

CORPORATE GOVERNANCE REPORT

The Company is pleased to present the Corporate Governance Report. The Company is committed to achieving high standards of corporate governance that properly protect and promote the interests of all the shareholders and enhance corporate value and accountability. The Company has applied the principles and complied with the code provisions prescribed in Appendix 14 – Code on Corporate Governance Practices (“CG Code”) as required under the Rules Governing the Listing of Securities (the “Listing Rules”) on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”), which became effective on 1 January, 2005, except for the following deviation from Code Provision A.2.1 and that Code Provision B.1 is complied in the second half of the year:–

1. Code Provision A.2.1 – The Code Provision stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. Mr. Tse Ping is the chairman and chief executive officer of the Company. The Board considers that Mr. Tse Ping’s substantial experience in the pharmaceutical business and management will enhance the Company’s decision making and operational efficiency. To help achieve better balance of power and authority, the chairman discusses important issues and decisions relating to the Group’s business with other executive directors.
2. Code Provision B.1 – The Company has established a remuneration committee on 6th October, 2005 with specific terms of reference in compliance with this Code Provision.

To ensure compliance with the CG Code, the Board has reviewed and proposed the necessary amendments to the Articles of Association of the Company to bring the constitution of the Company in alignment with certain provisions of the CG Code. This report describes our corporate governance practices and explains the applications of the principles of the CG Code and deviations (if any).

A. BOARD OF DIRECTORS

BOARD

The Board is accountable to the shareholders for leadership and control of the Company and is collectively responsible for promoting the success of the Company and its businesses by directing and supervising the Company’s affairs. The Board focuses on overall corporate strategies and policies with attention particularly paid to the growth and financial performance of the Group.

The Board has determined that certain matters such as strategic planning, significant transactions and budget be retained for the Board’s approval. It has formalised the functions reserved to the Board to achieve a clear division of the responsibilities between the Board and the management. The Board delegated its responsibilities to the senior management to deal with day-to-day operations and review those arrangements on a periodic basis. Management reports back to the Board and obtains prior approval before making decisions for key matters or entering into any material commitments on behalf of the Company.

To maximise the effectiveness of the Board and to encourage active participation and contribution from Board members, the Board has established an executive board committee, audit committee and remuneration committee with specific written terms of reference to assist in the execution of their duties. The terms of reference of each of the committees are reviewed and amended (if necessary) from time to time, including the committees’ structure, duties and memberships.

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The Company Secretary and the Qualified Accountant shall, as far as possible, attend all meetings of the Board/committees to advise on corporate governance, statutory compliance, accounting and financial matters. All directors have access to the Company Secretary who is responsible for the Group's compliance with the continuing obligations of the Listing Rules, Code on Takeover and Mergers and Share Repurchases, Companies Ordinance, Securities and Futures Ordinance and other applicable laws, rules and regulations etc.

All directors are given the opportunities to include matters to be discussed in the agenda of the Board/committee meetings. The Company Secretary is delegated with the responsibility of preparing the agenda and, where appropriate, take into account any matters proposed by each director/committee member for inclusion in the agenda.

Other than exceptional circumstances, an agenda accompanied by any related materials are circulated to all directors in a timely manner and at least three days before the date of scheduled meeting. Where queries are raised by directors, responses are given as promptly and fully as possible within a reasonable time.

The Board meets regularly and at least four board meetings are scheduled annually at approximately quarterly intervals. Ad-hoc meetings are convened when it considers necessary. Notices of regular Board/committee meetings are given at least 14 days before the date of meeting. For all other Board/committee meetings, reasonable notices are given.

Minutes of the Board/committee meetings are recorded in details including the matters considered by the participants of such meetings, decisions reached and concerns raised by directors or dissenting views expressed. Draft and final versions of minutes are circulated to relevant directors or committee members within a reasonable time after the meetings are held and taken as the true records of the proceedings of such meetings. They are kept by the Company Secretary or secretary of the committees and are open for inspection at any reasonable time on reasonable notice by any director. All directors are entitled to have access to board papers and related materials unless there are legal or regulatory restrictions on disclosure due to regulatory requirements.

Directors are provided with complete, adequate explanation and information to enable them to make an informed decision or assessment of the Group's performance, position and prospects, and to discharge their duties and responsibilities on a timely basis. The directors, to properly discharge their duties, will be given access to independent professional advisers when necessary, at the expense of the Company.

If a substantial shareholder or a director has a conflict of interest in a matter to be considered by the Board which the Board has determined to be material, the matter will be dealt with by way of a Board/committee meeting and the interested shareholder or director shall not vote nor shall he/she be counted in the quorum present at the relevant meeting. Independent non-executive director ("INED") who, and whose associates, have no material interest in the transaction, may be present at such a board meeting.

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BOARD COMPOSITION

The Board currently consists of twelve directors, namely a Chairman and Chief Executive Officer (“CEO”), eight Executive directors, a Non-executive director and three INEDs.

| Position | Name |
|--------------------------------------|-------------------------------------|
| Chairman, CEO and executive director | : Mr. Tse Ping |
| Executive directors | : Mr. Tao Huiqi |
| | Mr. Wang Jinyu |
| | Mr. He Huiyu |
| | Ms. Cheng Cheung Ling |
| | Ms. Zhao Yanping |
| | Mr. Tse Hsin |
| | Mr. Zhang Baowen |
| Non-executive director (“NED”) | : Ms. Josephine Price (“Ms. Price”) |
| INEDs | : Mr. Lu Zhengfei |
| | Mr. Li Dakui |
| | Ms. Li Jun |

The attributes, skills and expertise among the existing directors are a balanced mix of core competencies in areas such as pharmaceutical, accounting and finance, legal, business and management and marketing strategies.

The INEDs meet the requirements of independence under the Listing Rules so that there is a sufficient element of independence in the Board to exercise independent judgement. The Board considers that all of the INEDs are independent and has received from each of them the confirmation of independence as required by the Listing Rules.

The INEDs have the same duties of care and skill and fiduciary duties as the executive directors. They are expressly identified as such in all corporate communications that disclose the names of directors of the Company. The functions of INEDs include, but not limited to:

- participating in Board meetings to bring an independent judgement to bear on issues of corporate strategy, corporate performance, accountability, resources, key appointments and standard of conducts;
- taking the lead where potential conflicts of interests arise;
- serving and active participating on committees, if invited;
- attending general meetings of the Company and developing a balanced understanding of the views of shareholders; and
- scrutinising the Group’s performance in achieving agreed corporate goals and objectives and monitoring the reporting of performance.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The Chairman and CEO of the Company is Mr. Tse Ping. He is the spouse of Ms. Cheng Cheung Ling, an Executive director of the Company. He and Mr. Tse Hsin, an Executive director, are cousins. The Chairman is responsible for overseeing the function of the Board and formulating overall strategies and policies of the Company. Being the CEO of the Company, Mr. Tse is also responsible for managing the Group’s business and operations.

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The Chairman also seeks to ensure that all directors are properly briefed on issues arising at Board meetings and receive adequate and reliable information in a timely manner.

APPOINTMENT, RE-ELECTION AND REMOVAL

Appointment of new directors is a matter for consideration by the Board. It reviews the profiles of the candidates and makes recommendations on the appointment, re-election and retirement of directors. During the year, six directors were appointed by the Board.

A special resolution was passed on 13 May, 2005 at an extraordinary general meeting to amend the Articles of Association of the Company to provide that (1) one-third of the directors for the time being or, if their number is not a multiple of three, the number nearest to but not less than one-third shall be subject to retirement by rotation provided that every director shall be subject to retirement by rotation at least once every three years; and (2) the directors to retire by rotation shall include any director who wishes to retire and not to offer himself for re-election. The retiring directors shall be those who have longest in office since their last re-election or appointment and that all retiring directors are eligible for re-election.

Newly appointed director(s) of the Company will receive induction and reference materials to enable him/them to familiarise with the Group's history, mission, business operations and the Company's policies. Each director is briefed and updated to ensure that he has a proper understanding of the operations and business of the Group and that he is fully aware of his responsibilities of the latest changes under statute and common law, the Listing Rules, Companies Ordinance, Securities and Futures Ordinance, applicable legal and other regulatory requirements and the governance policies of the Company. Every new director received a "Memorandum on the Duties and Responsibilities of Directors of a Company Listed on the Main Board of The Stock Exchange of Hong Kong Limited" which set out guidelines on statutory and regulatory requirements.

Each of the Executive Directors are appointed for a term of three years. Ms. Price, NED and each of the INEDs are appointed for a term of two years. All the Directors are subject to retirement by rotation and re-election at the Annual General Meeting ("AGM") of the Company, in accordance with the Articles of Association of the Company.

The names and biographical details of the directors who will offer themselves for election or re-election at the AGM are set out in a circular, which will be despatched together with the annual report accompanying the notice of AGM, to assist shareholders in making an informed decision on their elections.

Every director shall ensure that he can contribute sufficient time and effort to the corporate affairs of the Company once he accepts the appointment.

COMMITTEES

The Board has established Executive Board Committee ("EBC") and Remuneration Committee ("RC") in October, 2005 with written terms of reference to enable such committees to discharge their functions properly.

Executive Board Committee

The EBC consists of Mr. Tse Ping (Chairman), Ms. Zhao Yanping and Mr. Tse Hsin.

The EBC meets as and when required to oversee the day-to-day management of the Group.

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All resolutions or recommendations approved by the EBC will be reported to the Board, unless there are legal or regulatory restriction.

Remuneration Committee

The RC consists of Mr. Tse Ping (Chairman), Mr. Lu Zhengfei (INED) and Ms. Li Jun (INED).

The principal functions of the RC include:

- recommending the Board on the Company's policies and structure for the remuneration of the directors and senior management of the Group;
- determining the remuneration packages of all executive directors and senior management;
- reviewing and approving their performance-based remuneration;
- reviewing and approving compensation to directors and senior management in connection with any loss or termination of their office or appointment; and
- ensuring no director or any of his associates is involved in deciding his own remuneration.

The RC has held a meeting to discuss and review the remuneration policy and package for directors. The emoluments of directors are determined by reference to the skills, experiences, responsibilities, employment conditions and time-commitment in the Group's affairs and performance of each director as well as salaries paid by comparable companies and the prevailing market conditions. The Company has adopted a share option scheme on 24th November, 2003. The share option scheme serves as an incentive to attract, retain and motivate talented eligible staff, including the directors. Members of the RC, however, do not participate in the determination of their own remuneration.

The RC consults the Chairman and the CEO about its proposals relating to the remuneration of other executive directors and has access to professional advice if it considers necessary. The Company provides sufficient resources to RC to discharge its duties.

The terms of reference of the RC is available from the Company Secretary on request and is posted on the Company's website.

Audit Committee

The Audit Committee ("AC") was established on 19 September, 2000. The AC consists of three INEDs, Mr. Lu, Zhengfei, Mr. Li Dakui and Ms. Li Jun, who together have sufficient accounting and financial management expertise, legal and business experience to discharge their duties. In accordance with the provisions of the CG Code, the terms of reference of the AC were revised on 27 June, 2005 in terms substantially the same as the provisions set out in the CG Code.

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The Company provides sufficient resources to the AC for discharging the duties. The duties and responsibilities are set out clearly in the terms of reference which includes:

- considering and recommending the appointment, re-appointment and removal of external auditors;
- approving the remuneration and terms of engagement of external auditor, any questions of resignation or dismissal of that auditor;
- discussing with external auditor's independency, the nature and scope of the audit and reporting obligations before the audit commences;
- monitoring integrity of financial statements and reviewing the quarterly, interim and annual financial statements and reports before submission to the Board;
- reviewing the Group's financial controls, internal control and risk management systems;
- considering any findings of major investigations of internal control matters as delegated by the Board or on its own initiative and management's response; and
- reviewing the external auditors' management letter, any material queries raised by the auditor to management in respect of the accounting records, financial accounts or systems of control and management's response and ensuring that the Board will provide a timely response to the issues raised.

The AC met two times during the year 2005 and performed the following work:

- Reviewed and discussed with management and the external auditors regarding the audited financial statements for the year ended 31 December, 2004 and management letter;
- Reviewed with management the unaudited quarterly financial statements for the three months ended 31 March, 2005, interim financial statements for the six months ended 30 June, 2005 and the quarterly financial statements for the nine months ended 30 September, 2005;
- Reviewed the findings and recommendations of the internal audit department on the operations and performance of Group;
- Reviewed the effectiveness of internal control system;
- Reviewed the external auditors' statutory audit plan and engagement letter; and
- Recommended to the Board, for the approval by shareholders, of the re-appointment of the auditors.

Minutes of AC are kept by the Secretary. Draft and final versions of minutes have been sent to all members of the AC within a reasonable time after the meeting for their comments and records respectively.

The terms of reference of the AC is available from the Secretary on request and is posted on the Company's website.

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BOARD AND COMMITTEE ATTENDANCE

The Board held four regular meetings and two additional meetings in 2005. Details of the attendance of individual director at Board meetings and committee meetings during the year 2005 are set out below:

| Directors | No. of meetings attended/held | | |
|--|-------------------------------|------------------------|-----------------|
| | Board | Remuneration Committee | Audit Committee |
| Executive Directors | | | |
| Mr. Tse Ping (Chairman and CEO) | 6/6 | 1/1 | N/A |
| Mr. Tao Huiqi | 3/6 | N/A | N/A |
| Mr. Wang Jinyu | 2/6 | N/A | N/A |
| Mr. He Huiyu (appointed on 13/1/2005) | 5/6 | N/A | N/A |
| Ms. Cheng Cheung Ling (appointed on 13/1/2005) | 4/6 | N/A | N/A |
| Ms. Zhao Yanping (appointed on 13/1/2005) | 4/6 | N/A | N/A |
| Mr. Tse Hsin (appointed on 7/4/2005) | 4/6 | N/A | N/A |
| Mr. Zhang Baowen (appointed on 11/4/2006) | – | N/A | N/A |
| Non-Executive Director | | | |
| Ms. Josephine Price | 3/6 | N/A | N/A |
| Independent Non-Executive Directors | | | |
| Mr. Lu Zhengfei (appointed on 22/11/2005) | – | 1/1 | – |
| Mr. Li Dakui | 4/6 | N/A | 1/2 |
| Ms. Li Jun (appointed on 13/1/2005) | 5/6 | 1/1 | 2/2 |
| Ms. Zheng Qun, Grace (resigned on 22/11/2005) | 5/6 | – | 2/2 |
| Mr. Hu Ximing (resigned on 13/1/2005) | – | N/A | N/A |
| No. of meetings | 6 | 1 | 2 |

Mr. Tse Ping, the Chairman and CEO, is the spouse of Ms. Cheng Cheung Ling, an Executive director of the Company. Mr. Tse Ping and Mr. Tse Hsin, an Executive director, are cousins. Save as disclosed above, there are no family relationships among members of the Board and between the Chairman and the CEO.

SECURITIES TRANSACTIONS BY DIRECTORS/OFFICERS

The Company has adopted a code of securities dealing for directors/senior management/employees (the "Code") on terms no less exacting than the model code for securities transactions by directors of listed issuers (the "Model Code") as set out in Appendix 10 of the Listing Rules, as its own code of conduct regarding securities transactions.

Having made specific enquiry of all directors, they have confirmed that they have fully complied with the required standards as set out in the Model Code.

Officers/employees as defined in the Code deemed to be in possession of unpublished price-sensitive or confidential information in relation to the Company or its shares are required to prohibit to deal in securities of the Company during the black-out period for compliance with the Code.

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B. ACCOUNTABILITY AND AUDIT

FINANCIAL REPORTING

The Board acknowledges its responsibility for preparing the accounts which give a true and fair view of the state of affairs of the Company and of the Group on a going concern basis, with supporting assumptions or qualifications as necessary. The directors have also ensure the timely publication of the financial statements of the Group.

The management provides explanation and information to the Board to enable it to make an informed assessment of the financial and other information to be approved.

The Board endeavours to ensure a balanced, clear and understandable assessment of the Group's position and prospects to extend the Group's financial reporting including annual and interim reports, other price-sensitive announcements and other financial disclosures required under the Listing Rules, and reports to regulators as well as to information required to be disclosed pursuant to statutory requirements and application accounting standards.

INTERNAL CONTROLS

The Board is responsible for managing business and operational risks, and maintaining a proper and effective system of internal control to safeguard the shareholders' investment and the Group's assets.

The directors conducted annual review of the effectiveness of the Group's system of internal control covering all material controls, including financial, operational and compliance and risk management functions.

The Group maintain a centralised cash management system for the Group's treasury function to oversee the Group's investment, lending and borrowing activities.

The Group has established guidelines and procedures for the approval and control of expenditure. Operating expenditures are subject to the overall budget control and are controlled by each business with approval levels for such expenditures being set by reference to each executive's and officer's level of responsibility. Capital expenditures are subject to overall control within the annual budget review and approval process, and more specific control and approval prior to commitment.

AUDITORS' REMUNERATION

During the year under review, the remuneration paid to the Group's external auditors, Messrs Ernst & Young is set out as follows:

| | Fee Paid/Payable 2005 (HK\$'000) |
|--------------------|--|
| Services rendered | |
| Audit Services | 880 |
| Non-Audit Services | — |

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C. COMMUNICATION WITH SHAREHOLDERS AND INVESTORS

The Company aims to provide its shareholders with high standards of disclosure and financial transparency through the publication of annual and interim reports, quarterly, interim and annual results press announcements and circulars made through the Company's and Stock Exchange's websites.

The AGM or other general meetings provide a useful forum for shareholders to exchange views with the Board. The Chairman of the Board as well as the Chairmen of AC and/or RC, or in their absence, members of the committees or senior management of the Company should be available to answer the shareholders' questions. The Chairman of the independent board committee should also attend the general meetings for approving a connected transaction or any transaction that is subject to independent shareholders' approval.

Separate resolutions are proposed at general meetings on each substantially separate issue, including the election of individual directors.

Details of the poll voting procedures and rights of shareholders to demand a poll are included in circular convening a general meeting despatching to the shareholders of the Company. The Chairman of the meeting should ensure compliance with the voting by poll requirement.

The Company should count all proxy votes, and except where a poll is required, the Chairman of a meeting should indicate to the meeting the level of proxies lodged on each resolution, and the balance for and against the resolution, after it has been dealt with on a show of hands. The Company should ensure that votes cast are properly counted and recorded.

The Company regularly releases latest corporate news of the Group's developments on its website at <http://www.sinobiopharm.com>. The public are welcome to give comments and make enquiries through the Company's website.