

## Directors' Report

The Directors have pleasure in submitting their report together with the audited consolidated financial statements of the Group for the year ended 31 December 2006.

### 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 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 is set out in note 6 to the consolidated financial statements.

### RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated income statement on page 32.

The Directors recommended a final dividend of HK1 cent per ordinary share for the year ended 31 December 2006 to the shareholders whose names appear on the register of members on 11 May 2007. Subject to shareholders' approval of payment of the final dividend, the dividend will be payable on 21 May 2007. The effect of the final dividend herein would be payment of approximately HK\$15,417,000.

The register of members of the Company will be closed from 7 May 2007 (Monday) to 11 May 2007 (Friday), both days inclusive, during which period no transfer of shares will be effected. In order to be qualified for the final dividend of year 2006, all transfers accompanied with relevant share certificates must be lodged with the Company's share registrar, Union Registrars Limited, Room 1803, Fook Lee Commercial Centre, Town Place, 33 Lockhart Road, Wanchai, Hong Kong, at no later than 4:00 p.m. on 4 May 2007 (Friday).

### FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the five years ended 31 December 2006 is set out on page 2 of the annual report.

### RESERVES

Movements in the reserves of the Group during the year are set out in page 35 of the annual report.



## INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT

Details of the movements in intangible assets and property, plant and equipment of the Group are set out in notes 14 and 15 to the consolidated financial statements respectively.

## SUBSIDIARIES

Details of the principal subsidiaries of the Company are set out in note 38 to the consolidated financial statements.

## SHARE CAPITAL

Details of the movements in share capital of the Company are set out in note 28 to the consolidated financial statements.

## DIRECTORS

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

### Executive directors

Mr. Tao Lung (*Chairman*) ("Mr. Tao")

Mr. Huang Jianming (*Chief Executive Officer*) ("Mr. Huang") (re-designated on 18/1/2006)

Mr. Shen Songqing ("Mr. Shen")

Mr. Liu James Jin ("Mr. Liu")

Mr. Xu Xiaofan ("Mr. Xu") (re-designated on 18/1/2006)

Mr. Jin Wei ("Mr. Jin") (resigned on 18/1/2006)

### Independent non-executive directors

Mr. Lui Tin Nang ("Mr. Lui")

Mr. Lee Kwong Yiu ("Mr. Lee")

Mr. Chong Cha Hwa ("Mr. Chong") (appointed on 19/10/2006)

Mr. Lo Wa Kei Roy ("Mr. Lo") (resigned on 19/10/2006)

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

In accordance with article 112 of the articles of association of the Company, the office of directorship of Mr. Chong will end 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. Shen and Mr. Huang from 1 April 2004, Mr. Xu from 21 October 2004 and Mr. Liu from 22 November 2004) and will continue thereafter until terminated by not less than three months' notice in writing served by either party to the other. Except Mr. Huang is entitled to a monthly salary of approximately HK\$115,000, each of the other executive directors is entitled to a basic monthly salary of HK\$80,000 (subject to an annual increment at the discretion of the Directors). The emoluments of the executive directors are recommended by remuneration committee of the Company and are based on the working experience, skill, knowledge and involvement in the Company's affairs of each of them and are determined by reference to the Company's performance and profitability, as well as remuneration benchmark in the industry and the prevailing market conditions. Executive directors are also entitled to certain level of share based payment. 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 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 2007 and Mr. Chong have been appointed for a term of two years expiring on 18 October 2008. Save for a director fee of HK\$20,000 per month and certain share based payment for each of them, the independent non-executive directors are not entitled to any other remuneration.

22 Save as disclosed above, 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 12 to 14 of the annual report.

### DISTRIBUTABLE RESERVES

Distributable reserves of the Company as at 31 December 2006 amounted to approximately HK\$340,910,000.

### 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.

## **SHARE OPTIONS**

The share option scheme effective on 26 January 2002 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 the Scheme. Subsequently, the general scheme limit was refreshed and approved at the annual general meeting on 31 May 2005, and the limit was re-set to 154,170,699 shares.

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.

## Directors' Report

### SHARE OPTIONS *(Continued)*

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

#### **First phase:**

On 21 June 2002, the Directors granted 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 – approximately 6,850,000 shares

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

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

From 1 January 2005 to 6 February 2012 – approximately 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 2006, there is no option granted was exercised and an aggregate of 9,860,000 option was forfeited or cancelled. As at 31 December 2006, 1,180,000 share options remained outstanding and exercisable.

#### **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.

All of the options in this phase were fully exercised in 2004.

#### **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 2 January 2004 to 6 February 2012 as below:

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

From 2 July 2004 to 6 February 2012 – approximately 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 2006, there is no option granted was exercised and an aggregate of 6,300,000 option was forfeited or cancelled during the year. As at 31 December 2006, 13,760,000 share options remained outstanding and exercisable.



## SHARE OPTIONS *(Continued)*

### Fourth phase:

On 12 September 2005, the Directors granted options to subscribe for an aggregate of 69,800,000 shares of the Company, with an exercise price at HK\$0.23 per share. Those who were granted with the options can exercise their rights in two periods starting from 1 January 2006 to 6 February 2012 as below:

From 1 January 2006 to 6 February 2012 – approximately 34,900,000 shares

From 1 January 2007 to 6 February 2012 – approximately 34,900,000 shares

Among the grantees in this grant of share options, 12 of them are full-time employees of the Company and an aggregate of 11,000,000 options were granted to them; 3 of them are executive directors of the Company and an aggregate of 35,000,000 options were granted to them; 3 of them are independent non-executive directors of the Company and an aggregate of 4,500,000 options were granted to them; 2 of them are ex-executive directors of the Company in the past 12 months and an aggregate of 18,000,000 options are granted to them; and 2 of them are directors of certain subsidiaries of the Group and an aggregate of 1,300,000 options are granted to them. During the year ended 31 December 2006, there is no option granted was exercised and an aggregate of 28,000,000 option was forfeited or cancelled during the year. As at 31 December 2006, 41,800,000 share options remained outstanding and 20,900,000 share options are exercisable.

### 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. All of the options in this phase were fully exercised in 2005.

## RETIREMENT BENEFIT SCHEMES

Details of the retirement benefit schemes are set out in notes 3(p) and 12 to the consolidated financial statements.

## 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 2006, the interests and short positions of the Company's directors, chief executives and their associates in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which will have 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 are 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 pursuant to the Model Code for Securities Transactions by Directors of Listed Companies in the Listing Rules, to be notified to the Company and the Stock Exchange, 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)	7.19%
	Company	Interest of a controlled corporation (Note 2)	522,526,940 (L)	33.89%
	Perfect Develop Holding Inc. ("Perfect Develop")	Beneficial owner	4,000 ordinary shares of US\$0.01 each (L)	58.28%
Mr. Liu James Jin	Company	Beneficial owner	14,630,400 (L)	0.95%
Mr. Shen Songqing	Company	Beneficial owner	12,160,000 (L)	0.79%

#### Notes:

- The letter "L" stands for the Director's long position 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 58.28% by Mr. Tao, 30.67% by Mr. Huang and 11.05% by Mr. Liu. Accordingly, Mr. Tao is deemed to be interested in all the Shares which Perfect Develop is interested by virtue of the SFO.



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

(Continued)

Save as disclosed above, as at 31 December 2006, none of the Company's directors and the chief executive had any interest and short positions in the shares, 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 Division 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' AND CHIEF EXECUTIVES' RIGHT TO SUBSCRIBE FOR SHARES

Save as disclosed in the annual report, 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 2006, according to the register of members 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 of the Company, the following persons/entities, other than a director or chief executive of the Company, had an interest or short position in the shares and underlying shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or, directly, or indirectly, interested in 10% 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)	33.89%

Notes:

1. The letter "L" denotes the person's/entity's long position in the shares.
2. The issued share capital of Perfect Develop is owned as to 58.28% by Mr. Tao, 30.67% by Mr. Huang and 11.05% by Mr. Liu. Both of them are the founders of the Group and the executive directors of the Company.

## Directors' Report

### 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	67%
– five largest suppliers combined	84%

#### Sales

– the largest customer	43%
– five largest customers combined	76%

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.

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### CONTINUING CONNECTED TRANSACTION

During the year 2006, the Group purchased raw materials from Pharmco International, Inc., was the beneficial shareholder of the minority shareholder of a subsidiary of the Company, and a connected person of the Company.

The Auditors of the Company have reported their factual findings on these procedures to the Board of Directors. The independent non-executive directors of the Company have reviewed the above transactions and opined that the transactions for the year ended 31 December 2006 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; and
- (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.

### 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 23 March 2007, 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**

No significant post balance sheet events of the Group.

## **AUDITORS**

Messrs.PricewaterhouseCoopers had resigned as auditors of the Company with effect from 17 December 2004 and Messrs.Ho and Ho & Company have been appointed as new auditors of the Company with effect from 20 December 2004 to fill the causal vacancy.

As Messrs.Ho and Ho & Company has joined with Messrs.ShineWing Certified Public Accountants in China and established Messrs.SHINEWING (HK) CPA Limited.Messrs.Ho and Ho & Company had resigned as auditors of the Company with effect from 29 December 2006 and Messrs.SHINEWING (HK) CPA Limited have been appointed as new auditors of the Company with effect from the same date to fill the causal vacancy.

The consolidated financial statements for the year ended 31 December 2006 have been audited by Messrs.SHINEWING (HK) CPA Limited who will retire and, being eligible, offer themselves for reappointment in the forthcoming Annual General Meeting.

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By Order of the Board

**Tao Lung**

*Chairman*

Hong Kong, 23 March 2007