

## **DIRECTORS' REPORT**

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The directors present their annual report and the audited consolidated financial statements of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended December 31, 2006.

### **PRINCIPAL ACTIVITIES**

The Company acts as an investment holding company. Details of the activities of its subsidiaries and jointly controlled entity are set out in notes 40 and 19 to the consolidated financial statements, respectively.

### **MAJOR CUSTOMERS AND SUPPLIERS**

The aggregate sales and purchases attributable to the Group's five largest customers and suppliers were less than 30% of the Group's total sales and purchases for the year, respectively.

### **RESULTS AND APPROPRIATIONS**

The results of the Group for the year ended December 31, 2006 are set out in the consolidated income statement on page 18 of the annual report.

The directors do not recommend the payment of a dividend and propose that the profit for the year be retained.

### **DISTRIBUTABLE RESERVES OF THE COMPANY**

The Company's reserves available for distribution to shareholders as at December 31, 2006 comprised the retained profits of HK\$139,975,000 (2005: HK\$187,898,000).

### **PROPERTY, PLANT AND EQUIPMENT**

During the year, the Group continued to upgrade its production facilities for bulk drug products and finished drug products. Details of these and other movements during the year in the property, plant and equipment of the Group are set out in note 14 to the consolidated financial statements.

### **SHARE CAPITAL AND SHARE OPTIONS**

Details of movements during the year in the share capital and share options of the Company are set out in notes 29 and 30 to the consolidated financial statements, respectively.

### **DIRECTORS**

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

*Executive directors:*

Cai Dongchen, Chairman

Yue Jin

Feng Zhenying

Ji Jianming

Chak Kin Man

Pan Weidong

(appointed on October 1, 2006)

Li Zhibiao

(appointed on October 1, 2006)

Zhang Zheng

(appointed on October 1, 2006)

Wei Fumin

(resigned on April 2, 2007)

Yao Shian

(resigned on June 20, 2006)

**DIRECTORS – continued**

*Non-executive director:*

Lee Ka Sze, Carmelo

*Independent non-executive directors:*

Huo Zhenxing

Qi Moujia

Guo Shichang

Chan Siu Keung, Leonard

In accordance with Article 92 of the Company's Article of Association, Messrs. Pan Weidong, Li Zhibiao and Zhang Zheng retires at the forthcoming annual general meeting and being eligible, offers themselves for re-election.

In accordance with Article 101 of the Company's Articles of Association, Messrs. Cai Dongchen, Ji Jianming, Lee Ka Sze, Carmelo, Qi Moujia and Chan Siu Keung, Leonard retire at the forthcoming annual general meeting by rotation and, being eligible, offer themselves for re-election.

**DIRECTORS' SERVICE CONTRACTS**

Each of the non-executive director and independent non-executive directors of the Company has entered into a service contract for a term of two years from January 1, 2007.

Other than as disclosed above, no directors proposed for re-election at the forthcoming annual general meeting has a service contract which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

**BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT**

**CAI Dongchen**

Mr. Cai, aged 53, Chairman of the Company, was appointed as an executive director of the Company in 1998. He is also the Chairman of Shijiazhuang Pharmaceutical Group Company Limited ("SPG"), the Company's ultimate holding company. Mr. Cai graduated from Hebei Pharmaceutical Finance College in the People's Republic of China (the "PRC") has over thirty years of technical and management experience in the pharmaceutical industry.

**YUE Jin**

Mr. Yue, aged 43, was appointed as an executive director of the Company in 2001. He graduated from Hebei University in the PRC and has over twenty years of technical and management experience in the pharmaceutical industry.

**FENG Zhenying**

Mr. Feng, aged 51, was appointed as an executive director of the Company in 2003. He graduated from Hebei Chemical College in the PRC and has over twenty years of technical and management experience in the pharmaceutical industry.

**BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT – continued****JI Jianming**

Mr. Ji, aged 44, was appointed as an executive director of the Company in 2005. He graduated from Hebei University in the PRC and has over twenty years of technical and management experience in the pharmaceutical industry.

**CHAK Kin Man**

Mr. Chak, aged 41 was appointed as an executive director of the Company in 2005. He is a certified public accountant of the Hong Kong Institute of Certified Public Accountants and a fellow member of the Association of Chartered Certified Accountants. He holds a Bachelor of Social Sciences degree from the University of Hong Kong and has over sixteen years of experience in auditing and financial management.

**PAN Weidong**

Mr. Pan, aged 37, was appointed as an executive director of the Company in 2006. He graduated from Shijiazhuang Post College in the PRC and has over fifteen years of experience in financial management and accounting.

**LI Zhibiao**

Mr. Li, aged 43, was appointed as an executive director of the Company in 2006. He holds a Master of Biology degree from Hebei Normal University in the PRC and has over fifteen years of business development and marketing experience in the pharmaceutical industry.

**ZHANG Zheng**

Mr. Zhang, aged 26, was appointed as an executive director of the Company in 2006. He holds a Bachelor of Business Studies degree from Charles Sturt University in Australia.

**LEE Ka Sze, Carmelo**

Mr. Lee, aged 46, was appointed as an independent non-executive director of the Company in 1996 and re-designated as a non-executive director in 2004. He is also a member of the Audit Committee and Remuneration Committee of the Company. He holds a Bachelor of Laws degree from the University of Hong Kong. He is a solicitor by profession and is a partner of a law firm in Hong Kong.

**HUO Zhenxing**

Mr. Huo, aged 71, was appointed as an independent non-executive director of the Company in 1994. He is also a member of the Audit Committee and Remuneration Committee of the Company. He was the former head of Industrial and Commercial Bank of China, Hebei Province branch and Shijiazhuang sub-branch.

**QI Moujia**

Mr. Qi, aged 74, was appointed as an independent non-executive director of the Company in 1996. He was the former director of the State Drug Administration of China (the "SDA", now known as the State Food and Drug Administration of China). He was the deputy chairman and chairman of the SDA in 1978 and 1982-1994, respectively.

**BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT – continued**

**GUO Shichang**

Mr. Guo, aged 65, was appointed as an independent non-executive director of the Company in 2004. He was the Vice Governor of Hebei Provincial People's Government, the PRC from 1993 to 2002.

**CHAN Siu Keung, Leonard**

Mr. Chan, aged 49, was appointed as an independent non-executive director of the Company in 2004. He is also a member of the Audit Committee and the Remuneration Committee of the Company. He is a qualified accountant and a member of the Institute of Chartered Accountants of Ontario. He holds a Master of Business Administration degree from York University, Ontario, Canada and has extensive experience in finance and investment.

**DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE**

Woo, Kwan, Lee & Lo, a firm of solicitors of which Mr. Lee Ka Sze, Carmelo is a partner, rendered professional services to the Group for which it received normal remuneration.

Other than as disclosed above, no contracts of significance to which the Company, its holding company, fellow subsidiaries or subsidiaries was 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.

**DIRECTORS' INTERESTS IN SHARES, UNDERLYING SHARES AND DEBENTURES**

As at December 31, 2006, the interests of the directors 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 (the "SFO")), as recorded in the register maintained by the Company pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") contained in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"), were as follows:

*Long positions:*

Name of director	Capacity	Number of issued ordinary shares held	Percentage of the issued share capital of the Company
Mr. Cai Dongchen	Beneficial owner	2,000,000	0.13%
Mr. Chak Kin Man	Beneficial owner	4,000	0.00026%

Other than as disclosed above, none of the directors nor their associates had any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO), as recorded in the register required to be kept under Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

**ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES**

Other than as disclosed in note 30 to the consolidated financial statements, at no time during the year was the Company, its holding company, fellow subsidiaries and subsidiaries, a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

**SUBSTANTIAL SHAREHOLDER**

As at December 31, 2006, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO shows that the following shareholder had notified the Company of relevant interests in the issued share capital of the Company.

Name of substantial shareholder	Capacity	Number of ordinary shares of the Company held	Percentage of issued share capital
SPG	Beneficial owner and controlled corporation	783,316,161 <i>(Note)</i>	50.93%

*Note:* In respect of the 783,316,161 shares, 773,436,399 shares are held by SPG and 9,879,762 shares are held by China Charmaine Pharmaceutical Company Limited, a wholly-owned subsidiary of SPG.

Other than as disclosed above, the Company has not been notified of any other relevant interests or short positions in the issued share capital of the Company or any other interests representing 5% or more of the issued share capital of the Company as at December 31, 2006.

**CONNECTED TRANSACTIONS**

Details of the discloseable connected transactions during the year are set out in note 24 to the consolidated financial statements. Pursuant to Rule 14A.38 of the Listing Rules, the board of directors engaged the auditors of the Company to perform certain agreed upon procedures in respect of the continuing connected transactions of the Group. The auditors have reported their factual findings on these procedures to the board of directors. The independent non-executive directors have reviewed the continuing connected transactions and the report of the auditors and have confirmed that the transactions have been entered into by the Group:

- (i) in the ordinary and usual course of the Group's business;
- (ii) either on normal commercial terms or on terms no less favourable than terms available to or from independent third parties; and
- (iii) in accordance with the relevant agreements governing such transactions on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

**PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES**

During the year, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

**DISCLOSURE UNDER RULE 13.18 OF THE LISTING RULES**

Pursuant to two bank loan agreements, it will be an event of default under each of the loan agreements if SPG owns less than 40% of the issued share capital of the Company. The outstanding principal of these bank loans at December 31, 2006 amounted to HK\$654,000,000 and the last instalment repayment is due in April 2009.

Save as disclosed above, there are no other events which are required to be disclosed by the Company under Rule 13.18 of the Listing Rules.

**APPOINTMENT OF INDEPENDENT NON-EXECUTIVE DIRECTORS**

The Company has received, from each of the independent non-executive directors, an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Company considers all of the independent non-executive directors are independent.

**EMOLUMENT POLICY**

The emoluments of the directors of the Company are determined by the Remuneration Committee, having regard to the Company's operating results, individual performance and comparable market statistics.

The Company has adopted a share option scheme as an incentive to directors and eligible employees, details of the scheme are set out in note 30 to the consolidated financial statements.

**SUFFICIENCY OF PUBLIC FLOAT**

The Company has maintained a sufficient public float of not less than 25% of the Company's issued shares as required under the Listing Rules throughout the year ended December 31, 2006.

**AUDITORS**

A resolution will be submitted to the annual general meeting of the Company to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.

On behalf of the Board  
**Cai Dongchen**  
*CHAIRMAN*

Hong Kong, April 11, 2007