



CORPORATE GOVERNANCE PRACTICES

The Group is committed to achieving high standards of corporate governance to safeguard the interests of all shareholders and to enhance corporate value and accountability. Throughout the year ended 31 December 2006, the Group has applied the principles and complied with most of the code provisions and recommended best practices prescribed in the Code on Corporate Governance Practices (“CG Code”) set out in the Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”), and was in force prior to 1 January 2005. This report describes its corporate governance practices, explains the applications of the principles of the CG Code and deviations, if any.

BOARD OF DIRECTORS

The Composition of the Board of Directors

As at 31 December 2006, the Board of Directors of the Company comprises eight Directors, of whom five are executive Directors, namely Mr. Zhong Houtai, Chairman, Mr. Zhong Houyao, Mr. Chong Hoi Fung, Mr. Sun Daquan, Mr. Chai Chung Wai and, three are independent non-executive Directors, namely Mr. Cheung Chuen, Mr. Pei Renjiu, Mr. Li Kai Ming. The composition of the Board of Directors is well balanced with each Director having sound knowledge, experience and/or expertise relevant to the business of the Group. Each of the Directors’ respective biographical details is set out in the “Biographical Details of Directors and Senior Management” of this annual report. The Directors are aware of their collective and individual responsibilities to the Shareholders and have exercised their duties with care, skill and diligence, contributing to the successful performance of the Group for the year under review. Besides, to the best knowledge of the Company, there is no financial, business, family or other material/relevant relationship between the Directors and each of the Directors also does not have any direct or indirect material relationship with the Group.

According to the code provision A2.1 of the CG Code, the roles of the chairman and the chief executive officer should be segregated. However, the Company has no chief executive officer currently. Mr. Zhong Houtai is the chairman and executive Director of the Company responsible for the Group’s operations in the PRC. The responsibility of that of a chief executive officer is currently taken up by the chairman of the Company. If the Company can identify a suitable person with capable leadership, knowledge on medicines and relevant skills and experiences for the post from within the Group or outside, the Company may consider appointing a chief executive officer. Owing to the business nature and scope of the Company, a suitable person shall have profound understanding and experiences on medicines, therefore there is no definite timetable for the appointment of chief executive officer.



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Functions of the Board of Directors

The Board of Directors has separate functions and duties from the managements. The functions and duties of the Board include convening the Shareholders' general meetings; making decisions on the Company's operational plans, financial accounts and profit distribution scheme; formulating merger, separation, dissolution proposals and significant acquisition or sale proposals; and implementing the resolutions passed at the Shareholders' general meetings. The management is accountable to the Board of Directors and responsible for the day-to-day operations of the Group. Its main functions and duties include production and operation management, organization and implementation of the annual operational plans and investment proposals approved by the Board of Directors, and implementation of the resolutions passed by the Board of Directors. According to the code requirement of the CG Code, the Company should arrange appropriate insurance cover in respect of legal action against its Directors. However, no insurance coverage has been purchased for any of the Directors as the Board does not foresee any contingent liabilities against the Group.

Directors' Appointment, Re-election and Removal

Each of the executive Directors has entered into a service contract with the Company for an initial fixed term of 3 years commencing from 24 November 2003, and will continue thereafter until terminated by not less than 3 months' notice in writing served by either party on the other, which notice shall not expire until after the fixed term.

According to the code provision A4.1 of the CG Code, independent non-executive Directors should be appointed for a specific term of service. However, independent non-executive Directors of the Company are not appointed for a specific term as required under the CG Code, but they are subject to retirement in rotation at the annual general meeting of the Company according to the Articles of the Company.

Save as aforesaid, none of the Directors has or is proposed to have a service contract with the Company or any of its subsidiaries (other than contracts expiring or determinable by the Company within one year without the payment of compensation (other than statutory compensation)).

According to the provisions of the articles of association of the Company (the "Articles"), any Director appointed by the Board either to fill a casual vacancy or as an addition to the Board shall hold office until the next following annual general meeting of the Company and shall then be eligible for re-election. Furthermore, at each annual general meeting one-third of the Directors for the time being (or, if their number is not a multiple of three (3), the number nearest to but not less than one-third) shall retire from office by rotation.



Board meetings and Board Practices

The Board of Directors holds meetings on a regular basis. If necessary, the Board of Directors will convene additional meetings. The Company Secretary is responsible for distributing detailed documents to Directors prior to the meetings of the Board of Directors to ensure that the Directors are able to make informed decisions regarding the matters discussed in the meetings. The Company Secretary is also responsible for ensuring the procedures of the Board meetings are observed and providing to the Board of Directors opinions on matters in relation to the compliance with the procedures of the Board meetings. In addition, to facilitate the decision-making process, the Directors are free to have access to the management for enquiries and to obtain further information, when required. The Directors can also seek independent professional advice, in appropriate circumstances, at the Company's expense in discharging their duties to the Company.

During the year ended 31 December 2006, the Company held 4 Board meetings, and the Directors' attendance records for the meetings held are set out below.

Directors' Attendance at Board Meetings

| | Number of Board meeting attended/ Number of Board meeting held |
|--|---|
| Executive Directors | |
| Mr. Zhong Houtai (<i>Chairman</i>) | 4/4 |
| Mr. Zhong Houyao | 2/4 |
| Mr. Chong Hoi Fung | 1/4 |
| Mr. Sun Daquan | 4/4 |
| Mr. Chai Chung Wai | 4/4 |
| Independent non-Executive Directors | |
| Mr. Cheung Chuen | 2/4 |
| Mr. Pei Renjiu | 2/4 |
| Mr. Li Kai Ming | 2/4 |



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Independent non-executive Directors

In compliance of Rule 3.10(1) of the Listing Rules, there are three independent non-executive Directors representing over one-third of the Board of Directors. Amongst them, Mr. Cheung Chuen, who is currently a member of the American Institute of Certified Public Accountants and the Hong Kong Institute of Certified Public Accountants and has more than six years' experience in accounting and auditing, has the appropriate professional qualifications required under Rule 3.10(2) of the Listing Rules. In addition, Mr. Chai Chung Wai, an executive Director, and Mr. Chow Chi Wa, the chief financial officer are qualified accountants responsible for oversight of the Group's financial reporting procedures, in compliance of Rule 3.24.

The independent non-executive Directors have participated in Board meetings as well as its various Board committees, and have given their opinions on the decision-making on significant matters by making use of their professional knowledge and experience. They have conscientiously examined the connected transactions and capital dealings with connected parties to ensure fairness and impartiality, expressing their independent opinions and performing their duties independently. The Board considered that all non-executive Directors to be independent in character and judgement. None of the independent non-executive Directors have relationships or circumstances that are likely to effect their professional judgement and the independent non-executive Directors have made active contribution to protecting the interests of the Company as a whole and the legal rights of all of shareholders of the Company, as well as promoting the healthy development of the Company.

Three independent non-executive Directors separately submitted their confirmation letters on their independence, confirming that they had strictly observed the requirements for independence as set out in Rule 3.13 of the Listing Rules during the year under review. Independent non-executive Directors are independent persons of the Company.



DIRECTORS' SECURITIES TRANSACTIONS

The Board has adopted the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") as set out in Appendix 10 of the Listing Rules as the code for securities transactions by Directors. During the accounting period covered by this annual report, the Company had complied with the Model Code. After making inquiry of the Directors, the Company confirmed that the Directors had complied with the provisions of the Model Code.

BOARD COMMITTEES

Audit Committee

The Company has established an audit committee on 3 November 2003 with written terms of reference in compliance with the CG Code. The audit committee has three members, including the Company's three independent non-executive Directors, namely Mr. Pei Renjiu, Mr. Li Kai Ming and Mr. Cheung Chuen. Mr. Cheung Chuen is the chairman of the committee. The duties of the audit committee are to review the Company's annual report and accounts, interim reports and to provide advice and comments thereon to the Board. In addition, the audit committee will consider any significant and unusual items that are, or may need to be reflected in such reports and accounts and must give due consideration to any matter that has been raised by the Company's qualified accountant, compliance officer and auditors. The audit committee is also responsible for reviewing and supervising the financial reporting process and the internal control system of the Group. Besides, the audit committee will make recommendations to the Board on matters regarding the appointment of external auditors and auditing fee etc. Every year, the audit committee meets with external auditors of the Company to discuss the annual audit plan. 4 meetings were held during the current financial year to, inter alia, review the audited financial statements for the year ended 31 December 2006. The attendance records for the audit committee meetings are set out below:

| | Number of audit committee meeting attended/ Number of audit committee meeting held |
|---------------------------------------|---|
| Members of the audit committee | |
| Mr. Cheung Chuen | 4/4 |
| Mr. Pei Renjiu | 4/4 |
| Mr. Li Kai Ming | 4/4 |

Nomination Committee

According to the CG Code, the Company shall set up a nomination committee with a majority of the members thereof being independent non-executive Directors. However, the Company did not establish a nomination committee.



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The process and criteria adopted by the Board to select and recommend candidates for directorship are based on assessment of their professional qualifications and experience. The Company is responsible for determining the independence of each Director and conducting formal assessment of the effectiveness of the Board as a whole and the contribution of each Director to the effectiveness of the Board. During the year, no Director has been newly appointed.

Remuneration Committee

The Company established a remuneration committee on 5 August 2005. The remuneration committee is led by Mr. Li Kai Ming, an independent non-executive Director. Other members of the remuneration committee include Mr. Pei Renjiu and Mr. Cheung Chuen, both are independent non-executive Director. The remuneration committee has adopted a defined terms of reference in consistence with the CG Code and it is available from the Company Secretary at any time.

The duties of the remuneration committee includes making recommendations with respect to the remuneration of the executive Directors for approval by the Board, reviewing and recommending salaries, bonuses, merit plans, reward and recognition strategies, including the appropriation of funds for incentive awards for Directors, and administering and making determinations with regard to the Company's share option scheme.

The remuneration committee meets at least once a year. During the financial year ended 31 December 2006, the remuneration committee has held its first meeting on 20 April 2006 to define its terms of reference, to review the existing remuneration packages of each Directors and senior management of the Company, and to recommend to the Board the salaries and bonuses of the executive Directors. The attendance record of individual committee members is set out below:

| | Number of remuneration committee meeting attended/ Number of remuneration committee meeting held |
|--|---|
| Members of the remuneration committee | |
| Mr. Li Kai Ming | 1/1 |
| Mr. Cheung Chuen | 1/1 |
| Mr. Pei Renjiu | 1/1 |



Remuneration package for executive Directors

Each of these executive Directors is entitled to the respective basic salary which is reviewed annually. In addition, for the financial year ending 31 December 2003 and each of the financial years thereafter during the initial term, each of the executive Directors is also entitled to a discretionary bonus provided that the aggregate amount of the bonuses payable to all the executive Directors in respect of any financial year of the Company shall not exceed 5% of the audited net profit of the Company (or as the case may be, combined or, consolidated audited net profit of the Company and its subsidiaries (if any)) (after taxation but before extraordinary and exceptional items and payment of such bonuses) in respect of that financial year of the Company. An executive Director shall not vote on any resolution of the Directors regarding the amount of the discretionary bonus payable to him.

In order to attract, retain and motivate executives and key employees serving any member of the Group or other persons contributing to the Group, the Company has conditionally adopted the Share Option Scheme, the principal terms of which are set out in the paragraph headed "Share Option Scheme" in Appendix 4 to the prospectus issued by the Company on 11 November 2003 and in note 22 to the financial statements on pages 67 to 69 of this annual report. Such incentive schemes enable the eligible persons to obtain an ownership interest in the Company and thus will motivate them to optimize their contributions to the Group. The Group also provides retirement benefits to its employees. The retirement contributions paid by the Group are based on certain percentage of the relevant portion of the payroll of all qualifying employees in accordance with the relevant regulations in the PRC and are charged to the income statement as incurred. In Hong Kong, the Group has set up a retirement scheme in accordance with the mandatory provident fund requirements prescribed by the Mandatory Provident Fund Schemes Ordinance, Chapter 485 of the Laws of Hong Kong. All Hong Kong based employees and the Group are required to contribute 5% of their respective monthly wages (up to a maximum contribution of HK\$1,000 each of the employee and the Group) on a monthly basis to the fund. In addition, the Group provides housing allowances and meal allowances to its employees.

ACCOUNTABILITY AND AUDIT

Directors' Responsibility for the Financial Statements

The Board is responsible for the preparation of the financial statements. In preparing the financial statements, the generally accepted accounting standards in Hong Kong have been adopted, appropriate accounting policies have been used and applied consistently, and reasonable and prudent judgements and estimates have been made.

Having made appropriate enquiries, the Board is not aware of any material uncertainties relating to events or conditions which may cast significant doubt over the Group's ability to continue as a going concern. Accordingly, the Board has continued to adopt the going concern basis in preparing the financial statements.



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Internal controls

The Board through the audit committee is responsible for maintaining proper internal controls within the Company.

The internal control systems are designed to provide reasonable assurance of the Company's assets, safeguarding them against unauthorized use or disposition by making sure transactions are executed in accordance with management's authorization and that the accounting records are reliable for the preparation of financial information used for the business and publication. The Company has adopted proper procedures with duly assigned levels of authority in areas of financial, operational and compliance controls and risk management to ensure the Company's assets and resources are safeguarded.

The Board, the audit committee and CCIF Corporate Consultancy Limited have reviewed the effectiveness of the Group's material internal controls. The Board and the audit committee are satisfied that, based on information furnished to it and on its own observations, the present internal controls of the Group are satisfactory and will make further improvements.

Auditors' Remuneration

During the year ended 31 December 2006, the fees paid/payable to the CCIF CPA Limited (the "CCIF"), the auditors of the Company, in respect of audit and non-audit services provided by the CCIF to the Group were as follows:

| | 2006 HK\$'000 |
|--------------------------------|--------------------------|
| Audit services | 480,000 |
| Non-audit services | |
| Taxation advisory services | – |
| Review on 2006 interim results | 90,000 |
| Other advisory services | – |
| Total: | <u>570,000</u> |

The audit committee reviews each year a letter from the auditors of the Company confirming their independence and objectivity. The audit committee has held meetings with CCIF to discuss the scope of their audit.

COMMUNICATION WITH SHAREHOLDERS

The Board of Directors recognizes the importance of maintaining clear, timely and effective communication with shareholders of the Company and investors. The Company is dedicated to providing quality and timely disclosure of information to enhance transparency. Information on the Group's business activities and financial performance is disseminated through the distribution of press releases, press conferences, announcements, and interim and annual reports. The Company apprizes its Annual General Meeting as an important channel for having face-to-face dialogue with shareholders of the Company. At the meeting, the Directors and key executives of the Group will answer and explain to shareholders issues relating to the Group's business strategies and financial results.