## 1. GENERAL

The Company was incorporated in the Cayman Islands on 16 April 2003 as an exempted company with limited liability under the Companies Law (2002 Revision) of the Cayman Islands and its shares have been listed on The Stock Exchange of Hong Kong Limited with effect from 24 November 2003.

The addresses of the registered office and principal place of business of the Company are disclosed in the "Corporate Information" section of the annual report.

The principal activities of the Group are manufacture, sale, research and development of pharmaceutical products and investment holding.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### (a) Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 31).

The HKICPA has issued a number of new and revised HKFRSs that are effective or available for early adoption for the current accounting period of the Group and the Company. The adoption of the new HKFRSs had no material effect on how the results for the current or prior accounting periods have been prepared and presented. Accordingly, no prior period adjustment has been required.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (b) Basis of preparation of financial statements

The consolidated financial statements for the year ended 31 December 2006 comprise the Company and its subsidiaries.

The measurement basis used in the preparation of the financial statements is the historical cost basis except as otherwise set out in the accounting policies below.

The preparation of financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 29.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (c) Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less impairment losses, if any, unless the investment is classified as held for sale.

### (d) Goodwill

Goodwill represents the excess of the cost of a business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less accumulated impairment losses. Goodwill is allocated to cash generating units and is tested annually for impairment.

Any excess of the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination is recognised immediately in income statement.

On disposal of a cash generating unit during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Property, plant and equipment

Property, plant and equipment are stated in the balance sheet at cost less accumulated depreciation and accumulated impairment losses, if any.

Depreciation is calculated to write off the cost of items of property, plant and equipment, less their estimated residual value, if any, on a straight-line basis over their estimated useful lives. The principal annual rates are as follows:

| | |
|---|---|
| Buildings situated on leasehold land | Over the shorter of the term of the lease or 20 years |
| Leasehold improvement | 20% |
| Office and other equipment | 20% |
| Motor vehicles | 10% |
| Plant and machinery | 10% |

Where parts of an item of property, plant and equipment have different useful lives, the cost of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

Gain or loss arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in income statement on the date of retirement or disposal.

### (f) Intangible Asset

***Patents***

Purchased patents are stated in the balance sheet at cost less accumulated amortisation (where the estimated useful life is other than indefinite) and any identified impairment losses. Patents are amortised on a straight-line basis over their estimated useful lives of five to ten years. Both the period and method of amortisation are reviewed annually.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (g) Leased assets

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal form of a lease.

#### *(i) Classification of assets leased to the Group*

Assets that are held by Group under leases which transfer to the Group substantially all the risks and rewards of ownership are classified as being held under finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the Group are classified as operating leases, with the following exceptions;

– property held under operating leases that would otherwise meet the definition of an investment property is classified as an investment property, is accounted for as if held under a finance lease; and

– land held for own use under an operating lease, the fair value of which cannot be measured separately from the fair value of a building situated thereon at the inception of the lease, is accounted for as being held under a finance lease, unless the building is also clearly held under an operating lease. For these purposes, the inception of the lease is the time that the lease was first entered into by the Group, or taken over from the previous lessee.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (g) Leased assets (Continued)

#### *(ii) Assets acquired under finance leases*

Where the Group acquires the use of assets under finance leases, the amounts representing the fair value of the leased asset, or, if lower, the present value of the minimum lease payments, of such assets are included in fixed assets and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation is provided at rates which write off the cost or valuation of the assets over the term of the relevant lease or, where it is likely the Group will obtain ownership of the asset, the life of the asset. Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(h). Finance charges implicit in the lease payments are charged to income statement over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period. Contingent rentals are charged to income statement in the accounting period in which they are incurred.

#### *(iii) Operating lease charges*

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to income statement in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to income statement in the accounting period in which they are incurred.

The cost of acquiring land held under an operating lease is amortised on a straight-line basis over the period of the lease term except where the property is classified as an investment property.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (h) Impairment of assets

#### *(i) Impairment of receivables*

Current and non-current receivables that are stated at cost or amortised cost are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, any impairment loss is determined and recognised as follows:

– For trade and other current receivables and other financial assets carried at amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets), where the effect of discounting is material.

  If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through income statement. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

#### *(ii) Impairment of other assets*

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

– property, plant and equipment
– prepaid lease payments
– intangible assets; and
– investments in subsidiaries

If any such indication exists, the asset's recoverable amount is estimated. In addition, intangible assets that are not yet available for use, the recoverable amount is estimated annually whether or not there is any indication of impairment.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (h) Impairment of assets (Continued)

***Calculation of recoverable amount***

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

***Recognition of impairment losses***

An impairment loss is recognised in income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

***Reversals of impairment losses***

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of an impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to income statement in the year in which the reversals are recognised.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (i) Inventories

Inventories are stated at the lower of cost and net realisable value.

Cost is calculated using the weighted-average cost formula and comprises direct materials and, where appropriate, direct labour costs and those overhead that have been incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business, less expected costs of completion and the estimated costs necessary to make the sale. Provision is made for obsolete, slow-moving or defective items where appropriate.

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

### (j) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see note 2(h)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts.

### (k) Trade and other payables

Trade and other payables are initially recognised at fair value. Trade and other payables are subsequently stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (l) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

### (m) Employee benefits

#### *(i) Short term employee benefits and contributions to defined contribution retirement plans*

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

#### *(ii) Share based payments*

The fair value of share options granted to employees is recognised as an employee cost with a corresponding increase in share option reserve within equity. The fair value is measured at grant date, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to the share options, the total estimated fair value of the share options is spread over the vesting period, taking into account the probability that the options will vest.

During the vesting period, the number of share options that is expected to vest is reviewed. Any adjustment to the cumulative fair value recognised in prior years is charged/credited to income statement for the year of the review, unless the original employee expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of share options that vest (with a corresponding adjustment to the capital reserve) except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the Company's shares. The equity amount is recognised in the capital reserve until either the option is exercised (when it is transferred to the share premium account) or the option expires (when it is released directly to retained profits).

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (m) Employee benefits (Continued)

#### *(iii) Termination benefits*

Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

### (n) Share-based payment transactions

***Equity-settled share-based payment transactions***

*Share options granted to employees*

The accounting policy is set out in note 2 (m)(ii)

*Share options granted to suppliers/consultants*

Share options issued in exchange for goods or services are measured at the fair values of share options granted. The fair values of the goods or services received are recognised as expenses immediately, unless the goods or services quality for recognition as assets. Corresponding adjustment has been made to equity (share option reserve).

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (o) Income Tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in income statement except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination) and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (o) Income Tax (Continued)

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

– in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

– in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

  – the same taxable entity; or

  – different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (p) Provision and Contingencies

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Company has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

### (q) Revenue Recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in income statement as follows:

***(i) Sales of goods***

Revenue is recognised when goods are delivered at the customers' premises which is taken to be the point in time when the customer has accepted the goods and the related risks and rewards of ownership. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

***(ii) Interest income***

Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (r) Foreign Currency Translation

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated of the foreign exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in income statement.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

The results of foreign operations are translated into Hong Kong Dollar at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items are translated into Hong Kong Dollar at the foreign exchange rates ruling at the balance sheet date. The resulting exchange differences are recognised directly in a separate component of equity.

On disposal of a foreign operation, the cumulative amount of the exchange differences recognised in equity which relate to that foreign operation is included in the calculation of the profit or loss on disposal.

### (s) Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if:

(i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;

(ii) the Group and the party are subject to common control;

(iii) the party is an associate of the Group or a joint venture in which the Group is a venturer;

(iv) the party is a member of key management personnel of the Group or the Group's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;

## 2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (s) Related parties (Continued)

(v) the party is a close family member of a party referred to in (i) or a an entity under the control, joint control or significant influence of such individuals; or

(vi) the party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

### (t) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of these financial statements.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. For example, segment assets may include inventories, trade receivables and property, plant and equipment. Segment revenue, expenses, assets, and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group entities within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets, interest-bearing loans, borrowings, tax balances, corporate and financing expenses.

## 3. TURNOVER AND OTHER REVENUE

Turnover represents the invoiced value of goods sold after deducting goods returned, trade discount and sale tax.

Turnover and other revenue consisted of:

| | **2006**<br>**HK$'000** | 2005<br>HK$'000 |
|---|---|---|
| Turnover | | |
| Sales of pharmaceutical products | **342,232** | 259,832 |
| Other revenue | | |
| Exchange gain | **3,406** | 1,681 |
| Interest income | **1,174** | 693 |
| Reversal of revaluation on prepaid lease payments | **–** | 712 |
| | **4,580** | 3,086 |
| Total revenue | **346,812** | 262,918 |

## 4. FINANCE COSTS

| | **2006**<br>**HK$'000** | 2005<br>HK$'000 |
|---|---|---|
| Bank charges | **–** | 2 |

## 5. PROFIT BEFORE TAXATION

The profit before taxation are stated after charging the following:

| | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|
| Amortisation of intangible assets | **11,328** | 5,328 |
| Amortisation of prepaid lease payments | **144** | 183 |
| Auditors' remuneration | **570** | 590 |
| Cost of inventories | **205,251** | 156,120 |
| Depreciation | **7,638** | 6,382 |
| Research and development costs | **101** | 121 |
| Staff costs (including directors' remuneration) | | |
| Salaries and allowance | **5,189** | 4,957 |
| Contributions to retirement scheme | **807** | 737 |
| | **5,996** | 5,694 |
| Operating lease payment in respect of premises | **590** | 329 |

Notes: Cost of inventories includes HK$6,139,000 (2005: HK$8,389,000) relating to staff costs and depreciation, which amount is also included in the respective total amounts disclosed separately above.

## 6. INCOME TAX

| | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|
| Current tax – PRC enterprise income tax | | |
| Provision for the year | **16,391** | 13,198 |

(i) Fujian Nanshaolin Pharmaceutical Co., Ltd. (formerly known as Fuqing Pharmaceutical Company Ltd), a wholly foreign owned enterprise, was subject to PRC enterprise income tax at a rate of 15% applicable to the company on the assessable profits for the year.

(ii) No provision for Hong Kong profits tax has been made as the Group had no assessable profits for the year (2005: Nil).

(iii) The Group had no significant unprovided deferred taxation arising during the year or at 31 December 2006 (2005: Nil).

## 6. INCOME TAX (Continued)

Reconciliation between tax expense and accounting profit at applicable tax rates:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Profit before taxation | **100,318** | 79,202 |
| Notional tax on profit before tax, calculated at the rates, applicable to profits in the countries concerned | **14,930** | 11,784 |
| Tax effect of non-taxable income | **(243)** | (85) |
| Tax effect of unrecognised tax losses | **821** | 675 |
| Temporary difference | **883** | 824 |
| Actual tax expense | **16,391** | 13,198 |

## 7. PROFIT ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The consolidated profit attributable to equity shareholders of the Company includes a loss of approximately HK$4,680,000 (2005: a loss of HK$3,852,000) which has been dealt with in the financial statements of the Company.

## 8. DIVIDENDS

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Dividends payable to equity shareholders of the Company attributable to the year | **–** | – |

Final dividend proposal after the balance sheet date of HK$16,720,000 (2005: Nil) at HK3.8 cents per share (2005: Nil) has not been recognised as a liability at the balance sheet date.

## 9. EARNINGS PER SHARE

### (a) Basic earnings per share

The calculation of basic earnings per share for the year is based on the consolidated profit attributable to equity shareholders of approximately HK$83,927,000 (2005: HK$66,004,000) and the weighted-average number of 400,000,000 (2005: 400,000,000) ordinary shares in issue during the year.

### (b) Diluted earnings per share

The calculation of diluted earnings per share is based on the profit attributable to ordinary equity shareholders of the Company of HK$83,927,000 and the weighted average number of ordinary shares of 400,768,898 shares, calculated as follow:

***Weighted average number of ordinary shares (diluted)***

| | **2006** | 2005 |
|---|---|---|
| | **'000** | '000 |
| Weighted average number of ordinary shares at 31 December | **400,000** | 400,000 |
| Effect of deemed issued of shares under the Company's share option scheme for nil consideration | **769** | – |
| Weighted average number of ordinary shares (diluted) at 31 December | **400,769** | 400,000 |

Diluted earnings per share is not presented for 2005 as there were no dilutive potential ordinary shares during the year ended 31 December 2005.

## 10. STAFF RETIREMENT BENEFITS

The Group has arranged its Hong Kong employees to join the Mandatory Provident Fund Scheme (the "MPF Scheme"), under the Hong Kong Mandatory Provident Fund Schemes Ordinance under the jurisdiction of the Hong Kong Employment Ordinance. The MPF Scheme is a defined contribution retirement plan managed by independent trustees. Under the MPF Scheme, each of the Group (the employer) and its employees makes monthly contributions to the scheme at 5% of the employees' earnings as defined under the Mandatory Provident Fund legislation. The contributions from each of the employer and employees are subject to a cap of HK$1,000 per month and thereafter contributions are voluntary. Contributions to plan vest immediately.

The employees of the Group's subsidiary in the PRC are members of a state-sponsored retirement plan, which is a defined contribution retirement plan operated by the local government in the PRC and this subsidiary make mandatory contributions to the state-sponsored retirement plan to fund the employees retirement benefits. The retirement contributions paid by the PRC subsidiary 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. The Group discharges its retirement obligations upon payment of the retirement contributions to the state-sponsored retirement plan operated by the local government in the PRC.

The contributions paid for the year were approximately HK$807,000 (2005: HK$737,000). As at 31 December 2006, there were no material forfeitures available to offset the Group's future contributions (2005: Nil).

## 11. DIRECTORS' REMUNERATION

The directors of the Company were members of the senior management of the Group during the year ended 31 December 2006 and 2005, directors' remuneration disclosed pursuant to section 161 of the Hong Kong Companies Ordinance is as follows:

| | For the year ended 31 December 2006 | | | | |
|---|---|---|---|---|---|
| | **Directors' fees HK$'000** | **Salaries, allowances and benefits in kind HK$'000** | **Bonuses HK$'000** | **Retirement scheme contributions HK$'000** | **Total HK$'000** |
| *Executive directors* | | | | | |
| Zhong Houtai | – | **456** | **25** | **17** | **498** |
| Chai Chung Wai | – | **650** | – | **12** | **662** |
| Zhong Houyao | – | **60** | – | – | **60** |
| Chong Hoi Fung | – | – | – | – | – |
| Sun Daquan | – | **60** | – | – | **60** |
| *Independent non-executive directors* | | | | | |
| Pei Renjiu | **30** | – | – | – | **30** |
| Li Kai Ming | **30** | – | – | – | **30** |
| Cheung Chuen | **45** | – | – | – | **45** |
| | **105** | **1,226** | **25** | **29** | **1,385** |

| | For the year ended 31 December 2005 | | | | |
|---|---|---|---|---|---|
| | Directors' fees HK$'000 | Salaries, allowances and benefits in kind HK$'000 | Bonuses HK$'000 | Retirement scheme contributions HK$'000 | Total HK$'000 |
| *Executive directors* | | | | | |
| Zhong Houtai | – | 539 | 25 | 21 | 585 |
| Chai Chung Wai | – | 650 | – | 12 | 662 |
| Zhong Houyao | – | 63 | – | 1 | 64 |
| Chong Hoi Fung | – | 60 | – | – | 60 |
| Sun Daquan | – | 60 | – | – | 60 |
| *Independent non-executive directors* | | | | | |
| Pei Renjiu | 30 | – | – | – | 30 |
| Li Kai Ming | 30 | – | – | – | 30 |
| Cheung Chuen | 45 | – | – | – | 45 |
| | 105 | 1,372 | 25 | 34 | 1,536 |

## 12. INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five individuals with the highest emoluments, two (2005: all) are directors whose emoluments are disclosed in note 11. The aggregate of the emoluments in respect of the other three individuals (2005: nil) are as follows:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Basic salaries and allowances | **194** | – |
| Bonuses | **132** | – |
| Contributions to retirement scheme | **26** | – |
| | **352** | – |

The emoluments of the three individuals with the highest emoluments are below RMB1,020,000 (equivalent of HK$1,000,000). The emoluments of all the five highest paid individuals (including directors and other employees) for the year ended 31 December 2005 are directors of the Company, the details of which is disclosed in note 11.

During the year, no emoluments had been paid by the Group to the directors or the five highest paid individuals as an inducement to join or upon joining the Group, or as compensation for loss of office. No directors waived or agreed to waive any emoluments during the year.

## 13. PROPERTY, PLANT AND EQUIPMENT

### The Group

| | Buildings | Leasehold improvement | Plant and machinery | Office and other equipment | Motor vehicles | Total |
|---|---|---|---|---|---|---|
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| **Cost or valuation** | | | | | | |
| At 1 January 2005 (restated) | 35,063 | 289 | 20,573 | 658 | 1,292 | 57,875 |
| Exchange adjustments | 708 | – | 395 | 10 | 25 | 1,138 |
| Less: Restatement under HKAS 16 | 3,452 | – | – | – | – | 3,452 |
| Additions | 19,794 | – | 26,224 | 1,156 | – | 47,174 |
| Transfer | – | – | – | – | – | – |
| At 31 December 2005 and 1 January 2006 | 59,017 | 289 | 47,192 | 1,824 | 1,317 | 109,639 |
| Exchange adjustments | 2,360 | – | 1,888 | 67 | 53 | 4,368 |
| Additions | 46,000 | – | 12,086 | 1,271 | – | 59,357 |
| At 31 December 2006 | 107,377 | 289 | 61,166 | 3,162 | 1,370 | 173,364 |
| **Accumulated depreciation** | | | | | | |
| At 1 January 2005 (restated) | 1,184 | 58 | 4,713 | 285 | 379 | 6,619 |
| Exchange adjustments | 72 | – | 126 | 6 | 9 | 213 |
| Less: Restatement under HKAS 16 | 2,740 | – | – | – | – | 2,740 |
| Charge for the year | 2,336 | 58 | 3,748 | 123 | 117 | 6,382 |
| At 31 December 2005 and 1 January 2006 | 6,332 | 116 | 8,587 | 414 | 505 | 15,954 |
| Exchange adjustments | 307 | – | 432 | 20 | 23 | 782 |
| Charge for the year | 2,708 | 58 | 4,419 | 332 | 121 | 7,638 |
| At 31 December 2006 | 9,347 | 174 | 13,438 | 766 | 649 | 24,374 |
| **Net book value** | | | | | | |
| At 31 December 2006 | **98,030** | **115** | **47,728** | **2,396** | **721** | **148,990** |
| At 31 December 2005 | 52,685 | 173 | 38,605 | 1,410 | 812 | 93,685 |

## 13. PROPERTY, PLANT AND EQUIPMENT (Continued)

### The Company

| | Leasehold improvement HK$'000 | Office and other equipment HK$'000 | Total HK$'000 |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2005, 31 December 2005, 1 January 2006 and 31 December 2006 | 289 | 134 | 423 |
| **Accumulated depreciation** | | | |
| At 1 January 2005 | 58 | 27 | 85 |
| Charge for the year | 57 | 27 | 84 |
| At 31 December 2005 and 1 January 2006 | 115 | 54 | 169 |
| Charge for the year | 58 | 27 | 85 |
| At 31 December 2006 | 173 | 81 | 254 |
| **Net book value** | | | |
| At 31 December 2006 | **116** | **53** | **169** |
| At 31 December 2005 | 174 | 80 | 254 |

## 14. PREPAID LEASE PAYMENTS

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Beginning of the year | **3,320** | 2,821 |
| Exchange adjustments | **130** | 52 |
| Additions | **9** | 630 |
| Amortisation | **(144)** | (183) |
| End of the year | **3,315** | 3,320 |

The prepaid lease payments represent prepayment of lease premium for land are situated in the PRC under medium-term leases.

## 15. INTANGIBLE ASSET

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| **Patents** | | |
| Cost | | |
| At beginning of the year | **77,308** | 11,132 |
| Exchange adjustments | **3,093** | 214 |
| Additions | **22,000** | 65,962 |
| At end of the year | **102,401** | 77,308 |
| Accumulated amortisation | | |
| At beginning of the year | **5,379** | – |
| Exchange adjustments | **442** | 51 |
| Amortisation | **11,328** | 5,328 |
| At end of the year | **17,149** | 5,379 |
| Net book value | | |
| At end of the year | **85,252** | 71,929 |

## 16. INVESTMENT IN SUBSIDIARIES

| | The Company 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|
| Unlisted shares, at cost | **134,065** | 134,065 |
| Due from subsidiaries | **52,468** | 56,380 |
| | **186,533** | 190,445 |

Amounts due from subsidiaries are unsecured, non-interest bearing and repayable on demand.

Details of subsidiaries as at 31 December 2006 are as follows:

| Name | Country of incorporation/ operation | Class of share held | Issued capital | Proportion of nominal value of issued/ registered capital held by the Company Directly | Indirectly | Principal activities |
|---|---|---|---|---|---|---|
| Long Master International Limited | British Virgin Islands/ Hong Kong | Ordinary | US$10,000 | 100% | – | Investment holding |
| Fujian Nanshaolin Pharmaceutical Co., Ltd. ("Fujian Nanshaolin") (Formerly known as Fujian Fuqing Pharmaceutical Company Limited) | PRC/PRC | Ordinary | RMB21,000,000 | – | 100% | Manufacture, sale, research and development of pharmaceutical products |

* Fujian Nanshaolin was incorporated in the PRC on 30 December 1996 as a domestic enterprise with a registered capital of RMB8,000,000. Effective from 16 November 1999, Fujian Nanshaolin was changed from a domestic enterprise to a wholly-foreign owned enterprise and its registered capital was increased to RMB21,000,000. Fujian Nanshaolin has an operating period from 30 December 1996 to 30 October 2022.

## 17. NEGATIVE GOODWILL

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Gross amount | | |
| At beginning of the year | **–** | 1,612 |
| Derecognised during the year | **–** | (1,612) |
| At end of the year | **–** | – |
| Released to income | | |
| At beginning of the year | **–** | 859 |
| Derecognised during the year | **–** | (859) |
| At end of the year | **–** | – |
| Carrying amount | | |
| At end of the year | **–** | – |

## 18. INVENTORIES

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| Raw material | **6,596** | 4,870 |
| Work in progress | **2,585** | – |
| Finished goods | **1,835** | 2,591 |
| Total | **11,016** | 7,461 |

## 19. TRADE RECEIVABLES

The Group normally grants credit terms of 60 to 90 days to its customers.

The ageing analysis of trade receivables is as follows:

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| 0 to 30 days | **47,880** | 35,923 |
| 31 to 60 days | **31,748** | 34,122 |
| 61 to 90 days | **6,548** | – |
| | **86,176** | 70,045 |

## 20. TRADE PAYABLES

The ageing analysis of accounts payables is as follows:

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | **HK$'000** | HK$'000 |
| 0 to 30 days | **22,492** | 18,158 |
| 31 to 60 days | **41** | – |
| 61 to 90 days | **13** | – |
| | **22,546** | 18,158 |

## 21. SHARE CAPITAL

### The Company

| | Number of shares | | Amount | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| Ordinary shares of HK$0.1 each | **'000** | '000 | **HK$'000** | HK$'000 |
| Authorised | **2,000,000** | 2,000,000 | **200,000** | 200,000 |
| Issued and fully paid | **400,000** | 400,000 | **40,000** | 40,000 |

## 22. SHARE OPTION SCHEME

The Company's share option scheme (the "Share Option Scheme") was adopted pursuant to a resolution passed on 3 November 2003. The purpose of the Share Option Scheme is to enable the Company to grant options to selected participants as incentives and/or rewards for their contribution and support to the Company. Under the Share Option Scheme, the Board of Directors of the Company may grant options to the following eligible participants:

(i) any employee (whether full time or part time, including any executive director but excluding any non-executive director) of the Company, any of its subsidiaries and any entity ("Invested Entity") in which any member of the Group holds any equity interest;

(ii) any non-executive director (including independent non-executive director) of the Company, any of its subsidiaries and any Invested Entity;

(iii) any supplier of goods or services to any member of the Group or any Invested Entity;

(iv) any customer of any member of the Group or any Invested Entity;

(v) any person or entity that provides research, development or other technological support to the Group or any Invested Entity;

(vi) any shareholder of any member of the Group or any Invested Entity or any holder of any securities issued or proposed to be issued by any member of the Group or any Invested Entity; and

(vii) any adviser (professional or otherwise) or consultant to any area of business or business development of any member of the Group or any Invested Entity.

The maximum number of shares in respect of which options may be granted under the Share Option Scheme must not in aggregate exceed 30% of the shares of the Company in issue from time to time. The number of shares in respect of which options may be granted to any participant is not permitted to exceed 1% of the shares of the Company in issue during the twelve-month period before the date of grant, without prior approval from the Company's shareholders.

HK$1 per option is payable on the acceptance of an option offer. Options may be exercised in accordance with the terms of the Share Option Scheme and expiring in accordance with the terms of the Share Option Scheme or the expiry of the tenth anniversary of the Share Option Scheme, whichever is the earlier.

## 22. SHARE OPTION SCHEME (Continued)

The exercise price is determined by the Board of Directors, and shall not be less than the highest of (i) the official closing price of the Company's shares as stated in the daily quotations sheet of the Stock Exchange on the date of grant; (ii) the average official closing price of the Company's shares as stated in the daily quotations sheet of the Stock Exchange for the five business days immediately preceding the date of grant; and (iii) the nominal value of a Company's share.

The Share Option Scheme will remain in force for a period of 10 years commencing on 3 November 2003.

No option had been granted or agreed to be granted under the Share Option Scheme from the date of adoption of the scheme until 31 December 2005.

**(a)** The terms and conditions of the grants that existed during the years are as follows, whereby all options are settled by physical delivery of shares:

| | **Number of instruments** | **Vesting conditions** | **Contractual life of options** |
|---|---|---|---|
| Option granted to a consultant | 2,000,000 shares | No vesting conditions | 2 years |

**(b)** The number and weighted average exercise prices of share options are as follows:

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Weighted average exercise price** | **Number of options '000** | Weighted average exercise price | Number of options '000 |
| Outstanding at the beginning of the year | **–** | **–** | – | – |
| Granted during the year | **HK$0.57** | **2,000** | – | – |
| Outstanding at the end of the year | **HK$0.57** | **2,000** | – | – |
| Exercisable at the end of the year | **HK$0.57** | **2,000** | – | – |

## 22. SHARE OPTION SCHEME (Continued)

### (c) Fair value of share options and assumptions

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the share options granted is measured based on a Black-Scholes option pricing model ("Black-Scholes OPM"). The contractual life of the share option is used as an input into this model. Expectations of early exercise are incorporated into the Black-Scholes OPM.

| **Fair value of share options and assumptions** | **2006** | 2005 |
|---|---|---|
| Fair value per share at measurement date | **HK$0.2455** | N/A |
| Market value per share at the date of grant of options | **HK$0.72** | N/A |
| Exercise price per share | **HK$0.57** | N/A |
| Expected volatility (expressed as weighted average volatility used in the modelling under Black-Scholes OPM) | **58.25%** | N/A |
| Option life (expressed as weighted average life used in the modelling under Black-Scholes OPM) | **2 years** | N/A |
| Expected dividends | **–** | N/A |
| Risk-free interest rate (based on Exchange Fund Notes) | **3.65%** | N/A |

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility based on publicly available information. Expected dividends are based on historical dividends.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services received. There were no market conditions associated with the share options grants.

*For the year ended 31 December 2006*

## 23. RESERVES

### (a) The Group

| | Share premium | Statutory reserve | General reserve | Special reserve (note c) | Exchange reserve | Share option reserve | Retained profit | Total |
|---|---|---|---|---|---|---|---|---|
| | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 | HK$'000 |
| As at 31 December 2004 (restated) | 27,944 | 9,906 | 16,341 | 19,608 | – | – | 155,593 | 229,392 |
| Adjustment arising from derecognition of negative goodwill | – | – | – | – | – | – | 753 | 753 |
| As at 1 January 2005 (restated) | 27,944 | 9,906 | 16,341 | 19,608 | – | – | 156,346 | 230,145 |
| Profit attributable to shareholders | – | – | – | – | – | – | 66,004 | 66,004 |
| Transfer to reserve | – | – | 3,776 | – | – | – | (3,776) | – |
| Exchange differences arising from translation of financial statements of overseas subsidiaries | – | – | – | – | 4,104 | – | – | 4,104 |
| As at 31 December 2005 and 1 January 2006 | 27,944 | 9,906 | 20,117 | 19,608 | 4,104 | – | 218,574 | 300,253 |
| Profit attributable to shareholders | – | – | – | – | – | – | 83,927 | 83,927 |
| Transfer to reserve | – | – | 4,640 | – | – | – | (4,640) | – |
| Exchange differences arising from translation of financial statements of overseas subsidiaries | – | – | – | – | 11,825 | – | – | 11,825 |
| Recognition of equity-settled share-based payment | **–** | **–** | **–** | **–** | **–** | **491** | **–** | **491** |
| As at 31 December 2006 | **27,944** | **9,906** | **24,757** | **19,608** | **15,929** | **491** | **297,861** | **396,496** |

## 23. RESERVES (Continued)

### (b) The Company

| | Share premium HK$'000 | Contributed surplus HK$'000 | Share option reserve HK$'000 | (Accumulated losses) HK$'000 | Total HK$'000 |
|---|---|---|---|---|---|
| As at 1 January 2005 | 27,944 | 133,865 | – | (6,904) | 154,905 |
| Loss attributable to shareholders | – | – | – | (3,852) | (3,852) |
| As at 31 December 2005 and 1 January 2006 | 27,944 | 133,865 | – | (10,756) | 151,053 |
| Loss attributable to shareholders | – | – | – | (4,680) | (4,680) |
| Recognition of equity-settled share-based payment | – | – | 491 | – | 491 |
| As at 31 December 2006 | **27,944** | **133,865** | **491** | **(15,436)** | **146,864** |

### (c) Nature and purpose of reserves

#### *(i) Share premium*

Under the Companies Law (revised) of the Cayman Island, the share premium account of the Company is distributable to the shareholders of the Company provided that immediately following the date on which the dividend is proposed to be distributed the Company will be in a position to pay off its debts and they fall due in the ordinary course of business.

## 23. RESERVES (Continued)

### (c) Nature and purpose of reserves (Continued)

#### *(ii) Statutory reserve*

Fujian Nanshaolin, a wholly-foreign owned enterprise in The People's Republic of China, is required to appropriate at least 10% of after-tax profit (after offsetting prior year losses) to a statutory reserve until the balance of the reserve reaches 50% of its share capital and thereafter any further appropriation is optional. The statutory reserve can be utilised to offset prior year losses, or for the issuance of bonus shares on the condition that the statutory reserve shall be maintained at a minimum of 25% of the share capital after such issuance.

The balance of the statutory reserve has reached 50% of the share capital of Fujian Nanshaolin and the board of directors has determined that no further appropriation is necessary unless there is an increase in share capital of Fujian Nanshaolin.

#### *(iii) General reserve*

General reserve represents enterprise expansion fund which is non-distributable. Appropriations to such reserve is made out of net profit after taxation of the statutory financial statements of the PRC subsidiaries while the amount and allocation basis are decided by its board of directors annually. The enterprise expansion fund is used for expanding the capital base of the PRC subsidiaries by means of capitalisation issue.

#### *(iv) Special reserve*

The special reserve of the Group represents the differences between the nominal value and premium of the shares of the acquired subsidiaries and the nominal value of the Company's shares issued for the acquisition at the time of the reorganisation.

#### *(v) Exchange reserve*

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. The reserve is dealt with in accordance with the accounting policies set out in note 2(r).

## 23. RESERVES (Continued)

### (c) Nature and purpose of reserves (Continued)

#### *(vi) Share option reserve*

The share option reserve of the Company and the Group arises on the grant of share options to directors of the Company, suppliers of goods or services to the Group and consultant of the Group. The reserve is dealt with in accordance with the accounting policies set out in note 2(n).

#### *(vii) Contributed surplus*

The contributed surplus represents the difference between the nominal value of the ordinary shares issued by the Company and the net asset value of subsidiaries acquired through an exchange of shares pursuant to the group reorganisation prior to listing of the Company's shares in 2003.

### (d) Distributable reserves of the Company

Under the Companies Law (revised) of the Cayman Islands, share premium and contributed surplus are distributable to shareholders, subject to the condition that the Company cannot declare or pay a dividend, or make a distribution out of share premium, capital redemption reserve and contributed surplus if (i) it is, or would after the payment be, unable to pay its liabilities as they become due, or (ii) the realisable value of its assets would thereby be less than the aggregate of its liabilities and its share capital account.

As at 31 December 2006, the Company's reserves available for distribution to shareholders amounted to approximately HK$146,373,000 (2005: HK$151,053,000) computed in accordance with the Companies Law (Revised) of the Cayman Islands and the Company's articles of association. This includes the Company's share premium of HK$27,944,000 (2005: HK$27,944,000) and contributed surplus of HK$133,865,000 (2005: HK$133,865,000), less accumulated losses of HK$15,436,000 (2005: HK$10,756,000), which is available for distribution provided that immediately following the date on which the dividend is proposed, the Company will be able to pay its debts as they fall due in the ordinary course of business.

## 24. SEGMENT REPORTING

More than 95% of the operating profits and assets are attributable to the Group's operations, manufacturing and sales of pharmaceutical products in the PRC. Accordingly, no analysis by geographical and business segment is presented here.

## 25. FINANCIAL INSTRUMENTS

Exposure to credit, liquidity, interest rate and currency risks arises in the normal course of the Group's business. These risks are limited by the Group's financial management policies and practices described below.

### (a) Fair values

The carrying amounts of the cash and bank deposits, trade and other receivables and payables, and short-term bank loans and balances with related parties approximate their fair values because of the short maturity of these instruments.

### (b) Credit risk

The Group has no significant concentrations of credit risk. The carrying amount of bank and cash balances and trade and other receivables represent the Group's maximum exposure to credit risk in relation to financial assets. The Group has a credit policy in place and the exposures to these credit risks are monitored on an ongoing basis.

In respect of trade and other receivables, credit evaluations are performed on all customers requiring credit over a certain amount. These receivables are due within 90 days from the date of billing. Debtors with balances that are more than 3 months overdue are requested to settle all outstanding balances before any further credit is granted. Normally the Group does not obtain collateral from customers.

### (c) Interest rate risk

The Group does not have substantial interest-bearing assets and liabilities. The Group's income and operating cash flows are substantially independent of changes in market interest rates.

## 25. FINANCIAL INSTRUMENTS (Continued)

### (d) Liquidity risk

The Group's policy is to maintain sufficient cash and cash equivalents to meet its commitments over the next year in accordance with its strategic plan.

### (e) Currency risk

The Group is exposed to foreign currency risk primarily through sales and purchases that are denominated in a currency other than the functional currency of the operations to which they relate. The currencies giving rise to this risk are primarily Renminbi (RMB). The Group has not used any forward contracts, currency borrowings or other means to hedge its foreign currency exposure. Hong Kong Dollars against RMB were relatively stable during the year and as a result, the Group considers it has no material foreign risk.

## 26. COMMITMENTS

### (a) Capital commitments

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Capital expenditure in respect of land lease payments in PRC contracted for but not provided in the financial statements | **500** | 500 |

## 26. COMMITMENTS (Continued)

### (b) Operating lease commitments

As at 31 December 2006, the Group had commitments for future minimum lease payments in respect of properties under non-cancellable operating leases which fall due as follows:

| | **2006** | 2005 |
|---|---|---|
| | **HK$'000** | HK$'000 |
| Within one year | **742** | 7 |

Significant leasing arrangements in respect of land held under operating leases are described in note 14.

## 27. MATERIAL RELATED PARTY TRANSACTIONS

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Group entered into the following material related party transactions.

### Key management personnel remuneration

Key management personnel are executive directors of the Company. Remuneration for key management personnel is disclosed in note 11.

## 28. IMMEDIATE AND ULTIMATE HOLDING COMPANY

At 31 December 2006, the directors consider the immediate and ultimate controlling party of the Company to be Elite Achieve Limited, which is incorporated in the British Virgin Islands. This entity does not produce financial statements available for public use.

## 29. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In the process of applying the entity's accounting policies which are described in note 2 to the financial statements, management has made the following judgements that have significant effect on the amount recognised in the financial statements. The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are also discussed below.

### Useful lives of property, plant and equipment

The Group's management determines the estimated useful lives for its property, plant and equipment. This estimate is based on the historical experience of the actual useful lives of property, plant and equipment of similar nature and functions.

### Net realisable value of inventories

Net realisable value of inventories is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expense. These estimates are based on the current market condition and the historical experience of manufacturing and selling products of similar nature. It could change significantly as a result of changes in customer taste and competitor actions in response to severe industry cycles. Management will reassess the estimates by the balance sheet date.

### Allowances for bad and doubtful debts

The policy for allowance of bad and doubtful debts of the Group is based on the evaluation of collectability and ageing analysis of accounts and on management's judgement. A considerable amount of judgement is required in assessing the ultimate realisation of these receivables, including the current creditworthiness and the past collection history of each customer. If the financial conditions of customers of the Group were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

## 30. POST BALANCE SHEET EVENTS

On 14 February 2007, Elite Achieve Limited, a company wholly and beneficially owned by Mr. Zhong Houtai, an executive Director and the chairman of the Board entered into (i) the Placing Agreement with the Company and Galaxy China Opportunities Fund, ("the Purchaser"), a third party independent of the Company and connected persons of the Company, pursuant to which the Seller agreed to sell and the Purchaser agreed to buy 40,000,000 shares of the Company ("the Sale Shares") at the price of HK$0.88 per Sale Share and (ii) the Subscription Agreement with the Company and the Purchaser, pursuant to which the Company has conditionally agreed to allot and issue 40,000,000 new Shares to the Seller at the price of HK$0.88 per Subscription Share.

The price per Sale Share of HK$0.88 represents (i) a discount of approximately 18.52% to the closing price of HK$1.08 per share as quoted on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 9 February 2007, being the last day of trading of the shares on the Stock Exchange (the "Last Trading Day"); (ii) a discount of approximately 12.00% to the average closing price of HK$1.00 per share as quoted on the Stock Exchange for the last five trading days up to and including the Last Trading Day. The net proceeds of the placement of HK$35,200,000 was used for additional working capital of the Group.

The placing of 40,000,000 shares was completed on 15 February 2007. The issued and fully paid share capital has been increased by HK$4,000,000.

## 31. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2006

Up to the date of issue of these financial statements, the HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2006 and which have not been adopted in these financial statements.

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Group's results of operations and financial position.

In addition, the following developments may result in new or amended disclosures in the financial statements:

The Group has not early applied the following new standards, amendments and interpretations that have been issued but are not yet effective. The directors of the Company anticipate that the application of these new standards, amendments or interpretations will not have material impact on the results and financial position of the Group.

| | |
|---|---|
| HKAS 1 (Amendment) | Capital Disclosures[1] |
| HKFRS 7 | Financial Instruments: Disclosures[1] |
| HKFRS 8 | Operating Segments[2] |
| HK(IFRIC) – Int-7 | Applying the Restatement Approach under HKAS29 Financial Reporting in Hyperinflationary Economies[3] |
| HK(IFRIC) – Int-8 | Scope of HKFRS2[4] |
| HK(IFRIC) – Int-9 | Reassessment of Embedded Derivatives[5] |
| HK(IFRIC) – Int-10 | Interim Financial Reporting and Impairment[6] |
| HK(IFRIC) – Int-11 | HKFRS 2 – Group and Treasury Share Transactions[7] |
| HK(IFRIC) – Int-12 | Service Concession Arrangements[8] |

1 Effective for annual periods beginning on or after 1 January 2007.

2 Effective for annual periods beginning on or after 1 January 2009.

3 Effective for annual periods beginning on or after 1 March 2006.

4 Effective for annual periods beginning on or after 1 May 2006.

5 Effective for annual periods beginning on or after 1 June 2006.

6 Effective for annual periods beginning on or after 1 November 2006.

7 Effective for annual periods beginning on or after 1 March 2007.

8 Effective for annual periods beginning on or after 1 January 2008.