NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in RMB)

1. GENERAL INFORMATION

Lijun International Pharmaceutical (Holding) Co., Ltd. (the "Company") and its subsidiaries (together the "Group") are principally engaged in the research, development, manufacture and sale of a wide range of finished medicines and bulk pharmaceuticals through a network of independent retailers. The Group has manufacturing plants in the Shaanxi Province, the People's Republic of China ("PRC"), and sells to customers mainly in the PRC.

The Company is a limited liability company incorporated in the Cayman Islands on 28 September 2004. The address of its registered office is Century Yard, Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY1-1111, Cayman Islands.

The Company's shares have been listed on The Stock Exchange of Hong Kong Limited since 20 December 2005.

These consolidated financial statements are presented in Renminbi (RMB), unless otherwise stated. These consolidated financial statements have been approved for issue by the Company's Board of Directors on 26 April 2007.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The financial statements of Lijun International Pharmaceutical (Holding) Co., Ltd. have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS"). The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets.

The preparation of financial statements in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

(a) Amendments to published standards effective in 2006

Hong Kong Accounting Standards ("HKAS") 19 (Amendment), Employee Benefits, is mandatory for a company's accounting periods beginning on or after 1 January 2006. It introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. The amendment does not have significant impact to the Group and the adoption of this amendment only impacts the format and extent of disclosures presented in the consolidated financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.1 Basis of preparation *(Continued)*

(b) Standards and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

The following standards and interpretations to existing standards that have been issued and will become mandatory for a company's accounting periods beginning on or after 1 May 2006 but which the Group has not early adopted:

HKFRS 7, Financial instruments: Disclosures, and the complementary Amendment to HKAS 1, Presentation of Financial Statements — Capital Disclosures. HKFRS 7 introduces new disclosures relating to financial instruments. This standard does not have any impact on the classification and valuation of the Group's financial instruments.

HKFRS 8, 'Operating segments', effective for annual periods beginning on or after 1 January 2009. This standard supersedes HKAS 14 Segment Reporting, under which segments were identified and reported on risk and return analysis. Items were reported on the accounting policies used for external reporting. Under HKFRS 8, segments are components of an entity regularly reviewed by an entity's chief operating decision-maker. Items are reported based on the internal reporting. Management is currently assessing the impact of HKFRS 8 on the Group's operations. The Group will apply HKFRS 8 with effect from 1 January 2009.

Hong Kong International Financial Reporting Interpretation Committee ("HK(IFRIC)")-Int 8, Scope of HKFRS 2 (effective for annual periods beginning on or after 1 May 2006). HK(IFRIC)-Int 8 requires the consideration of transactions involving the issuance of equity instruments — where the identifiable consideration received is less than the fair value of the equity instruments issued as to whether they fall within the scope of HKFRS 2. The Group will adopt HK(IFRIC)-Int 8 from 1 January 2007, but it is not expected to have any impact on the Group's consolidated financial statements.

HK(IFRIC)-Int 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). HK(IFRIC)-Int 10 prohibits the reversal of impairment losses recognised in an interim period in respect of goodwill, investments in equity instruments and investments in financial assets carried at cost, at a subsequent balance sheet date. The Group will adopt HK(IFRIC)-Int 10 from 1 January 2007, but it is not expected to have significant impact on the Group's consolidated financial statements.

(c) Interpretations to existing standards that are not yet effective and not relevant to the Group's operations

The following interpretations to existing standards have been issued and are mandatory for a company's accounting periods beginning on or after 1 March 2006 but are not relevant to the Group's operations:

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.1 Basis of preparation *(Continued)*

(c) Interpretations to existing standards that are not yet effective and not relevant to the Group's operations *(Continued)*

HK(IFRIC)-Int 7, Applying the Restatement Approach under HKAS 29, Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006). HK(IFRIC)-Int 7 provides guidance on how to apply requirements of HKAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period. As none of the Group's entities operates in a hyperinflationary economy, HK(IFRIC)-Int 7 is not relevant to the Group's operations;

HK(IFRIC)-Int 9, Reassessment of embedded derivatives (effective for annual periods beginning on or after 1 June 2006). HK(IFRIC)-Int 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment if required. As none of the Group's entities have changed the terms of their contracts, HK(IFRIC)-Int 9 is not relevant to the Group's operations.

(d) Standards, amendments and interpretations effective in 2006 but not relevant to the Group's operations

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but are not relevant to the Group's operations:

- HKAS 21 Amendment — Net Investment in a Foreign Operation;
- HKAS 39 Amendment — Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- HKAS 39 Amendment — The Fair Value Option;
- HKAS 39 and IFRS 4 Amendment — Financial Guarantee Contracts;
- HKFRS 6, Exploration for and Evaluation of Mineral Resources;
- HKFRS 1 Amendment — First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;
- HK(IFRIC)-Int 4, Determining whether an Arrangement contains a Lease;
- HK(IFRIC)-Int 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
- HK(IFRIC)-Int 6, Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries made up to 31 December.

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill (Note 2.7). If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses (Note 2.9). The results of subsidiaries are accounted by the Company on the basis of dividend received and receivable.

(b) Transactions with minority interests

The Group applies a policy of treating transactions with minority interests as transactions with equity owners of the Group. For purchases from minority interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is deducted from equity. Gains or losses on disposals to minority interests are also recorded in equity. For disposals to minority interests, differences between any proceeds received and the relevant share of minority interests are also recorded in equity.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The financial statements are presented in Chinese Renminbi ("RMB"), which is the Company's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges or qualifying net investment hedges.

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount are recognised in equity.

Translation differences on non-monetary financial assets and liabilities are reported as part of the fair value gain or loss. Translation difference on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available for sale are included in the available-for-sale reserve in equity.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.5 Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses, if any. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged in the income statement during the financial period in which they are incurred.

Depreciation on other assets is calculated using the straight-line method to allocate their costs or revalued amounts to their residual values over their estimated useful lives, as follows:

—	Buildings	20-40 years
—	Plant and machinery	8-18 years
—	Vehicles	5-10 years
—	Furniture, fittings and equipment	8-10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.9).

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within other (losses)/gains — net, in the income statements. When revalued assets are sold, the amounts included in other reserves are transferred to retained earnings.

Construction-in-progress represents buildings, plant and machinery under construction or pending installation and is stated at cost less accumulated impairment losses, if any. Cost includes the costs of construction and acquisition. No provision for depreciation is made on construction-in-progress until such time as the relevant assets are completed and ready for intended use. When the assets concerned are available for the intended use, the costs are transferred to property, plant and equipment and depreciated in accordance with the policy as stated above.

2.6 Land use rights

All land in the PRC is state-owned or collectively-owned and no individual land ownership right exists. The Group acquired the right to use certain land. The premiums paid for such right are treated as prepayment for operating lease and recorded as land use rights, which are amortised over the use terms of 50 years using the straight-line method.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.7 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates and is tested annually for impairment as part of the overall balance. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

(b) Patents

Acquired patents are shown at historical cost. Patents have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of patents over their estimated useful lives (8 years).

2.8 Financial assets

The Group classifies its financial assets in the following categories: loans and receivable and available-for-sale. The classification depends on the purposes for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as trade and other receivables in the balance sheet (Note 2.11).

(b) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.8 Financial assets *(Continued)*

Regular purchases and sales of financial assets are recognised on the trade-date — the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences on monetary securities are recognised in profit or loss; translation differences on non-monetary securities are recognised in equity. Changes in the fair value of monetary and non-monetary securities classified as available for sale are recognised in equity.

When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as gains and losses from investment securities.

Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement as part of other income. Dividends on available-for-sale equity instruments are recognised in the income statement as part of other income when the Group's right to receive payments is established.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group established fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets in impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss — measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss — is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described in Note 2.11.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.9 Impairment of investments in subsidiaries and non-financial assets

Assets that have an indefinite useful life or have not yet available for use are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.10 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses.

2.11 Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the assets is reduced through the use of an allowance account, and the amount of the loss is recognised in the income statement within selling and marketing costs. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against selling and marketing costs in the income statement.

2.12 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

2.13 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.14 Trade and other payables

Trade and other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.15 Borrowings and borrowing costs

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Borrowing costs incurred for the construction of any qualifying asset that is required to complete and prepare the asset for its intended use are capitalised as part of the cost of that asset. Other borrowing costs are expensed.

2.16 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statement. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference can be controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.17 Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave are recognised when they are accrued to employees. A provision is made for the estimated liability for annual leave and long-service leave as a result of service rendered by employees up to the balance sheet date. Employee entitlements to sick leave and maternity leave are not recognised until the time of leave.

(ii) Pension obligations

The Group has arranged for its Hong Kong employees to join the Mandatory Provident Fund Scheme (the "MPF Scheme"). Under the MPF Scheme, the Group and its Hong Kong employees make monthly contributions to the scheme at 5% of the employees' earnings as defined under the Mandatory Provident Fund legislation, subject to a cap of Hong Kong dollar 1,000 per person per month and any excess contributions are voluntary.

The Group contributes on a monthly basis to defined contribution plans organised by provincial government in the PRC based on a percentage of the relevant employee's monthly salaries. The Group's contributions to defined contributions plans are expensed as incurred. The Group has no legal or constructive obligations to pay further contributions even if the schemes do not hold sufficient assets to pay all employees the benefits relating to employee in the current and prior periods.

Compensations for employee termination and early retirement are recognised in the earlier of the periods in which the Group established a constructive obligation and created a valid expectation on the employee, entered into an agreement with the employee specifying the terms, or after the individual employee has been advised of the specific terms.

2.18 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one items included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessment of the time value of money and the risk specific to the obligation. The increase in the provision due to the passage of time is recognised as interest expense.

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(Continued)*

2.19 Revenue recognition

Revenue comprises the fair value of consideration received or receivable for the sale of goods in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts.

The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Revenue from the sale of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the Group entity has delivered products to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

Processing income is recognised in the accounting period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Interest income is recognised on a time-proportion basis using the effective interest method.

Dividend income is recognised when the right to receive payment is established.

2.20 Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

2.21 Research and development costs

Research expenditure is expensed as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility, and costs can be measured reliably. Other development expenditures are expensed as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs with a finite useful life that have been capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit.

2.22 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

3. FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: interest rate risk, credit risk, liquidity risk and foreign exchange risk.

(i) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates as the Group has no significant interest-bearing assets. The Group's exposure to changes in interest rates is mainly attributable to its bank loans. Bank loans at variable rates expose the Group to cash flow interest-rate risk. Details of the Group's bank borrowings have been disclosed in Note 21 of this section.

The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

(ii) Credit risk

The Group has no significant concentrations of credit risk. The carrying amounts of bank and cash balances, trade and bills receivables, and other receivables represent the Group's maximum exposure to credit risk in relation to financial assets. The Group has policies that limit the amount of credit exposure to any financial institutions. The Group has also policies in place to ensure that the sales of products are made to customers with appropriate credit history and the Group performs periodic credit evaluations of its customers.

3. FINANCIAL RISK MANAGEMENT *(Continued)*

3.1 Financial risk factors *(Continued)*

(iii) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities. The Group aims to maintain flexibility in funding by keeping committed credit lines available.

(iv) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions denominated and settled in RMB. However, foreign currencies, mainly United States Dollars ("USD"), are required to settle the Group's sales of bulk pharmaceuticals to overseas customers and the relative expenses. RMB is not freely convertible into other foreign currencies and conversion of RMB into foreign currencies is subject to rules and regulations of foreign exchange control promulgated by the PRC government.

The Group has not used any forward contracts, currency borrowings or other means to hedge its foreign currency exposure. As a result, the Group considers it has no material foreign exchange risk.

3.2 Fair value estimation

The carrying amounts of the Group's financial assets which mainly include bank and cash balances, trade and bills receivables, other receivables; and financial liabilities, which mainly include trade and bills payables, short-term bank loans, approximate their fair values due to their short maturities.

The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments. The fair values of non-current borrowings are disclosed in Note 21.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

4.1 Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS *(Continued)*

4.1 Critical accounting estimates and assumptions *(Continued)*

(i) 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. It could change significantly as a result of technical innovations and competitor actions in response to severe industry cycles.

Management will increase the depreciation charge where useful lives are less than previously estimated lives, or will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

(ii) 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 expenses. 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 competitor actions in response to severe industry cycles. Management will reassess the estimations by the balance sheet date.

(iii) Impairment of trade and bills receivable

The Group's management determines the provision for impairment of trade and bills receivables. This estimate is based on the credit history of its customers and the current market condition. Management reassess the provision on each of the balance sheet date.

(iv) Impairment of property, plant and equipment

The impairment loss for property, plant and equipment is recognised for the amount by which the carrying amount exceeds its recoverable amount in accordance with the accounting policy stated in Note 2.9. The recoverable amounts have been determined based on fair value less costs to sell, which is based on the best information available to reflect the amount that obtainable at each of the balance sheet date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs to disposal.

5. SEGMENT INFORMATION

The Group primarily operates in one business segment — manufacturing and sale of pharmaceutical products. It operates principally in one geographical segment — the PRC. Substantially all of the Group's assets were located in the PRC. Accordingly, no analysis of segment information is presented.

6. LAND USE RIGHTS — GROUP

	RMB'000
At 1 January 2005	
Cost	10,455
Accumulated amortisation	(441)
Net book amount	10,014
Year ended 31 December 2005	
Opening net book amount	10,014
Disposals	(2,918)
Amortisation charge for the year	(82)
Closing net book amount	7,014
At 31 December 2005	
Cost	7,425
Accumulated amortisation	(411)
Net book amount	7,014
Year ended 31 December 2006	
Opening net book amount	7,014
Amortisation charge for the year	(69)
Closing net book amount	6,945
At 31 December 2006	
Cost	7,425
Accumulated amortisation	(480)
Net book amount	6,945

All of the Group's land use rights are located in Xi'an and Weinan, Shaanxi Province, the PRC and are held on leases of 50 years from the dates of acquisition.

As at 31 December 2006, the net book amount of the Group's land use rights of approximately RMB 4,000,000 (2005: RMB 4,000,000) was pledged as collateral for the Group's bank loans (Note 19(d)).

The amortisation of land use rights is charged to general and administrative expenses.

7. PROPERTY, PLANT AND EQUIPMENT

Group

	Buildings RMB'000	Plant and machinery RMB'000	Furniture and fixtures RMB'000	Vehicles RMB'000	Construction-in-progress RMB'000	Total RMB'000
At 1 January 2005						
Cost	201,291	256,893	17,054	24,694	22,184	522,116
Accumulated depreciation and impairment losses	(40,926)	(130,512)	(6,606)	(8,759)	—	(186,803)
Net book amount	160,365	126,381	10,448	15,935	22,184	335,313
Year ended 31 December 2005						
Opening net book amount	160,365	126,381	10,448	15,935	22,184	335,313
Additions	—	—	1,260	1,912	34,744	37,916
Transfer	10,124	17,257	398	—	(27,779)	—
Disposal	(1,420)	(39)	—	—	—	(1,459)
Charge for the year *(Note 24)*	(6,690)	(23,497)	(2,417)	(2,440)	—	(35,044)
Closing net book amount	162,379	120,102	9,689	15,407	29,149	336,726
At 31 December 2005						
Cost	209,407	273,872	18,688	26,349	29,149	557,465
Accumulated depreciation and impairment losses	(47,028)	(153,770)	(8,999)	(10,942)	—	(220,739)
Net book amount	162,379	120,102	9,689	15,407	29,149	336,726
Year ended 31 December 2006						
Opening net book amount	162,379	120,102	9,689	15,407	29,149	336,726
Additions	954	874	1,366	4,502	46,019	53,715
Transfer	3,982	2,628	—	—	(6,610)	—
Disposal	—	—	—	(341)	(25)	(366)
Charge for the year *(Note 24)*	(6,858)	(18,271)	(2,201)	(2,802)	—	(30,132)
Closing net book amount	160,457	105,333	8,854	16,766	68,533	359,943
At 31 December 2006						
Cost	214,343	277,374	20,054	30,264	68,533	610,568
Accumulated depreciation and impairment losses	(53,886)	(172,041)	(11,200)	(13,498)	—	(250,625)
Net book amount	160,457	105,333	8,854	16,766	68,533	359,943

The buildings are located in Xi'an and Weinan, Shaanxi Province, the PRC.

The depreciation of property, plant and equipment is charged to cost of sales, selling and marketing costs and general and administrative expenses.

7. PROPERTY, PLANT AND EQUIPMENT *(Continued)*

Company

	Furniture and fixtures *RMB'000*	Vehicles *RMB'000*	Total *RMB'000*
Year ended 31 December 2005			
Addition	1,076	—	1,076
Charge for the year	(36)	—	(36)
Closing net book amount	1,040	—	1,040
At 31 December 2005			
Cost	1,076	—	1,076
Accumulated depreciation and impairment losses	(36)	—	(36)
Net book amount	1,040	—	1,040
Year ended 31 December 2006			
Opening net book amount	1,040	—	1,040
Addition	18	1,830	1,848
Charge for the year	(104)	(225)	(329)
Closing net book amount	954	1,605	2,559
At 31 December 2006			
Cost	1,094	1,830	2,924
Accumulated depreciation and impairment losses	(140)	(225)	(365)
Net book amount	954	1,605	2,559

8. INTANGIBLE ASSETS — GROUP

	Goodwill *RMB'000*	Patent *RMB'000*	Total *RMB'000*
At 1 January 2005			
Cost	751	—	751
Accumulated amortisation and impairment	(150)	—	(150)
Net book amount	601	—	601
Year ended 31 December 2005			
Opening net book amount	601	—	601
Impairment for the year *(Note 24)*	(601)	—	(601)
Closing net book amount	—	—	—
At 31 December 2005			
Cost	751	—	751
Accumulated amortisation and impairment	(751)	—	(751)
Net book amount	—	—	—
Year ended 31 December 2006			
Opening net book amount	—	—	—
Additions	—	7,367	7,367
Amortisation for the year *(Note 24)*	—	(384)	(384)
Closing net book amount	—	6,983	6,983
At 31 December 2006			
Cost	751	7,367	8,118
Accumulated amortisation and impairment	(751)	(384)	(1,135)
Net book amount	—	6,983	6,983

9. INVESTMENTS IN A SUBSIDIARY — COMPANY

	Company	
	2006	2005
	RMB'000	*RMB'000*
Unlisted shares	**323,697**	152,040

The following is a list of the principal subsidiaries at 31 December 2006:

Name	Place of incorporation and kind of legal entity	Principal activities and place of operation	Paid in, issued and fully paid share capital	Interest held	
				2006	2005
Xi'an Lijun Pharmaceutical Co., Ltd. ("Xi'an Lijun")	Limited liability company incorporated in PRC	Manufacturing and sale of pharmaceutical products in PRC	RMB 280,000,000	**100% (Directly held)**	80% (Directly held)
Shaanxi Rejoy Hengxintang Pharmaceutical Co., Ltd. ("Hengxintang")	Limited liability company incorporated in PRC	Manufacturing and sale of traditional Chinese medicine in PRC	RMB 10,000,000	**51% (Indirectly held)**	41% (Indirectly held)

10. DEFERRED INCOME TAX ASSET — GROUP

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Deferred tax assets:		
— Deferred tax asset to be recovered after more than 12 months	**5,455**	7,436
— Deferred tax asset to be recovered within 12 months	**2,947**	—
	8,402	7,436

10. DEFERRED INCOME TAX ASSET — GROUP

The movements in deferred tax assets are as follows:

	Accrual of sales commission and others *RMB'000*	Provisions for impairment of trade receivables *RMB'000*	Inventory write-down *RMB'000*	Timing difference in expense recognition *RMB'000*	Total *RMB'000*
At 1 January 2005	8,563	6,993	1,879	5,123	22,558
Recognised in the income statement *(Note 26)*	(8,563)	(4,086)	(708)	(1,765)	(15,122)
At 31 December 2005	—	2,907	1,171	3,358	7,436
Recognised in the income statement *(Note 26)*	2,663	(1,109)	(143)	(445)	966
At 31 December 2006	2,663	1,798	1,028	2,913	8,402

11. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Available-for-sale financial assets represent unlisted and listed shares in certain limited liability companies in the PRC.

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Equity securities:		
Xi'an Lijun Transportation Co., Ltd. — unlisted	**129**	129
Sichuan Quanxing Co., Ltd. — listed	**480**	480
	609	609

The Group's investment in unlisted shares represents the 14.37% share of a joint venture in the PRC, Xi'an Lijun Transportation Co., Ltd..

12. INVENTORIES — GROUP

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Raw materials	**38,934**	41,907
Work in progress	**23,874**	13,935
Finished goods	**32,229**	47,304
	95,037	103,146
Less: Provision for impairment of inventory	**(9,552)**	(9,761)
	85,485	93,385

The Group reversed RMB 209,000 (2005: RMB 2,764,000) for impairment of inventories during the year ended 31 December 2006. The reversal has been included in cost of sales (Note 32).

13. TRADE AND BILL RECEIVABLE — GROUP

The Group generally required its customers to settle sales invoices within 3 months. Ageing analysis of trade and bills receivables is as follows:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Within 3 months	**182,551**	127,698
4 to 6 months	**24,027**	18,525
7 to 12 months	**14,185**	9,534
1 to 2 years	**2,265**	2,204
2 to 3 years	**683**	2,234
More than 3 years	**3,843**	13,638
	227,554	173,833
Less: Provision for impairment of receivables	**(11,687)**	(22,507)
	215,867	151,326

The Group has written off approximately RMB 14,478,000 (2005: RMB 983,000) and recognised loss of RMB 3,658,000 (2005: Write back of RMB 3,784,000) for impairment of its trade receivables during the year ended 31 December 2006. The loss has been included in general and administrative expenses.

There is no concentration of credit risk with respect to trade and bills receivables, as the Group has a large number of customers, nationally dispersed. The carrying amounts of the trade and bills receivables approximate their fair value.

13. TRADE AND BILL RECEIVABLE — GROUP *(Continued)*

At the respective balance sheet dates, the trade and bills receivables were denominated in currencies as follows:

	2006	2005
	RMB'000	*RMB'000*
USD	**1,329**	65
RMB	**226,225**	173,768
	227,554	173,833

14. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group As at 31 December		Company As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Proceeds from new issue of shares retained by the underwriters *(Note 32)*	—	30,606	—	30,606
Receivables relating to disposal of staff quarters	**16,416**	12,916	—	—
Prepayments to suppliers	**11,681**	9,633	—	—
Prepaid advertising expenses	**7,774**	3,067	—	—
Receivables relating to disposal of land use right	**2,940**	2,940	—	—
Other receivables	**8,228**	6,838	**2,890**	1,475
	47,039	66,000	**2,890**	32,081

15. RESTRICTED CASH

As at 31 December 2006, the Group has restricted deposits amounted to RMB 16,248,000 (2005: nil) as guarantee of the bank borrowings *(Note 19)*.

16. BANK AND CASH BALANCES

Bank and cash balances were denominated in currencies as follows:

	Group		Company	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
RMB	**116,068**	145,106	**—**	—
HKD	**46,469**	129,745	**13,740**	129,745
EUR	**4,690**	—	**—**	—
USD	**160**	271	**—**	—
	167,387	275,122	**13,740**	129,745

Cash and cash equivalents represented bank and cash balances. RMB is not a freely convertible currency in the international market. The remittance of these RMB funds out of the PRC is subject to the exchange control restrictions imposed by the PRC Government.

The weighted average effective interest rate per annum on cash at bank was approximately 1.08% (2005: 1.08%).

17. SHARE CAPITAL

	Number of shares	Amount
	(thousands)	*RMB'000*
At 1 January 2005	10	1
Capitalisation issue	209,990	21,851
	210,000	21,852
New share issue	80,500	8,377
At 31 December 2005 and 2006	290,500	30,229

The total authorised number of ordinary share is 1,000,000,000 (2005: 1,000,000,000), with a par value of HK$ 0.10 per share (2005: HK$ 0.10 per share).

On 18 October 2004, one share was allotted and issued at par.

On 28 December 2004, 9,999 shares were allotted, issued and fully paid at par.

In December 2005, the Company issued 80,500,000 shares at HK$2.15 per share for cash (including 70,000,000 shares on 19 December 2005 and 10,500,000 shares on 21 December 2005) in connection with the listing of the Company's share on the SEHK, and raised a net proceeds of approximately RMB 151,467,000 after netting off share issue expenses amounted to approximately RMB 28,635,000. In addition, 209,990,000 shares are credited as fully paid pursuant to the capitalisation issue immediately following the issue of new shares.

18. RESERVES

Group

	Share premium RMB'000	Capital reserve (Note a) RMB'000	Statutory reserves (Note b) RMB'000	Exchange difference RMB'000	Retained earnings RMB'000	Total RMB'000
At 1 January 2005	—	168,752	45,949	—	44,617	259,318
Issue of share capital	149,874	—	—	—	—	149,874
Share issue expenses	(28,635)	—	—	—	—	(28,635)
Profit for the year	—	—	—	—	93,311	93,311
Transfer to statutory reserves	—	—	13,804	—	(13,804)	—
Dividends	—	—	—	—	(3,372)	(3,372)
At 31 December 2005	121,239	168,752	59,753	—	120,752	470,496
Profit for the year	—	—	—	—	84,575	84,575
Transfer to statutory reserve	—	—	11,236	—	(11,236)	—
Dividends	—	—	—	—	(68,472)	(68,472)
Acquisition of minority interest *(Note 33)*	—	(11,859)	—	—	—	(11,859)
Exchange difference	—	—	—	(2,652)	—	(2,652)
At 31 December 2006	121,239	156,893	70,989	(2,652)	125,619	472,088

Company

	Share premium RMB'000	Capital Surplus RMB'000	Exchange difference RMB'000	Retained earnings RMB'000	Total RMB'000
At 1 January 2005	—	152,040	—	—	152,040
Issue of share capital	149,874	—	—	—	149,874
Share issue expenses	(28,635)	—	—	—	(28,635)
Profit for the year	—	—	—	54,426	54,426
At 31 December 2005	121,239	152,040	—	54,426	327,705
Profit for the year	—	—	—	35,574	35,574
Dividends	—	—	—	(68,472)	(68,472)
Exchange difference	—	—	(2,652)	—	(2,652)
At 31 December 2006	121,239	152,040	(2,652)	21,528	292,155

18. RESERVES *(Continued)*

	Group As at 31 December		Company As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Retained earnings representing:				
— Proposed final dividend	**20,430**	48,367	**20,430**	48,367
— Others	**105,189**	72,385	**1,098**	6,059
Total Retained earnings	**125,619**	120,752	**21,528**	54,426

(a) Capital reserve

Capital reserve of the Company includes the difference between the Company's 80% share in paid-up capital of Xi'an Lijun Pharmaceutical Co., Ltd. and the nominal value of the share capital issued by the Company upon the Reorganisation.

(b) Statutory reserves

In accordance with the PRC regulations and the Articles of the Association of the Group's subsidiaries established in the PRC, each of the Group's subsidiaries is required to set aside 10% of its statutory net profit for the year after offsetting any prior years' accumulative losses as determined under the PRC accounting regulations to the statutory surplus reserve fund before distributing their net profit. When the balance of such reserve reaches 50% of each PRC subsidiary's share capital, any further appropriation is optional. The statutory surplus reserve fund can be utilised to offset prior years' losses or to issue bonus shares. However, such statutory surplus reserve fund must be maintained at a minimum of 25% of the PRC subsidiary's share capital after such issuance.

In addition, each of the PRC subsidiaries is required to set aside 5% to 10% of its statutory net profit for the year to the statutory public welfare fund. The statutory public welfare fund is to be utilised to build or acquire capital items for the subsidiary's employees and cannot be used to pay off staff welfare expenses.

19. BANK BORROWINGS

	Group As at 31 December		Company As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Long-term				
— Due within one year	**12,057**	5,000	**12,057**	—
— Due over one year	**28,131**	—	**28,131**	—
Short-term	**169,188**	108,000	**40,188**	—
Total borrowings	**209,376**	113,000	**80,376**	—
Representing:				
Unsecured	**124,000**	108,000	**—**	—
Secured *	**5,000**	5,000	**—**	—
Guaranteed **	**80,376**	—	**80,376**	—
	209,376	113,000	**80,376**	—

* As at 31 December 2006, the net book amount of the Group's land use rights (Note 6) of approximately RMB 4,000,000 was pledged as collateral for the Group's bank borrowings (2005: RMB 4,000,000).

** The guaranteed bank borrowings as at 31 December 2006 was borrowed by the Company and guaranteed by Xi'an Lijun as well as bank deposits amounted to approximately RMB 16,248,000.

(a) An analysis of the carrying amounts of the Group's bank borrowings by type and currency is as follows:

	Group As at 31 December		Company As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
RMB				
— at floating rates	**129,000**	113,000	**—**	—
HK dollars				
— at floating rates	**80,376**	—	**80,376**	—
	209,376	113,000	**80,376**	—

The carrying amounts of the group's bank borrowings approximate their fair value.

(b) The weighted average effective interest rates per annum for bank loans was approximately 6.47% (2005: 6.40%).

19. BANK BORROWINGS *(Continued)*

(c) The maturity of the Group's non-current bank borrowings at respective balance sheet dates is as follows:

	Group As at 31 December		Company As at 31 December	
	2006 **RMB'000**	2005 *RMB'000*	**2006** **RMB'000**	2005 *RMB'000*
Within 1 year	**12,057**	5,000	**12,057**	—
Between 1 to 2 years	**16,075**	—	**16,075**	—
Between 2 to 5 years	**12,056**	—	**12,056**	—
	40,188	5,000	**40,188**	—

(d) The collaterals of the Group's borrowings are analysed as follows:

	As at 31 December		As at 31 December	
	2006 **RMB'000**	2005 *RMB'000*	**2006** **RMB'000**	2005 *RMB'000*
Net book amount of land use right *(Note 6)*	**4,000**	4,000	**—**	—

(e) The Group has the following undrawn borrowing facilities at the respective balance sheet dates:

	As at 31 December		As at 31 December	
	2006 **RMB'000**	2005 *RMB'000*	**2006** **RMB'000**	2005 *RMB'000*
Floating rate and expiring within one year	**364,000**	214,000	**—**	—

20. LONG-TERM PAYABLES — GROUP

Long term payables mainly represent retirement benefits and early retirement allowance payable to the employees of Xi'an Lijun Pharmaceutical Co., Ltd..

The maturity profile of the long-term payable is as follows:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Within 1 year	**2,361**	732
Between 1 to 2 years	**2,362**	659
Between 2 to 5 years	**3,557**	1,680
More than 5 years	**6,794**	14,173
	15,074	17,244
Less: Current portion included in current liabilities	**(2,361)**	(732)
	12,713	16,512

21. TRADE AND BILLS PAYABLE — GROUP

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Trade payable	**52,192**	56,264
Bills payable	**—**	4,000
	52,192	60,264

The carrying amounts of the trade and bills payable approximate their fair value.

Ageing analysis of trade and bills payable at respective balance sheet dates are as follows:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Within 3 months	**36,186**	55,037
4 to 6 months	**1,296**	1,003
7 to 12 months	**657**	897
1 to 3 years	**12,272**	1,709
More than 3 years	**1,781**	1,618
	52,192	60,264

22. ACCRUALS AND OTHER PAYABLES

	Group As at 31 December		Company As at 31 December	
	2006	2005	**2006**	2005
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Accrued distribution expenses	**21,190**	27,016	**—**	—
Taxation payables, other than income tax	**13,212**	10,527	**—**	—
Payable for property, plant and equipment	**11,343**	9,367	**—**	—
Welfare payables	**11,618**	23,271	**—**	—
Salary and wages payable	**10,240**	11,148	**—**	—
Amount due to Rejoy Group Limited Liability Company ("Rejoy Group")	**6,350**	—	**—**	—
Deposits from employees	**5,972**	5,407	**—**	—
Advertising expense payables	**3,027**	2,871	**—**	—
Accrued management bonus	**2,380**	3,000	**—**	—
Accrued advertising expenses	**961**	1,940	**—**	—
Professional fee payables	**761**	6,592	**761**	6,592
Others	**9,595**	7,692	**—**	9,432
	96,649	108,831	**761**	16,024

23. REVENUE AND OTHER GAINS

The Group is principally engaged in the manufacturing and sale of pharmaceutical products. Revenue recognised is as follows:

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Revenue:		
— Sales of pharmaceutical products	**857,456**	880,452
— Processing income	**2,312**	3,410
— Sales of raw materials and by products	**873**	847
	860,641	884,709
Other gains — net:		
— Investment income	**176**	—
— Gain on disposal of a land use right	**—**	508
	176	508
	860,817	885,217

24. EXPENSE BY NATURE — GROUP

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Raw material and consumables used	**307,306**	314,627
Sales commission	**105,865**	97,331
Staff costs including directors' emoluments		
— wages and salaries	**67,307**	66,635
— pension costs (Note 28)	**12,036**	9,912
— welfare expenses	**17,463**	10,861
Utility expenses	**54,032**	50,973
Advertising expenses	**52,999**	37,781
Depreciation of property, plant and equipment	**30,132**	35,044
Research and development costs	**7,833**	7,429
Operating leases — rental expenses in respect of land use right in the PRC	**5,461**	5,461
Provision/(reversal of) for impairment of receivables	**3,658**	(3,508)
Auditors' remuneration	**2,300**	1,768
Amortisation of intangible assets (charged to general and administrative expenses)	**384**	(39)
Amortisation of land use rights (charged to general and administrative expenses)	**69**	82
Loss/(gain) on disposal of property, plant and equipment	**61**	—
Impairment of goodwill	**—**	601
Reversal of inventory write-down	**(209)**	(2,764)
Change in investories of finished goods and work in progress	**(8,032)**	5,077
Others	**104,859**	110,778
Total cost of sales, selling and marketing costs and general and administrative expenses	**763,524**	748,049

25. FINANCE INCOME AND COSTS — GROUP

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Financial income		
— Interest income on demanded bank deposit	**5,340**	1,569
Financial costs		
— Interest expense on bank borrowings wholly repayable within five years	**(10,232)**	(7,069)

26. INCOME TAX EXPENSE

The Company was incorporated in the Cayman Islands as an exempted company with limited liability under the Company Law of the Cayman Islands and, accordingly, is exempted from payment of the Cayman Islands income tax.

No Hong Kong profits tax was provided as the Group had no assessable profit in Hong Kong in 2006 and 2005.

According to relevant PRC rules and regulations, Xi'an Lijun Pharmaceutical Co., Ltd., being qualified as an encouraged domestic enterprise in the western region of the PRC, is entitled to preferential PRC Enterprise Income Tax ("EIT") rate of 15% from 2002 to 2004, on an annual approval basis.

In December 2004, Xi'an Lijun Pharmaceutical Co., Ltd. has obtained approval to be designated as a sino-foreign joint venture enterprise and therefore ceased to be entitled to the preferential EIT rate of 15%. In May 2005, the EIT rate of Xi'an Lijun Pharmaceutical Co., Ltd has been approved to be 24%, which was effective from 1 Januanry 2005. Being incorporated as foreign investment enterprise in PRC, Xi'an Lijun Pharmaceutical Co., Ltd. has obtained approvals in May 2005 from the relevant tax authorities in Xi'an, which is also effective from 1 January 2005, for their entitlement to exemption from EIT for the first two years and 50% reduction in EIT for the next three years, commencing from the first profitable year after offsetting all unexpired tax losses carried forward from the previous years in accordance with the relevant tax rules and regulations applicable to foreign investment enterprises in PRC.

Shaanxi Rejoy Hengxintang Pharmaceutical Co., Ltd. is subject to EIT levied at an approved rate of taxable income based on its audited accounts prepared in accordance with the laws and regulations in the PRC. As at 31 December 2006, Shaanxi Rejoy Hengxintang Pharmaceutical Co., Ltd. has accumulated net losses brought forward and has submitted application for its applicable tax rate and is still awaiting approval from tax authority.

The amounts of taxation credited/(charged) to the income statement represent:

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Current taxation — EIT	**—**	—
Deferred taxation *(Note 10)*	**966**	(15,122)
	966	(15,122)

26. INCOME TAX EXPENSE *(Continued)*

The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using EIT rate as follows:

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Profit before income tax	**92,401**	131,668
Weighted average EIT rates in the PRC	**24%**	24%
Tax calculated at the weighted average EIT rate	**(22,176)**	(31,600)
Tax exemption	**21,755**	28,259
Effect of change in the estimate of the reversal period of temporary differences in which different tax rate are applied	**1,387**	—
Expenses not deductible for tax purposes	**—**	(345)
Effect of change of the Group's tax status for the calculation of deferred taxation	**—**	(11,436)
Tax charge	**966**	(15,122)

27. PROFIT ATTRIBUTABLE TO THE COMPANY's EQUITY HOLDERS

The consolidated profit attributable to the Company's equity holders includes profit of RMB 35,574,000 (2005: RMB 54,426,000) dealt with in the financial statements of the Company.

28. RETIREMENT BENEFITS — GROUP

(a) Pension obligations

As stipulated by the rules and regulations in the PRC, the Group has participated in state-sponsored defined contribution retirement plans for its employees in the PRC. The Group and the eligible employees are required to contribute 20% and 7%, respectively, of the employees' basic salary. The state-sponsored retirement plans are responsible for the entire pension obligations payable to retired employees. Moreover, the Group would pay monthly allowance to old retirement persons. The Group has no further pension obligation beyond the above contributions.

(b) Early retirement benefits

Compensation for early retirement is recognised in the earlier of the periods in which the Group established a constructive obligation and created a valid expectation on the employee, entered into an agreement with the employee specifying the terms, or after the individual employee has been advised of the specific terms.

29. DIRECTORS AND SENIOR MANAGEMENT'S EMOLUMENTS — GROUP

(a) Directors' emoluments

The emoluments of all executive and non-executive directors during the years, on a named basis, are set out as below:

Name of Director	Fees	Salary	Other benefits	Contribution to state-sponsored retirement plans	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
2005					
Executive Directors					
Mr. Wu Qin	874	145	29	8	1,056
Mr. Wu Zhihong	625	143	29	8	805
Mr. Huang Chao	624	143	29	8	804
Mr. Xie Yunfeng	375	75	27	8	485
Ms. Sun Xinglai	374	80	28	7	489
	2,872	586	142	39	3,639
Non-executive Directors					
Mr. Chow Kwok Wai	39	—	—	—	39
Mr. Leung Chong Shun	39	—	—	—	39
Mr. Qu Jiguang	39	—	—	—	39
Mr. Liu Zhiyong	14	—	—	—	14
	131	—	—	—	131
	3,003	586	142	39	3,770
2006					
Executive Directors					
Mr. Wu Qin	844	70	25	4	943
Mr. Wu Zhihong	603	151	8	4	766
Mr. Huang Chao	603	5	8	4	620
Mr. Xie Yunfeng	362	5	4	4	375
Ms. Sun Xinglai	362	181	21	4	568
Mr. Wang Xian Jun	653	151	17	—	821
	3,427	563	83	20	4,093
Non-executive Directors					
Mr. Chow Kwok Wai	181	—	—	—	181
Mr. Leung Chong Shun	181	—	—	—	181
Mr. Qu Jiguang	181	—	—	—	181
Mr. Liu Zhiyong	60	—	—	—	60
	603	—	—	—	603
	4,030	563	83	20	4,696

No Directors of the Company waived any emoluments during the years.

29. DIRECTORS AND SENIOR MANAGEMENT'S EMOLUMENTS — GROUP *(Continued)*

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group during the years are also directors of the Company and their emoluments are detailed in (a) above.

(c) During the years, no emoluments were paid by the Company to any of the directors as an inducement to join or upon joining the Group or as compensation for loss of office.

30. DIVIDENDS

An interim dividend in respect of the six months ended 30 June 2006 of HK$0.07 per share, amounting to a total dividend of RMB 20,933,000 was approved at the meeting of the board of directors on 1 September 2006.

A final dividend in respect of 2006 of HK$0.07 per share, amounting to a total dividend of RMB 20,430,000 is to be proposed at the upcoming annual general meeting. These financial statements do not reflect this dividend payable.

	2006	2005
	RMB'000	*RMB'000*
Approved interim dividend of HK$0.07(2005: Nil) per ordinary share	**20,933**	—
Proposed final dividend of HK$0.07(2005: HK$0.16) per ordinary share	**20,430**	48,367
	41,363	48,367

31. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company of RMB 84,575,000 by the weighted average number of 290,500,000 ordinary shares in issue during the year.

The comparative basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company of RMB 93,311,000 by the weighted average number of 212,426,000 ordinary shares in issue for the year ended 2005.

32. CONSOLIDATED CASH FLOW STATEMENT

(a) Cash generated from operations

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Profit before income tax	**92,401**	131,668
Provision/(reversal of) for impairment of receivables	**3,658**	(3,508)
Reversal of inventory write-downs	**(209)**	(2,764)
Depreciation of property, plant and equipment	**30,132**	35,044
Loss/(gain) on disposals of property, plant and equipment	**61**	(39)
Gain on disposal of a land use right	**—**	(508)
Amortisation of land use right	**69**	82
Amortisation of intangible assets	**384**	—
Impairment of goodwill	**—**	601
Interest income	**(5,340)**	(1,569)
Interest expense	**10,232**	7,069
Operating profit before working capital changes	**131,388**	166,076
Changes in working capital:		
Decrease/(increase)in inventories	**8,109**	(9,562)
Increase in trade and bills receivables	**(59,361)**	(21,076)
(Increase)/decrease in prepayments, deposits and other receivables	**(11,252)**	10,835
(Increase)/decrease in amounts due from related parties	**(8,838)**	27,518
Decrease in trade and bills payables and deposits and advance receipts from customers	**(11,928)**	(5,737)
Decrease in taxation payable, accruals, and other payables	**(12,328)**	(12,538)
Decrease in amounts due to related parties	**(310)**	(3,236)
Net cash inflow generated from operations	**35,480**	152,280

(b) Proceeds from disposal of property, plant and equipment

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Net book amount disposed *(Note 7)*	**366**	1,459
Gain/(loss) on disposal of property, plant and equipment	**(61)**	39
Proceeds from disposal of property, plant and equipment	**305**	1,498

32. CONSOLIDATED CASH FLOW STATEMENT *(Continued)*

(c) Proceeds from issue of new shares

	Year ended 31 December	
	2006	2005
	RMB'000	*RMB'000*
Proceeds from issue of new shares (including share premium)	—	180,102
Less: Share issue expenses	—	(28,635)
Net proceeds from issue of new shares (including share premium)	—	151,467
Proceeds received from/(retained by) the underwriters *(Note 14)*	**30,606**	(30,606)
Proceeds from share issue	**30,606**	120,861

33. BUSINESS COMBINATIONS — GROUP

In June 2006, the Company acquired 20% equity interests in Xi'an Lijun Pharmaceutical Co.,Ltd. ("Xi'an Lijun") from the Rejoy Group for a cash consideration of approximately RMB102,556,000.

Details of the acquisition are as follows:

	RMB'000
Purchase consideration — cash paid	102,556
Less: 20% minority interest of Xi'an Lijun	(90,697)
Excess of the consideration over the carrying amount of the interests acquired	11,859

Such excess of the consideration over the carrying amount of the interests acquired is recognised directly in equity.

(All amounts in RMB)

34. RELATED PARTY TRANSACTIONS AND BALANCES — GROUP

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control.

(a) During the years, the directors are of the view that the following companies are related parties of the Group:

Name	Relationship
Rejoy Group	Shareholder of Xi'an Lijun Pharmaceutical Co., Ltd. before 22 June 2006
Xi'an Rejoy Technology Investment Co., Ltd. ("Rejoy Technology")	Shareholder of Xi'an Lijun Pharmaceutical Co., Ltd. before 28 December 2004
Shaanxi Xi'an Pharmaceutical Factory ("Xi'an Pharmacy Factory")	Wholly-owned subsidiary of Rejoy Group
Xi'an Rejoy Packaging Materials Co., Ltd. ("Rejoy Packaging")	Subsidiary of Rejoy Technology
Rejoy Baichuan Medicines Chemical Engineering Co., Ltd. ("Rejoy Baichuan")	Subsidiary of Rejoy Technology
Liaoning Huabang Pharmaceutical Co., Ltd. ("Huabang Pharmaceutical")	Shareholder of Xi'an Lijun Pharmaceutical Co., Ltd. before 28 December 2004
Xi'an Rejoy Medicine Co., Ltd. ("Rejoy Medicine")	Subsidiary of Rejoy Group
Rejoy Group Zhenjiang Pharmaceutical Co., Ltd. ("Zhenjiang Pharmaceutical")	Subsidiary of Rejoy Group before October 2005
Xiyao Construction and Installation Co., Ltd. ("Xiyao Construction")	Joint venture of Xi'an Pharmacy Factory after March 2005 (wholly-owned subsidiary of Xi'an Pharmacy Factory before March 2005)
Xi'an Rejoy Real Estate Co., Ltd. ("Rejoy Real Estate")	Subsidiary of Rejoy Technology after November 2004 (Joint venture of Xi'an Lijun Pharmaceutical Co., Ltd. before November 2004)
Global Printing Co., Ltd. ("Global Printing")	Controlled by the same ultimate parent company of Rejoy Group

34. RELATED PARTY TRANSACTIONS AND BALANCES — GROUP *(Continued)*

(b) Saved as disclosed elsewhere in these consolidated financial statements, the Group had the following significant transactions with related parties:

Nature of transactions	Name of related party	Year ended 31 December	
		2006	2005
		RMB'000	*RMB'000*
Purchasing of raw materials and packaging materials	Global Printing	**6,636**	6,883
	Rejoy Baichuan	—	68
	Rejoy Packaging	—	717
	Zhenjiang Pharmaceutical	—	5,143
		6,636	12,811
Sales of finished goods	Rejoy Baichuan	**19,515**	9,043
	Rejoy Medicine	**10,154**	20,886
	Huabang Pharmaceutical	—	4,526
		29,699	34,455
Provision of utilities from	Xi'an Pharmacy Factory	**54,032**	50,973
Sharing of administrative costs from	Xi'an Pharmacy Factory	**13,000**	12,926
Lease of land use rights from	Rejoy Group	**5,461**	5,461
Lease of office premises to	Rejoy Group	**200**	200
Discontinued:			
Provision of assets management services by	Xi'an Pharmacy Factory	—	280
Provision of building construction services by	Xiyao Construction	—	1,809

34. RELATED PARTY TRANSACTIONS AND BALANCES — GROUP *(Continued)*

(c) The Group had the following significant balances with related parties:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Amounts due from related parties included in trade receivables		
— Rejoy Baichuan	**8,809**	1,627
— Rejoy Medicine	**8,268**	4,879
— Huabang Pharmaceutical	**—**	1,733
	17,077	8,239
Amounts due from related parties included in prepayments, deposits and other receivables		
— Xi'an Pharmacy Factory	**3,600**	404
— Rejoy Real Estate	**—**	30
— Rejoy Group	**—**	60
— Rejoy Technology	**—**	59
	3,600	553
Amounts due to related parties included in trade payables		
— Global Printing	**1,528**	1,656
— Rejoy Baichuan	**—**	5
— Rejoy Packaging	**—**	177
	1,528	1,838
Amounts due to related parties included in accruals and other payables		
— Rejoy Group	**6,350**	—
Dividend payable to the equity holders of the Company	**2,582**	—
Amount due to minority shareholder of a subsidiary	**11,742**	14,763

The related party balances are all unsecured, interest-free and have no pre-determined terms of repayment.

35. COMMITMENTS — GROUP

(a) Capital commitments

Capital expenditure at the balance sheet dates but not yet incurred is as follows:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Purchase of property, plant and equipment		
— Contracted but not provided for	**14,824**	10,158

35. COMMITMENTS — GROUP *(Continued)*

(b) Operating lease commitments

The future aggregate minimum lease rental expenses in respect of office premises in the PRC and Hong Kong under non-cancellable operating leases are payable as follows:

	As at 31 December	
	2006	2005
	RMB'000	*RMB'000*
Not later than one year	**6,760**	6,821
Later than one year and not later than five years	**1,091**	6,824
	7,851	13,645

36. CONTINGENT LIABILITIES

The Group did not have significant contingent liabilities as at 31 December 2006.

37. EVENTS AFTER THE BALANCE SHEET DATE

The significant subsequent events of the Group were as follow:

(i) On 25 March 2007, the Company entered into an acquisition agreement with CMP Group Limited (the "Vendor") and China Pharmaceutical Company Limited (being the guarantor of the Vendor under the acquisition agreement) to purchase the entire interests in, and a shareholder loan of, New Orient Investments Limited ("New Orient") at a consideration which is equivalent to the aggregate sum of (i) 7.5 times the audited profit attributable to the shareholders of New Orient and its subsidiaries (excluding any profit or loss generated in connection with foreign exchanges) for the year ended 31 December 2006; and (ii) any income generated in connection with foreign exchanges for the year ended 31 December 2006. However, in any event, the consideration shall not exceed HK$510,000,000.

(ii) On 9 February 2007, the directors of Xi'an Lijun proposed a final dividends of RMB 18,041,400 in respect of the year ended 31 December 2006.

(iii) On 16 March 2007, the National People's Congress approved the Corporate Income Tax Law of the People's Republic of China (the new "CIT Law"). The new CIT Law reduces (increases) the corporate income tax rate for domestic enterprises (foreign invested enterprises) from 33% (15% or 24%) to 25% with effect from 1 January 2008. The new CIT Law also provides for preferential tax rates, tax incentives for prescribed industries and activities, grandfathering provisions as well as determination of taxable profit. As at the date that these consolidated financial statements are approved for issue, detailed measures concerning these items has yet to be issued by the State Council. Consequently, the Group is not in a position to assess the impact, if any, to the carrying value of deferred tax assets and liabilities as at 31 December 2006. The Group will continue to evaluate the impact as more detailed regulations are announced.