–	–	6,442
At 31 December, 2003		97,718	52,605	28,924	7,101	20,853	(980)	67,365

### 32. RESERVES (Cont'd)

The Group's contributed surplus represents the difference between the nominal value of the shares and the share premium account of the former Group holding companies acquired pursuant to the Group reorganisation as stated in the Company's prospectus dated 22 September, 2000, over the nominal value of the Company's shares issued in exchange therefor.

On 24 November, 2004, the US\$4,500,000 convertible bonds were converted into 49,109,684 unit shares at a conversion price of HK\$0.7125 each, representing an increase in share capital of HK\$1,200,000 and an increase in share premium account of HK\$33,800,000 (see note 30).

Pursuant to the relevant laws and regulations for foreign investment enterprises incorporated under the Law of the Mainland China on Joint Venture Using Chinese and Foreign Investment and the articles of association of the Group's Mainland China joint ventures, profits of the Group's Mainland China joint ventures as determined in accordance with the accounting rules and regulations in the Mainland China are available for distribution in the form of cash dividends to the joint venture partners after the joint ventures have: (1) satisfied all tax liabilities; (2) provided for losses in previous years; and (3) made any required appropriations to the statutory reserve funds, including the general reserve fund, enterprise expansion fund and staff welfare and bonus fund. According to the articles of association of the respective Mainland China joint ventures of the Group, the appropriation to the statutory reserve funds are at the discretion of the board of directors of the respective joint ventures. The basis of appropriation of the general reserve fund and the enterprise expansion fund is 5% of the statutory annual net profit after tax of the respective Mainland China joint ventures. The appropriation to staff welfare and bonus fund is based on nil to 10% of the statutory annual net profit after tax of the respective Mainland China joint ventures and has been reclassified as expense on consolidation as it is a liability to the employees.

The general reserve fund can be used either to offset accumulated losses or be capitalised as equity. The enterprise expansion fund can be used to expand the joint venture's production and operation and subject to the approval of the relevant government authorities, can be utilised for increasing the capital of the joint venture. The staff welfare and bonus fund is recorded and reported as a current liability of the joint ventures and can be utilised for making special bonuses or collective welfare to the employees of the joint venture.

The capital reserve is non-distributable and arose from the capitalisation of the statutory reserve funds as paid-up capital upon approval for increasing the registered capital of the Mainland China joint ventures.

## 32. RESERVES (Cont'd)

**Company**

		Share premium account	Contributed surplus	Accumulated losses	Total
	Notes	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January, 2003		90,038	107,299	(39,752)	157,585
Issue of shares		7,680	–	–	7,680
Interim dividend for 2003	12	–	–	(16,600)	(16,600)
Net profit for the year		–	–	10,573	10,573
Proposed final 2003 dividend	12	–	–	(33,200)	(33,200)
At 31 December, 2003 and 1 January, 2004		97,718	107,299	(78,979)	126,038
Issue of shares	30	33,763	–	–	33,763
Interim dividend for 2004	12	–	–	(54,102)	(54,102)
Net profit for the year		–	–	74,897	74,897
Proposed final 2004 dividend	12	–	–	(55,084)	(55,084)
At 31 December, 2004		131,481	107,299	(113,268)	125,512

The contributed surplus of the Company represents the excess of the fair value of the shares of the subsidiaries acquired pursuant to the Group reorganisation as set out in the Company's prospectus dated 22 September, 2000, over the nominal value of the Company's shares issued in exchange therefor. Under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands, the share premium account may be distributed to shareholders under certain circumstances.

**33. CONVERTIBLE BONDS**

Pursuant to the shareholders' approval on 27 April, 2004 for the subdivision of each issued and un-issued shares of HK\$0.10 each of the Company into four subdivided shares of HK\$0.025 each, the conversion price of the 2002 Convertible Bond and the 2003 Convertible Bond issued by the Company has been adjusted from HK\$2.85 per share to HK\$0.7125 per subdivided share accordingly.

On 24 November, 2004, Jian Kang Ltd. exercised the conversion rights attached to the 2003 Convertible Bond in accordance with the terms and conditions contained in the instrument in the amount of US\$4,500,000 (approximately HK\$35,100,000) of the principal amount outstanding, and were converted into 49,109,684 shares of the Company at a conversion price of HK\$0.7125 per share, representing an increase in share capital of HK\$1,200,000 and share premium of HK\$33,800,000.

**34. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT****(a) Disposal of a subsidiary**

	2004 HK\$'000
Net assets disposed of:	
Fixed assets	180
Prepayments and other receivables	16
Inventories	40
Trade payables	(516)
Accruals and other payables	(23)
Taxes payable other than profits tax	157
	(146)
Gain on disposal of a subsidiary	805
	659
Satisfied by:	
Cash	659

An analysis of the net inflow of cash and cash equivalents in respect of the disposal of a subsidiary is as follows:

	2004 HK\$'000
Cash consideration	659
Cash and bank balances disposed of	—
Net inflow of cash and cash equivalents in respect of the disposal of a subsidiary	659

**34. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (Cont'd)****(b) Liquidation of a subsidiary**

On the date of liquidation, the subsidiary's balance sheet solely comprise amounts due from shareholders and retained profits. There was no cash flow effect arising from this liquidation.

**35. CONTINGENT LIABILITIES**

At the balance sheet dates, neither the Group nor the Company had any significant contingent liabilities.

**36. COMMITMENTS**

At the balance sheet dates, the Group had the following commitments:

**(a) Capital commitments**

	<b>Group</b>	
	<b>2004</b>	<b>2003</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Contracted, but not provided for the acquisition of:		
– fixed assets	<b>19,623</b>	25,583
– product technology	<b>3,914</b>	3,054
	<b>23,537</b>	28,637
Authorised, but not contracted for the acquisition of:		
– fixed assets	<b>27,263</b>	35,545

In addition, the Group's share of the jointly-controlled entity's capital commitments, which are not included in the above, were as follows:

	<b>Group</b>	
	<b>2004</b>	<b>2003</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>
Contracted, but not provided for the acquisition of:		
– fixed assets	<b>9,573</b>	19,233

The Company did not have any capital commitments at the balance sheet dates.

## 36. COMMITMENTS (Cont'd)

## (b) Commitments under operating leases

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

	Group		Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Within one year	2,751	2,862	1,605	832
In the second to fifth years, inclusive	3,087	4,089	342	55
After five years	23,515	24,037	–	–
	<b>29,353</b>	30,988	<b>1,947</b>	887

The Group's operating leases for land and buildings are entered into for terms ranging from one to fifty years.

In addition, the Group's share of the jointly-controlled entity's minimum lease payments under non-cancellable operating leases, which are not included in the above, were as follows:

	Group	
	2004 HK\$'000	2003 HK\$'000
Within one year	16	–

**37. RELATED PARTY TRANSACTIONS**

In addition to the transactions and balances detailed elsewhere in the consolidated financial statements, the Group had the following material transactions with related parties during the year:

	2004 HK\$'000	2003 HK\$'000
Sales of products to:		
– a Chinese joint venture partner of a subsidiary ( <i>note a</i> )	290	3,632
– a related party with a common shareholder of a subsidiary ( <i>note a</i> )	689	445
Purchases of raw materials from a related party with a common shareholder of a subsidiary ( <i>note b</i> )	18,704	15,056
Purchases of raw materials from:		
– a Chinese joint venture partner of a subsidiary ( <i>note b</i> )	1,780	1,834
– a company indirectly owned by a director ( <i>note b</i> )	40	317
Operating lease rentals payable to:		
– a fellow subsidiary of a subsidiary's Chinese joint venture partner ( <i>note c</i> )	4,756	4,340
– a Chinese joint venture partner of a subsidiary ( <i>note c</i> )	561	561
– a company beneficially owned by a director ( <i>note c</i> )	684	660
Research and development expenses to a fellow subsidiary of a subsidiary's Chinese joint venture partner ( <i>note d</i> )	941	6,406

*Notes:*

- (a) Sales of products to the Chinese joint venture partner of the subsidiary and a related party with a common shareholder of a subsidiary were conducted with reference to the market prices.
- (b) Purchases of raw materials were conducted with reference to the market prices.
- (c) Lease rentals were based on tenancy agreements entered into between the Group and each of the related parties with reference to the market prices.
- (d) Research and development expenses were based on the terms of the agreements entered into with the related party.

**38. POST BALANCE SHEET EVENTS**

Subsequent to the balance sheet date, on 30 March, 2005, the directors of the Company proposed a final dividend of HK\$0.04 per share which has been classified as a separate allocation of retained profits within the reserve section of the financial statements (notes 12 and 32). In addition, on the same date, the directors of the Company proposed a bonus issue of one share for every two existing shares of the Company.

### 39. COMPARATIVE AMOUNTS

As disclosed in note 13 to the financial statements, disclosure on the earnings per share has been revised to reflect the sub-division of shares during the year.

### 40. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 30 March, 2005.