

Directors' Report



The Directors have pleasure in submitting their report together with the audited accounts of the Company and the Group for the year ended 31 December 2004.

LISTING OF SHARES

The Company's shares had been listed on The Growth Enterprise Market (the "GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 7 February 2002. On 4 August 2003, the Company withdrew the listing of its shares on the GEM and on the same date, the Company's shares were listed on the main board of the Stock Exchange by way of introduction.

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The Company is an investment holding company. Its subsidiaries are principally engaged in research and development, selling and manufacturing of pharmaceutical products. An analysis of the Group's performance for the year by business and geographical segments is set out in note 2 to the accounts.

RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated profit and loss account on page 33.

The Directors have declared an interim dividend of HK0.5 cent per share, with option of 1 scrip share for every 75 shares or in cash. On 8 October 2004, the interim dividend was settled by cash of HK\$6,970,469 and by scrip share amounting to HK\$525,967.

The Directors do not recommend the payment of final dividend for the year 2004.

FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the five years ended 31 December 2004 is set out on page 2 of the annual report.

RESERVES

Movements in the reserves of the Group and the Company during the year are set out in note 24 to the accounts.

INTANGIBLE ASSETS AND FIXED ASSETS

Details of the movements in intangible assets and fixed assets of the Group are set out in notes 11 and 12 to the accounts respectively.

Directors' Report



SUBSIDIARIES

Details of the principal subsidiaries of the Company are set out in note 34 to the accounts.

SHARE CAPITAL

Details of the movements in share capital of the Company are set out in note 23 to the accounts.

DIRECTORS

The directors of the Company during the year and up to the date of this report were:

Executive directors

Mr. TAO Lung (<i>Chairman</i>) ("Mr. Tao")	(re-designated on 21/10/2004)
Mr. XU Xiaofan (<i>Chief Executive Officer</i>) ("Mr. Xu")	(appointed on 21/10/2004)
Mr. LIU James Jin ("Mr. Liu")	(re-designated from non-executive director to executive director on 22/11/2004)
Mr. JIN Wei ("Mr. Jin")	(appointed on 1/4/2004)
Mr. SHEN Songqing ("Mr. Shen")	(appointed on 1/4/2004)
Mr. HUANG Jianming ("Mr. Huang")	(appointed on 1/4/2004)
Mr. KO Sai Ying ("Mr. Ko")	(resigned on 21/10/2004)
Mr. AU YEUNG Terence Ping Yuen ("Mr. Au Yeung")	(resigned on 22/11/2004)
Mr. LIAO Yong Guang ("Mr. Liao")	(appointed on 1/4/2004 and resigned on 22/11/2004)

Independent non-executive directors

Mr. LUI Tin Nang ("Mr. Lui")	
Mr. LEE Kwong Yiu ("Mr. Lee")	
Mr. LO Wa Kei Roy ("Mr. Lo")	(appointed on 30/9/2004)

In accordance with article 112 of the articles of association of the Company, the office of directorship of each of Mr. Xu, Mr. Jin, Mr. Shen, Mr. Huang and Mr. Lo will end at the forthcoming annual general meeting of the Company and, being eligible, offer themselves for re-election.

In accordance with article 108 of the articles of association of the Company, Mr. Lee will retire from office by rotation at the forthcoming annual general meeting of the Company and, being eligible, offer himself for re-election.

Directors' Report



DIRECTORS' SERVICE CONTRACTS

All of the executive directors has entered into a service contract with the Company for an initial term of two years (commencing date: Mr. Tao from 1 December 2001, Mr. Xu from 21 October 2004, Mr. Liu from 22 November 2004, Mr. Jin, Mr. Shen and Mr. Huang from 1 April 2004) and will continue thereafter until terminated by not less than three months' notice in writing served by either party to the other. Each of these executive directors is entitled to a basic monthly salary of HK\$60,000 (subject to an annual increment at the discretion of the Directors). The emoluments of the executive directors are or will be determined by reference to the Company's performance and profitability, as well as remuneration benchmark in the industry and the prevailing market conditions. In addition, the executive directors are also entitled to a discretionary management bonus provided that the aggregate amount of the bonuses payable to all the executive directors for any financial year of the Company after 31 December 2001 may not exceed 10% of the audited profit attributable to the shareholders of the Company in respect of that financial year. An executive director may not vote on any resolution of the Directors regarding the amount of the management bonus payable to him. The independent non-executive directors, Mr. Lui and Mr. Lee have been appointed for a term of two years expiring on 31 December 2005 and Mr. Lo have been appointed for a term of two years expiring on 29 September 2006. Save for a director fee of HK\$11,000 per month for each of them, all independent non-executive directors are not entitled to any other remuneration.

Save as disclosed herein, there are no existing or proposed service contracts with the Company which is not determinable within one year without payment of compensation, other than statutory compensation.

DIRECTORS' INTERESTS IN CONTRACTS

No contracts of significance in relation to the Group's business to which the Company or its subsidiaries were a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Brief biographical details of Directors and senior management are set out on pages 16 to 19 of the annual report.

DISTRIBUTABLE RESERVES

Distributable reserves of the Company as at 31 December 2004 amounted to HK\$300,901,000.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's articles of association and there was no restriction against such rights under the laws of the Cayman Islands.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SHARES

None of the Company and its subsidiaries redeemed any of its shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the year.

Directors' Report



SHARE OPTIONS

The share option scheme effective on 26 January 2002 (the "Old Scheme") was replaced by a new share option scheme adopted by the shareholders on 23 July 2003 (the "Scheme").

The purpose of the Scheme is to grant share options to selected participants satisfying the criteria according to the Scheme as incentives or rewards for their contribution to the Group.

The maximum number of securities to be issued upon the exercise of all outstanding options granted and yet to be exercised under the Scheme and any other share option scheme must not in aggregate exceed 30% of the relevant shares capital of the Company in issue from time to time.

The total number of shares which may be issued upon exercise of all options to be granted under the Scheme must not in aggregate exceed 127,746,216 shares representing 10% of the share in issue at the date of adoption of the Scheme.

The total number of shares issued and which may fall to be issued upon exercise of the options granted under the Scheme to each participant in any 12-month period shall not exceed 1% of the issued share capital of the Company for the time being.

An option may be accepted by a participant within 21 days from the date of the offer of grant of the options. The subscription price for shares under the Scheme will be a price determined by the Directors but shall not be less than the highest of (i) the closing price of shares as stated in the Stock Exchange's daily quotation sheet for trades in one or more board lot of shares on the date of the offer of grant, or (ii) the average closing price of the shares as stated in the Stock Exchange's daily quotation sheets for trades in one or more board lot of shares for the five trading days immediately preceding the date of the offer of grant, and (iii) the nominal value of shares. A nominal consideration of HK\$1 is payable on acceptance of the grant of option.

An option may be exercised in accordance with the terms of the Scheme at any time during a period to be determined and notified by the Directors to each grantee, which period may commence from the date of acceptance of the offer but shall and in any event be not later than ten years from the date on which the offer is made subject to the provisions of early termination thereof.

The Scheme will remain in force for a period of ten years commencing on 23 July 2003.

Directors' Report



SHARE OPTIONS (Continued)

First phase:

On 21 June 2002, the Directors granted under the Old Scheme options to subscribe for an aggregate of 30,000,000 shares of the Company, with an exercise price at HK\$0.39 per share. Those who were granted with the options can exercise their rights in multiple periods starting from 16 August 2002 to 6 February 2012 as below:

From 16 August 2002 to 6 February 2012 – 6,850,000 shares

From 1 January 2003 to 6 February 2012 – 8,280,000 shares

From 1 January 2004 to 6 February 2012 – 6,510,000 shares

From 1 January 2005 to 6 February 2012 – 8,360,000 shares

Among the grantees in this grant of share options, 108 of them are full-time employees of the Company and an aggregate of 21,100,000 options were granted to them; 29 of them are staff of major customers of the Company and an aggregate of 8,900,000 options are granted to them. During the year ended 31 December 2004, an aggregate of 2,990,000 options granted were exercised and there is no option lapsed or was cancelled. As at 31 December 2004, 18,650,000 share options remained outstanding and exercisable under the Old Scheme.

Second phase:

On 28 February 2003, the Directors granted options to three directors of certain subsidiaries of the Group to subscribe for 19,800,000 shares of the Company, with an exercise price at HK\$0.24 per share. The grantees are entitled to exercise the subscription rights on or before 6 February 2012.

On 15 January 2004, the remaining 6,600,000 options granted were exercised. The closing price per share on the date when the options were exercised was HK\$0.66. All of the options in this phase were fully exercised during the year.

Third phase:

On 29 September 2003, the Directors granted options to subscribe for an aggregate of 30,000,000 shares of the Company, with an exercise price at HK\$0.51 per share. Those who were granted with the options can exercise their rights in two periods starting from 16 August 2002 to 6 February 2012 as below:

From 2 January 2004 to 6 February 2012 – 8,990,000 shares

From 2 July 2004 to 6 February 2012 – 21,010,000 shares

Among the grantees in this grant of share options, 14 of them are full-time employees of the Company and an aggregate of 16,595,000 options were granted to them; 5 of them are directors of certain subsidiaries of the Group and an aggregate of 12,405,000 options are granted to them; and one of them is a consultant of a wholly owned subsidiary and 1,000,000 options are granted. In year 2003, 1,500,000 options were waived by a grantee. During the year ended 31 December 2004, an aggregate of 3,180,000 options granted were exercised and no option lapsed or was cancelled during the year. As at 31 December 2004, 25,320,000 share options remained outstanding and exercisable under the Scheme.

Directors' Report



SHARE OPTIONS (Continued)

Valuation of the options granted under the Scheme:

The Company adopted Black-Scholes Options Pricing Model to calculate the value of share options.

First phase

For share options to subscribe for 30,000,000 shares granted on 21 June 2002 with an exercise price of HK\$0.39 each, the fair value of the options was HK\$0.25 at the date of grant with assumptions as follows:

1. Using the annual exchange fund notes interest rate of 1.57% as the risk-free interest rate;
2. The expected life is 9.5 years;
3. The expected volatility is 60.16% during the period from 7 February 2002, being the listing day on the GEM of the Company's shares, to 20 June 2002; and
4. No expected dividend as the Company is newly listed on the GEM.

Second phase

For share options to subscribe for 19,800,000 shares granted on 28 February 2003 with an exercise price of HK\$0.24 each, the fair value of the share options was HK\$0.15 at the date of grant with assumptions as follows:

1. Using the annual exchange fund notes interest rate of 1.9% as the risk-free interest rate;
2. The expected life is 9 years;
3. The expected volatility is 54.66% during the period from 7 February 2002, being the date of the listing of the Company's shares on the GEM, to 28 February 2003; and
4. No expected dividend as the Company has a track record of dividends for only 1 year.

Directors' Report



SHARE OPTIONS (Continued)

Third phase

For share options to subscribe for 30,000,000 shares granted on 29 September 2003 with an exercise price of HK\$0.51 each, the fair value of the share options was HK\$0.17 at the date of grant with assumptions as follows:

1. Using the annual exchange fund notes interest rate of 1.68% as the risk-free interest rate;
2. The expected life is 8.5 years;
3. The expected volatility is 48.16% during the period from 30 September 2002 to 29 September 2003; and
4. Expected annual dividend yield of the Company is 3.9%.

Note: The value of the share options is subject to a number of assumptions and with regard to the limitation of the model. Therefore the value may be subjective and difficult to determine.

OTHER SHARE OPTIONS

On 22 September 2003, the Group entered into an agreement to acquire the remaining 15% minority interest of the subsidiary, Vital Pharmaceuticals (Sichuan) Co Ltd. The remaining monetary considerations of the acquisition amounting to approximately HK\$28.3 million representing 60% of the total considerations will be settled at the sole option of the Company, either in cash or in new ordinary share of the Company. On or before the following dates, the Company may opt to pay cash or to issue new ordinary shares by serving a notice to the seller (the "Notice"):

- 22 March 2004: HK\$9,433,962;
- 22 September 2004: HK\$9,433,962; and
- 22 March 2005: HK\$9,433,962.

The number of option share is calculated at a price that is equal to the higher of the average 30 day closing price of the Company's share on the Stock Exchange immediate prior to the date of the Notice and HK\$0.46 per share. The maximum number of option share to be issued if based on HK\$0.46 per share will be 61,525,839. A conditional approval has been obtained from the Stock Exchange for the listing of the option shares.

During the year ended 31 December 2004, the Company issued 20,508,613 new ordinary shares and paid 9,433,962 monetary considerations to the seller. On 25 January 2005, the Company issued the 20,508,613 new ordinary shares for the final payment.

RETIREMENT BENEFIT SCHEMES

Details of the retirement benefit schemes are set out in notes 1(n) and 9 to the accounts.

Directors' Report



DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY OR ANY ASSOCIATED CORPORATION

As at 31 December 2004, the interests and short positions of the Company's directors and chief executives in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which had to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO), or which were required pursuant to section 352 of the SFO to be entered in the register referred to therein, or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers contained in the Listing Rules, were as follows:

Ordinary shares of HK\$0.01 each in the Company:

Name of Director	Company/name of associated corporation	Capacity	Number and class of securities (Note 1)	Percentage shareholding in the same class of securities
Mr. TAO Lung	Company	Beneficial owner	110,891,648 (L)	7.29%
	Company	Interest of a controlled corporation (Note 2)	522,526,940 (L)	34.35%
	Perfect Develop Holding Inc. ("Perfect Develop")	Beneficial owner	49 ordinary shares of US\$1 each (L)	49%
Mr. LIU James Jin	Company	Beneficial owner	14,630,400 (L)	0.96%
Mr. JIN Wei	Company	Beneficial owner	12,160,000 (L)	0.8%
Mr. SHEN Songqing	Company	Beneficial owner	12,160,000 (L)	0.8%

Notes:

- The letter "L" stands for the Director's interests in such securities.
- The interests in the shares are held by Perfect Develop. The issued share capital of Perfect Develop is beneficially owned as to 12% by Mr. Liu and 49% by Mr. Tao. Accordingly, Mr. Tao is deemed to be interested in all the Shares which Perfect Develop is interested by virtue of the SFO.

Save as disclosed above, as at 31 December 2004, none of the Company's directors and the chief executive had any interest and short positions in the share, underlying shares and debentures of the Company or its associated corporations (within the meaning of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO), or which were required, pursuant to section 352 of the SFO, to be entered in the register maintained by the Company referred to therein, or which were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers contained in the Listing Rules, to be notified to the Company and the Stock Exchange.

Directors' Report



DIRECTORS' AND CHIEF EXECUTIVES' RIGHT TO SUBSCRIBE FOR SHARES

Save as disclosed above, none of the Company's directors and chief executive (including their spouse and children under 18 years of age) had any interest in, or had been granted, or exercised, any rights to subscribe for shares, warrants or debentures (if applicable) of the Company and its associated corporations (within the meaning of the SFO) during the year.

SUBSTANTIAL SHAREHOLDERS' INTEREST AND SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES OF THE COMPANY

As at 31 December 2004, according to the register of substantial shareholders kept by the Company pursuant to section 336 of the SFO and so far as is known to, or can be ascertained after reasonable enquiry by the Directors, the following persons/ entities had an interest or short position in the Shares and underlying Shares which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO, or, directly, or indirectly, interested in 5% or more of the nominal value of any class of share capital carrying rights to vote on all circumstances at general meetings of the Company:

Name	Company/Name of Group member	Capacity	Number of shares (Note 1)	Approximate percentage of shareholding
Perfect Develop (Note 2)	Company	Beneficial owner	522,526,940 (L)	34.35%
Mr. TAO Lung (Note 3)	Company	Beneficial owner	110,891,648 (L)	7.29%
		Interest of a controlled corporation	522,526,940 (L)	34.35%
Ms. LI Chun Yi (Note 4)	Company	Interest of spouse	633,418,588 (L)	41.64%
Tiedemann Global Emerging Markets L.P.	Company	Beneficial owner	77,860,000 (L)	5.12%

Notes:

- The letter "L" denotes the person's/entity's interests in the shares.
- The issued share capital of Perfect Develop is owned as to 49% by Mr. Tao and 12% by Mr. Liu respectively. Mr. Tao and Mr. Liu are the founders of the Group and the executive directors of the Company.
- Mr. Tao owns in aggregate 49 shares in, representing approximately 49% of the issued share capital of Perfect Develop. Accordingly, Mr. Tao is deemed, by virtue of the SFO, to be interested in all the Shares in which Perfect Develop is interested, amounting to 522,526,940 shares. Together with 110,891,648 shares registered in his own name, Mr. Tao is deemed, by virtue of the SFO, to be interested in, 633,418,588 shares in aggregate, amounting to approximately 41.64% of the issued share capital of the Company as at 31 December 2004.
- Ms. Li is the wife of Mr. Tao and is taken to be interested in the shares in which Mr. Tao is interested by virtue of the SFO.

Directors' Report



SUBSTANTIAL SHAREHOLDERS' INTEREST AND SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES OF THE COMPANY (Continued)

Save as disclosed above, as at 31 December 2004, according to the register of substantial shareholders kept by the Company pursuant to section 336 of the SFO and so far as known to, or can be ascertained after reasonable enquiry by the Directors, no other persons/entities had an interest or short position in the Shares and underlying Shares which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

MAJOR CUSTOMERS AND SUPPLIERS

The percentages of purchases and sales for the year attributable to the Group's major suppliers and customers are as follows:

Purchases

- the largest supplier 64%
- five largest suppliers combined 83%

Sales

- the largest customer 72%
- five largest customers combined 90%

None of the Directors, their associates or any shareholder (which to the knowledge of the Directors owns more than 5% of the Company's share capital) had an interest in the major suppliers or customers noted above.

DISCLOSURE PURSUANT TO RULE 13.20 OF THE LISTING RULES

Pursuant to Rule 13.20 of the Listing Rules, the details of the trading receivable due from the entity as at 31 December 2004 which individually exceeded 8% of one or more of the relevant percentage ratios as set out in the Rule 14.07 of the Listing Rules as follow:

Entity	Amount of trading receivable <i>(Note 1)</i> HK\$'000	Percentage of Total Assets <i>(Note 2)</i>	Percentage of Market Capitalisation <i>(Note 3)</i>
四川恒泰醫藥有限公司 ("Sichuan Hengtai Medicine Limited")	93,947	16.3%	21%

Directors' Report



DISCLOSURE PURSUANT TO RULE 13.20 OF THE LISTING RULES (Continued)

Notes:

1. The trading receivable is unsecured, interest-free and with credit terms 90 days. The amount primarily arose from sales of the Group's house products.
2. "Total Assets" means the total assets of the Group of HK\$577,077,000 as at 31 December 2004 calculated in accordance with Rule 14.04(12) of the Listing Rules with reference to the Group's consolidated balance sheet as at 31 December 2004.
3. "Market Capitalisation" is the average closing price of the Company as stated in the daily quotation sheets of the Hong Kong Stock Exchange for trading days from 24 December 2004 to 31 December 2004 (both days inclusive), being the five business days immediately preceding 31 December 2004.

CONNECTED TRANSACTIONS

During the year 2004, the Group purchased raw materials from Pharmco International, Inc., the beneficial shareholder of the minority shareholder of a subsidiary of the Company and a connected person of the Company. The Stock Exchange has, subject to certain conditions, granted waivers to the Company from compliance with certain requirements of the Listing Rules. The independent non-executive Directors of the Company reviewed the above transactions and opined that the transactions are:

- (a) entered into by the Group in the ordinary and usual course of its business;
- (b) conducted on normal commercial terms or on terms that are fair and reasonable as far as the shareholders are concerned;
- (c) entered into either in accordance with the terms of the agreements governing the transactions or where there are no such agreements, on terms no less favorable than those available to or from independent third parties; and
- (d) where there is a limit on the amount of such transactions, the aggregate value of such transactions did not exceed the maximum imposed by the Stock Exchange.

The Company's auditors have also reviewed the transactions and confirmed in its letter to the Board, a copy of which has been provided to the Stock Exchange.

COMPLIANCE WITH THE CODE OF BEST PRACTICE OF THE LISTING RULES

Throughout the year, the Company was in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules in force during the year.

AUDIT COMMITTEE

The written terms of reference which describe the authority and duties of the Audit Committee were prepared and adopted with reference to "A Guide for The Formation of An Audit Committee" published by the Hong Kong Institute of Certified Public Accountants (formerly known as the Hong Kong Society of Accountants).

Directors' Report



AUDIT COMMITTEE (Continued)

The Audit Committee provides an important link between the Board and the Company's auditors in matters coming within the scope of the group audit. It also reviews the effectiveness of both the external and internal audit and of internal controls and risk evaluation. The Committee comprises three independent non-executive directors, namely Mr. Lui Tin Nang (Audit Committee Chairman), Mr. Lee Kwong Yiu and Mr. Lo Wa Kei Roy. Five meetings were held during the current financial year.

The Company has received from each of its independent non-executive directors the written confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Company, based on such confirmation, considers Mr. Lui, Mr. Lee and Mr. Lo to be independent.

DIRECTORS' INTERESTS IN COMPETING BUSINESS

None of the Directors, the management shareholders of the Company and their respective associates (as defined in the Listing Rules) had an interest in a business which causes or may cause any significant competition with the business of the Group and any other conflicts of interest which any such person has or may have with the Group.

PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the directors of the Company as at 25 April 2005, the latest practicable date prior to the issue of this report, the Company believe that the number of securities of the Company which are in the hands of the public is above the relevant prescribed minimum percentage.

SUBSEQUENT EVENT

Details of the significant post balance sheet events of the Group are set out in note 33 to the accounts.

AUDITORS

Ho and Ho & Company, Certified Public Accountants were appointed as auditors of the Company on 20 December 2004 to fill the casual vacancy so arising upon the resignation of PricewaterhouseCoopers on 17 December 2004. The accounts for the year ended 31 December 2004 have been audited by Ho and Ho & Company, Certified Public Accountants who will retire and, being eligible, offer themselves for re-appointment in the forthcoming Annual General Meeting.

By Order of the Board

TAO Lung

Chairman

Hong Kong, 25 April 2005